BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, Respondent.	DOCKET UE-240004, UG-240005 and UE-230810 (Consolidated)

POST-HEARING BRIEF OF COMMISSION STAFF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Regulations

Administrative Authorities

Other Authorities

I. INTRODUCTION

1 The subtext of PSE's testimony is clear: give us the rate increases we ask for or it is your fault if our progress on the clean energy transition stalls.[1] This politically charged rhetoric attempts to tie PSE's proposed rate increases to something the Company knows both the Commission and Washington state care deeply about: the transition to clean energy. But regardless of how often the Company repeats this claim, it is false. The Commission is not persuaded by rhetoric or political pressure, but by facts. And the facts do not support PSE's proposals. To be sure, the Company does need to increase rates in order to accomplish the clean energy transition. But several of PSE's proposals are unjustified, and Staff's recommended revenue requirement rectifies that mistake without jeopardizing the transition to clean energy.

2 The Commission should take a long view of PSE's core argument[2] in this case. The transition to clean energy will continue for at least the next 20 years. If, as PSE suggests,[3] the Commission lowers or circumvents its evidentiary standards today in the hopes of aiding the transition to clean energy, why would that same logic not apply to the next rate case, and the one after that? From now until 2045, the Commission will be reviewing rate cases wherein most, if not all, new generating resources are CETA compliant. The Commission should signal that

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[1] *See e.g.* Doyle, Exh. DAD-1CT at 12:1-9; Peterman, Exh. CGP-1T at 19:3-20:4; Steuerwalt, Exh. MS-1T at 31:18-22; Steuerwalt Exh. MS-4T at 3:9-14 ("If the funding for the clean energy transition is not authorized in rate proceedings, PSE's ability to move forward with the clean energy transition will necessarily be impaired. Forward looking ratemaking allows the Commission to effectively set the budget for the pace and scale of the transition. And more broadly, to the extent rates are not sufficient to fund utility activities, PSE will not be able to undertake those actions.");Steuerwalt, TR 81:9-11 (claiming that receiving the entirety of PSE's proposed revenue requirement would be necessary but not sufficient to meet CETA targets.)

[2] PSE's core argument in this case is that any reduction below the Company's requested revenue requirement will proportionally hinder either the transition to clean energy or the ability to provide safe and reliable service. Therefore, the Commission must provide exceptional rate relief in the form of PSE's proposals, regardless of whether these proposals would be acceptable under the Commission's ratemaking standards. For example, PSE asks for an increase to return on equity that would never be allowed under the Commission's gradualism policy, but reasons that doing so is necessary to increase cash flow, which it argues would aid the clean energy transition. *See* Peterman, Exh. CGP-11CT at 3:3-12.

[3] *See e.g.,* Steuerwalt, Exh. MS-4T at 3:11-13 (Likening a Commission-approved revenue requirement to setting a budget).

PSE's alarmism will not weaken the UTC's commitment to sound economic regulation. Accomplishing the clean energy transition cost effectively is a core aspect of CETA, not antithetical to it.[4]

3 Staff has no reason to doubt the sincerity of PSE's stated commitment to achieving the clean energy transition. But PSE is also a private company with an obligation to its investors, and the Commission should consider the Company's proposed adjustments with that context always in mind. PSE claims that it needs every cent of the increase it requests in this case or it will need to choose between the clean energy transition and providing safe and reliable service.[5] Were this true, it would mean that PSE pursued a shockingly poor litigation strategy in this case, one out of character with the company that Staff is familiar with.[6] A more plausible explanation is that PSE's proposals seek to achieve two objectives: enable the transition to clean energy and significantly increase benefits to investors. The former objective is a worthy goal, but one that can be achieved with Staff's recommended overall revenue requirement. PSE seeks to achieve the latter objective with a set of proposals[7] designed to allow the Company to enjoy the financial benefits of performance-based ratemaking (PBR) without the responsibilities that are meant to accompany those benefits.

[4] *See* McGuire, Exh. CRM-1Tr at 8:1-9:4.
[5] Steuerwalt, TR 81:5-11 Doyle, Exh. DAD-1CT at 2:1-3; Peterman, Exh. CGP-1T at 19:3-20:4; Steuerwalt, Exh. MS-1T at 31:18-22.
[6] With few exceptions, investor-owned utilities inflate their revenue requirement increase proposals in general rate cases. This gives the utility room for compromise during settlement negotiations, or if the case is litigated, it gives the utility a chance to receive a higher increase if issues or adjustments are missed. Thus, PSE's claim that a revenue requirement any lower than its litigation position would put it at risk of meeting the Company's legal obligations (CETA and the safe and reliable service standards under RCW 80) is highly implausible.
[7] *See* Steuerwalt, TR 70:24-71:20. PSE's proposed adjustments refers to the Company's position on ROE, Capital structure, CWIP for the Beaver Creek Project, the three proposed tracking mechanisms, return on PPAs, accelerated depreciation of gas plant and contested O&M adjustments.

4 The Commission is in the midst of two important transitions: the clean energy transition and the transition from traditional ratemaking to performance-based ratemaking. Ultimately, the difference between PSE's overall revenue requirement and Staff's recommendation is not a disagreement over the appropriate pace of the clean energy transition, as PSE suggests. It is a disagreement over the transition to performance-based rates. PSE appears to understand the transition to PBR as a slackening of regulatory standards. This is incorrect. While the transition to performance-based rates does allow the utility faster recovery, it does so *only* in exchange for guarantees of performance. PSE's proposed overall revenue requirement increase may have been acceptable had the request for additional "funding"[8] been paired with appropriate performance mechanisms or other regulatory tools that would protect ratepayers. Performance incentive mechanisms, an extended MYRP, and other regulatory tools could have provided that oversight. However, PSE did not include these elements in the rate plan and offers no assurances that customers will receive the benefits of the clean energy transition, even if the Commission grants PSE everything it requested.[9] Therefore, the additional funding PSE asks the Commission to approve should be denied.

5 The Commission should not grant such significant increases in customer rates based on PSE's vague assertions that it is necessary to accomplish the clean energy transition, or unverifiable speculation regarding the impact on the Company's credit rating. The need to make large investments is not unprecedented, nor are utility claims that during periods of high capital investment utilities face deteriorating financial conditions which, in turn, can make it more difficult to raise capital for construction requirements. During the early to mid-1980s – a period characterized by an abnormally high level of utility capital investment as well as high inflation –

[8] *See* Steuerwalt, TR 70:2-71:24.
[9] Steuerwalt, TR 81:9-11.

the Commission relieved the potential for deteriorating financial conditions by granting utilities attrition allowances[10] and inflation adjustments.[11] Effectively, attrition allowances and inflation adjustments provided utilities with additional revenues sufficient to cover forecasted (rather than test year) plant-in-service as well as inflation-adjusted costs.

6 However, the current regulatory scheme already provides PSE with similar relief. The multiyear rate plan (MYRP) statute upended the historical ratemaking paradigm by requiring the Commission to set rates sufficient to recover forecasted plant-in-service, effectively making an attrition allowance a standard component of revenue requirement. Furthermore, in this case PSE has included inflation-adjusted costs for both forecasted O&M expense and forecasted plant construction costs. That is, PSE will already receive relief through what is effectively an attrition allowance as well as through an inflation adjustment – relief the Commission has determined is sufficient to remedy the potential for deteriorating financial conditions associated with high levels of plant investment and inflation. However, PSE wants more so it requests that the Commission reach even further into its box of extraordinary ratemaking tools. The Company's proposals[12] are being made in an environment that is already extremely favorable to the utility and are well beyond what the Commission should authorize.[13] The Commission should adopt Staff's overall revenue requirement and policy recommendations. Staff's adjustments and policy

[10] *See, e.g., Wash. Utils. & Transp. Comm'n v. Wash. Water Power Co.*, Cause No. U-81-15/16, 2nd Suppl. Order, Sec. L (Nov. 25, 1981); *Wash. Utils. & Transp. Comm'n v. Wash. Water Power Co.*, Cause No. U-83-26, 5th Suppl. Order, Sec. VIII (Jan. 19, 1984); *Wash. Utils. & Transp. Comm'n v. Wash. Nat. Gas Co.*, Cause No. U-83-27, 2nd Suppl. Order, Sec. VI, (Sept. 28, 1983); *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light*, Cause No. U-84-65, 4th Suppl. Order, Sec. VI (Aug. 2, 1985); and *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light*, Cause No. U-86-02, 2nd Suppl. Order, Sec. VII (Sept. 19, 1986).
[11] *See, e.g., Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.*, Cause No. *U-81-41*, 2nd Suppl. Order, Sec. F (March 12, 1982); and *Wash. Utils. & Transp. Co. v. Wash. Nat. Gas*, Cause No. U-82-22/37, 3rd Suppl. Order, Sec. F, K (Dec. 28, 1982).
[12] *See* Steuerwalt, TR 70:24-71:20. PSE's proposed adjustments refers to the Company's position on ROE, Capital structure, CWIP for the Beaver Creek Project, the three proposed tracking mechanisms, return on PPAs, accelerated depreciation of gas plant and contested O&M adjustments.
[13] *See e.g.*, McGuire, Exh. CRM-1Tr at 67-69.

recommendations are reasonable and will allow PSE to continue the transition to clean energy at the currently required pace.

II. POLICY AND OVERALL REVENUE REQUIREMENT

7 The Commission places both the burden of production and the burden of persuasion on the utility seeking a rate increase.[14] Below, Staff outlines the areas where the Company's proposals are not supported by the record and would not lead to equitable, fair, just, reasonable and sufficient rates. The Company's requested O&M adjustment includes amounts that are not known and measurable, and therefore should be removed. The Company's request to include Construction Work in Progress (CWIP) harms low-income customers and is not in the public interest. The function CWIP once served has been supplanted with the MYRP. Staff's proposed changes to the annual capital review refund threshold ensures the process is consistent with RCW 80.04.250. Finally, the Commission should adopt Staff's proposed framework for evaluating tracking mechanisms. Applying that framework to PSE's three proposed tracking mechanisms, the Commission should reject the CGR and Decarb trackers but accept the Wildfire tracker. Staff does not address the rate of return on PPAs issue in this brief, but Staff's position on that issue remains the same.[15]

A. O&M Pro Forma Adjustment

8 The management reserve and reserve contingency included in PSE's pro forma O&M adjustment do not meet the known and measurable standard and should be removed from the revenue requirement. Under WAC 480-07-510(3)(c)(ii), all pro forma adjustments must be known and measurable. No exception is made for pro forma adjustments related to O&M. The

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[14] *Cascade v. Utils. & Transp. Comm'n*, Docket UG-210775, Order 09, 35 ¶108, (Aug. 23, 2022) (2021 Cascade GRC Order).
[15] McGuire, Exh. CRM-1Tr at 80-82.

Commission explained in the 2009 Avista GRC order that for a cost to meet the known and measurable standard, the dollar amount must be concrete and not *"an estimate, a projection, the product of a budget forecast*, or some similar exercise in judgment concerning future revenue, expense, or rate base."[16] The Used and Useful policy statement did not change the known and measurable standard.[17] PSE should be familiar with this standard given recent history. In the Company's last fully contested rate case, the Commission allowed in pro forma adjustments, but "included only amounts that are used and useful and known and measurable, consistent with Commission past practice, and *did not include forecasts or estimates.*[18][19] The Commission agreed, rejecting the 2021 wage increases as a pro forma adjustment because those costs were not finalized and the company had not demonstrated.[20] As the Company acknowledged,[21] the Commission has not amended WAC 480-07-510(3)(c)(ii) to change the known and measurable standard since the MYRP statute became effective.

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[16] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-090134, UG-090135 & UG-060518, Order 10, p. 21, ¶ 45 (Dec. 22, 2009) (2009 Avista GRC Order).

[17] *In re the Comm'n's Proceeding to Develop a Policy Statement Addressing Alternatives to Traditional Cost of Serv. Ratemaking*, Docket U-190531, Policy Statement on Property that Becomes Used and Useful After Rate Effective Date, 8, ¶ 22; 10, ¶ 27 (Jan. 31, 2020) ("WAC 480-07-510(3)(c)(ii), which defines pro forma adjustments, remains unchanged, applicable, and relevant. In particular, this rule defines the known and measurable standard and the offsetting factors standard, both of which are elements of the matching principle, and both of which are necessary to ensure that costs and offsetting benefits are accounted for during the period in which they occur. The known and measurable standard continues to require that an event that causes a change to revenue, expenses, or rate base must be "known" to have occurred during or after the historical 12-months of actual results of operations. It must also be demonstrated (i.e., known) that the effect of the event will be in place during the rate year.") citations omitted; ("With the changes to RCW 80.04.250(3), we find that the requirements for pro forma adjustments discussed above hold true for requests for rate-effective period property, although they cannot be reviewed completely prior to rates going into effect. Accordingly, we must replace the traditional prospective review with a retrospective review for rate-effective period property requests.") (Used and Useful Policy Statement).

[18] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy,* Dockets UE-190529, Order 08, p. 37 ¶ 110 (July 8, 2020). Emphasis added. *See also Id*. at 38 ¶ 114 ("Here, we need not rely on projections or estimates. Each of the investments we approve meets the used and useful standard because it is currently being used to provide service to customers, and their associated costs are known and measurable.") (2019 PSE GRC Order).

[19] *Wash. Utils. & Transp. Comm'n v. Cascade Nat. Gas Corp.*, UG-200568, Order 05, p. 56, ¶ 187-188, (May 18, 2021) (2020 Cascade GRC Order).

[20] 2020 Cascade GRC Order at 61-62, ¶ 207.

[21] Free, TR 258:4-7.

9 The Company admitted at the evidentiary hearing that its pro forma O&M request was for traditional pro forma treatment,[22] and that the overall O&M budget (and therefore the pro forma adjustment requested in this case) does not change regardless of whether the reserve contingency and management reserve amounts are doled out to specific projects and programs.[23] The Company admitted that it was asking for the UTC to approve a budget,[24] something that the Commission has stated does not meet the known and measurable standard.[25] The refinement process outlined in PSE's rebuttal testimony does not update estimates of O&M costs,[26] it merely allocates the extra dollars that were initially reported as management reserve and contingency reserve into more specific projects and programs.[27] This relabeling or reassignment process is irrelevant to the question of whether these costs are known and measurable, or appropriate for traditional pro forma treatment. The refinement process described by PSE does not make these costs known and measurable, they are still estimates based on a budget.[28] These reserves exist within PSE's budget in case actual costs for O&M go over the estimated costs.[29] whether that will actually happen is, by definition, not currently measurable.[30] PSE admits that the refinement

[22] Free, TR 254:15-19.

[23] Huizi, TR 114:1-11 ("Okay. So when you say it always reconciles back to the board-approved budget, does that mean that the overall amount of the budget does not change as a result of the refinement process you're describing in your testimony? A. The full budget -- that's correct -- does not change as a result of continually refining down to the lowest level of detail. Q. Okay. So is PSE asking the commission to approve its board-approved O&M budget for 2025 and 2026? A. Yes.") ; Huizi, Exh. TRH-1T at 18:9-13; 19:2-3.

[24] Huizi, TR 114:1-11.

[25] 2009 Avista GRC Order at 21 ¶ 45; *See also Id. at* ¶ 78 (noting the company's proposal was "tantamount to requiring either a continuous audit during the pendency of a rate proceeding or acceptance of budgeted or forecasted data as known and measurable.").

[26] In other words, the dollars from the reserve contingency and management reserve are not allocated to specific projects and programs because PSE is now certain that they are going to be above the originally estimated costs.

[27] Huizi, TR 114:1-8; 116:9-17;

[28] *See* Huizi, TR 117:4-25.

[29] Although in both prefiled testimony and at the evidentiary hearing PSE was circumspect about the definition of both management reserves and reserve contingency, definitions of these terms are publicly available and indicate that the above description of their purpose is accurate. *See e.g.* https://acqnotes.com/acqnote/careerfields/management-reserves; https://www.projectmanagement.com/blog-post/5806/management-reserves-and-contingency-reserves--what-s-the-difference-#_=_

[30] The dollar amount must be concrete and not "an estimate, a projection, the product of a budget forecast, or some similar exercise in judgment concerning future revenue, expense, or rate base." 2009 Avista GRC Order at 21, ¶ 45.

process would not and could not change the O&M adjustment request it makes in this rate case.[31] This makes the additional information PSE provided on rebuttal and in data request responses meaningless, as no amount of specificity would ever lead to a change the in amount requested as part of the O&M adjustment. The additional information does not tell the Commission that PSE's overall O&M budget is now more likely to be accurate. At most, the additional specificity PSE provides only tells the Commission what items PSE believes are more likely than others to go over budget.

10 PSE's response to Staff's position on this issue is unpersuasive. The Company argues that the MYRP statute allows the Commission to grant its O&M adjustment, even with the reserve and contingency amounts included.[32] But this argument is question begging; RCW 80.28.425(3)(d) allows the Commission to "use any standard, formula, method, or theory of valuation reasonably calculated to arrive at fair, just, reasonable, and sufficient rates[]" for operating expenses, but PSE makes no attempt to adequately explain why it would be fair, just, reasonable, and sufficient[33] to include the reserve contingency and management reserve amounts in a *traditional* pro forma adjustment. Because PSE is asking for these amounts as a traditional pro forma adjustment, in which there can be no refund to customers if these specific costs are overstated, there is no reason to deviate from the Commission's traditional standards. Those standards require that the pro forma adjustment amounts are known and measurable, and they are clearly not in the case of these management reserves and reserve contingencies which PSE

[31] Huizi, TR at 117:19-22. ("Q. Okay. So the process that you're talking about in your testimony doesn't change the overall amount that PSE is asking for, higher or lower? A. That is correct.")
[32] Free, TR 256:2-7 ("...the multiyear rate plan statute allows the commission to have discretion on how they value O&M for the rate years, and so I don't believe that the known and measurable standard has to be applied to allow the recovery for O&M.")
[33] 2019 PSE GRC Order at 25-26, para 71 ("the Commission's ultimate goal is to set rates that are *fair* to customers and to the Company's shareholders; *just* in the sense of being based solely on the record developed in a rate proceeding; *reasonable* in light of the range of possible outcomes supported by the evidence; and *sufficient* to meet the needs of the Company to cover its expenses and attract necessary capital on reasonable terms.")

includes in the O&M budget as extra padding to shield the Company from the risk of unexpected cost increases. This type of "padding" is exactly why the Commission has long rejected allowing pro forma adjustments that are based on estimates or budgets. Under traditional ratemaking, it is understood that during the rate year some actual costs will be higher, and some lower, than the figures the Commission used to set rates. This creates balance. Including estimates or budgets upsets that balance because they are often overstated, as is the case here, for the sake of accounting for anticipated but unknown additional costs. PSE tries to argue by analogy that including the reserve amounts in the O&M adjustment is similar to an attrition adjustment, in the sense that an attrition adjustment is not based on identifiable costs.[34] But this argument does not help PSE either. Attrition adjustments are only granted by the Commission after a utility has made a specific demonstration regarding the company's financial situation that PSE has not attempted to make here.[35] Attrition adjustments are an exception to the known and measurable standard that is only allowed when a utility has provided clear evidence to conclude that the overall revenue requirement would be insufficient without the adjustment.

B. Construction Work in Progress

11 Including CWIP[36] in rate base for the Beaver Creek Wind Project is not in the public interest. Approving PSE's CWIP proposal would harm low-income customers, and PSE does not need to earn a return on CWIP in order to be financially stable and healthy. Staff acknowledges that PSE is asking for this treatment for all capital additions placed in the Company's proposed CGR tracker, but because Staff is recommending denying that tracking mechanism, Staff will

[34] Free, TR 256:8-257:1.
[35] A utility requesting an attrition allowance must demonstrate: (1) a showing of chronic under-earning; and (2) that circumstances giving rise to the claimed attrition are beyond the utility's ability to control. *See* 2019 PSE GRC Order at 23 ¶ 62 (Staff position citing Avista 2016 GRC).
[36] Doyle, Exh. DAD-1CT at 61:17-62:7. While Staff understands that PSE's proposal is a hybrid between AFUDC and CWIP, for the sake of brevity we will simply address the proposal in this brief as CWIP.

only address CWIP as to the Beaver Creek Wind project. PSE argues that CETA requires an amount of construction the Commission has not seen since the energy crises of the 1970s and 1980s.[37] Therefore, PSE argues that it needs to recover construction costs through CWIP in the Company's rate base. PSE argues this will allow it "to maintain its financial strength and flexibility, mitigate the initial rate impact on customers when assets go into service, and . . . meet the clean energy transformation targets" of CETA.[38] Additionally, PSE argues that its proposal will "mitigate the rate shock impact" when Beaver Creek is completed, because it would avoid the significant rate increase that would occur if CWIP is not utilized.[39]

12 CWIP reflects a project's total capital costs at the end of each month of construction and accumulated up to the date the project is placed in service. CWIP is composed of the cumulative capital expenditures plus the cost of contributed capital which is calculated as the utility's authorized cost of capital multiplied by the total CWIP balance at the end of each month.[40] The Commission may include CWIP in rate base "to the extent that the commission finds that inclusion is in the public interest."[41] But CWIP is not the standard method of recovering these costs. The Commission typically uses allowance for funds used during construction (AFUDC).

13 The Commission defines AFUDC as follows:

> AFUDC is a regulatory method of accounting for the full cost of an asset under construction. The method compensates a utility for financing costs incurred during the construction of new facilities, which is a critical component of cost when considering that utilities are capital-intensive, the time it takes to complete large projects, and cash flow issues related to normal utility operations.[42]

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[37] Doyle, Exh. DAD-1CT at 62:18-21.
[38] Doyle, Exh. DAD-1CT at 64:6-9.
[39] Doyle, Exh. DAD-1CT at 65:20-22.
[40] McGuire, Exh. CRM-1T at 81:1-5.
[41] RCW 80.04.250.
[42] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy,* Docket UE-220066, Order 24, p. 98, n.603 (Dec. 22, 2022) (2022 PSE GRC Order).

14 Contrary to AFUDC, the Commission has "rarely permitted the collection of" CWIP from ratepayers.[43] As noted by PSE, CWIP was much more common in the 1970s and 1980s.

15 PSE has not demonstrated that it needs CWIP to maintain its financial integrity. Although PSE states that recovering CWIP for the Beaver Creek Wind Project will "increase cash flow to finance construction costs" and "provide greater flexibility for PSE to maintain its financial strength," the Company has not sufficiently demonstrated a financial need for CWIP.[44] For example, PSE concedes that credit rating agencies generally viewed PSE's 2022 rate case outcome favorably.[45] Additionally, it does not adequately demonstrate that it is facing an unstable financial outlook, nor does it claim that CWIP is necessary to preserve the company's integrity. Given that the Commission has historically only approved CWIP requests in more dire financial circumstances, it should conclude that CWIP is not necessary here, as PSE is not in dire financial straits.[46]

16 PSE attempts to liken the cases in which the Commission granted CWIP in the 1970s and 1980s with the situation it faces today, but this argument ignores an obvious difference: today the MYRP statute exists, along with many other supportive mechanisms.[47] MYRPs eliminate most regulatory lag and therefore already address the harm CWIP solved in the past. Today, PSE has a power cost mechanism, a decoupling mechanism, a rate plan, and rates that include the forecasted, rate-year level of plant-in-service, and as noted by Staff, 11 percent PSE's electric side revenue and 56 percent of its gas side revenue is recovered risk free.[48]

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[43] *Wash. Utils. & Transp. Comm'n, v. Iliad Water Serv., Inc.*, UW-060343, 2007 WL 274238 (Jan. 10, 2007).
[44] *See* Doyle, Exh. DAD-1CT at 64:4-9.
[45] *See id.* at 17:4-13.
[46] See *Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co*., U-82-38, 1983 WL 909312, at 16-17 (July 22, 1983).
[47] RCW 80.28.425.
[48] McGuire, Exh. CRM-1Tr at 67-69.

17 Further, the shorter construction timeline of Beaver Creek is such that PSE will be able to recover its costs in rate base next year. PSE stated that Beaver Creek "has an anticipated in-service date during the first year of the rate-effective period."[49] Unlike in the Commission's 1981 Pacific Power & Light proceedings, where it granted CWIP for projects estimated to take four years to complete, Beaver Creek will be completed within the next year, at which point PSE could begin to recover the project's costs – including capitalized AFUDC – in its base rates.[50]

18 Finally, Allowing CWIP in rate base would negatively impact low-income customers.[51] As Staff noted in response testimony, "PSE's [net present value] analysis does not examine the cost implications from the perspective of PSE's lower-income customers[.]"[52] The academic literature reviewed by Staff indicates that "[i]t is more likely that lower income customers have an opportunity cost of capital that is seven to 13 percentage points higher than the discount rate PSE used in its NPV analysis, which would be between approximately 12 percent and 18 percent."[53] Given the Commission's commitment to apply an equity lens to all public interest considerations,[54] this finding should be outcome determinative. On rebuttal, PSE argues that "[e]quity in and of itself is not a gating hurdle; it is component part of a broader cost-benefit review." Staff disagrees and is troubled to see the Company making this type of argument. This line of reasoning is what entrenches existing inequities by justifying negative outcomes for marginalized groups based on a perceived net positive for customers as a whole. The Commission should remind PSE that equity is indeed a prerequisite or a "gating hurdle" to proposals being approved.[55]

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[49] Doyle, Exh. DAD-1CT at 69:9-12.
[50] Id.; see *Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, U-81-17 (Dec. 16, 1981).
[51] *See* Stokes, Exh. SNS-1T at 65-67; McGuire, Exh. CRM-1Tr at 90:17-98:3.
[52] McGuire, Exh. CRM-1Tr at 89:18-19.
[53] McGuire, Exh. CRM-1T at 93:10-13.
[54] 2021 Cascade GRC Order at 17-18, ¶ 55.
[55] 2021 Cascade GRC Order at 19 ¶ 56.

C. Annual Capital Review Refund Threshold

19 The Commission should accept Staff's position on the annual capital review threshold, which is consistent with the terms reached in the PacifiCorp 2023 settlement terms approved by the Commission.[56] PSE asks to maintain the same terms that parties agreed to in the 2022 GRC. However, since that settlement Staff has concluded that "the annual retrospective review should compare the actual used and useful plant with the level of plant included in provisional rates, thus applying a refund threshold that is consistent with the property valuation statute, RCW 80.04.250."[57] The 0.5 percent threshold for issuing refunds[58] should be determined only after provisional plant that does not meet the used and useful standard is removed.[59]

20 An example will illustrate the difference between Staff and PSE's positions on this issue. First, suppose that the Commission allows PSE to include ten capital additions into rates as provisional pro forma plant. Nine of the plants come into service as expected and at the same cost as estimated. The other capital addition is abandoned by the Company after the Commission sets rates including this project, and was never in service. Under Staff's position, at the annual capital review the amounts related to the plant would be removed and refunded to customers completely given that it was not used and useful. Under PSE's position, the company would refund some of the money related to this plant, but only the amount above the 0.5 percent

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[56] See *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Dockets UE-230172 & UE-210852, McGuire, Exh. CRM-1T at 40:12-19 (filed Sept. 14, 2023); *see also* Order 08, Appendix A (Settlement stipulation) at 11, ¶ 30 (March 19. 2024) (" For the avoidance of doubt, PacifiCorp will refund all amounts for plant not placed in service by the forecasted date, regardless of the Company's earnings.") (2023 PacifiCorp GRC Order).

[57] McGuire, Exh. CRM-1T at 12:1-5.

[58] RCW 80.28.425(6). PSE points out that the refund threshold agreed to in the 2022 GRC was much smaller than the .5% threshold above ROR for the total revenue requirement in statute. Free, Exh. SEF-28T at 17:9-20. However, this is irrelevant to the question of principle that Staff's position is based on. Regardless of the amount PSE is asking to collect that is not tied to used and useful plant, Staff opposes it.

[59] McGuire, Exh. CRM-1T at 9-15.

threshold. The Company would thus be retaining some ratepayer money for plant that never came into service.

21 PSE makes the following argument against Staff's recommendation:

> Commission Staff assumes that if rates subject to refund are set too high compared to how rates would have been set based on actual plant, it inherently means rates are recovering plant that is not used and useful. I do not believe that is the case. The actual plant placed in service is used and useful and can be validated as such in the annual capital reviews. The threshold is meant to measure whether or not the rates subject to refund were set materially correct based on the used and useful plant that was eventually placed in service during the rate effective period.[60]

This argument ignores that while the plant itself may be used and useful, the dollars that ratepayers paid related to the discrepancy between estimated and actual provisional pro forma costs are not based on any used and useful plant. As another example, suppose all ten provisional pro forma capital additions were in service, used and useful, and prudent. The actual costs for nine of the capital additions came in at estimated cost. However, after rates were set, the utility scales back the tenth capital addition, which results in significantly lower actual costs than what was included in rates. In this scenario, the Company has built less actual plant than estimated, yet under PSE's refund threshold would be allowed to retain some or all of the difference.

22 On rebuttal, PSE cites to RCW 80.28.425(3)(d) as justification for allowing the Company to retain amounts that were not linked to used and useful plant.[61] However, subsection (3)(d) references subsection (3)(b), which makes clear that the discretion described under (3)(d) applies only to property "that is or will be used and useful under RCW 80.04.250[.]" In summary, the MYRP statute makes clear that the Commission's discretion on the valuation of property assumes that said property is (or will be) used and useful as a prerequisite. At the evidentiary hearing, PSE admitted that it would not expect to be allowed to retain *any* difference between

[60] Free, SEF-28T at 18:5-12.
[61] Free, SEF-28T at 18, n. 17.

estimated cost and actual costs for traditional pro forma adjustments.[62] Given the Commission's guidance in the Used and Useful policy statement that provisional pro forma adjustments are subject to the same standards applied retrospectively,[63] the same is true for provisional pro forma adjustments. Staff's proposed amendment to the terms of the annual capital review refund process ensure that the process for reviewing provisional pro forma is consistent with RCW 80.04.250.

D. Tracking Mechanisms and Staff's Proposed Framework

23 The Commission should adopt Staff's proposed framework for evaluating tracking mechanisms.[64] The criteria proposed by Staff is consistent with past commission decisions and it is appropriate to adopt Staff's criteria in this docket to provide guidance for future proposals. Criterion 1[65] fits in with the Commission's decisions related to conservation efforts.[66] It is also consistent with mechanisms the Commission has authorized related to replacement of high-risk natural gas pipe.[67] Criterion 2[68] fits with the Commission's decision in the prior docket related to PSE's Schedule 111. [69] The rationale the Commission gave for approving Schedule 111 in that

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[62] Free, TR 261:7-262:25.
[63] Used and Useful Policy Statement at 10 ¶ 27.
[64] McGuire, Exh. CRM-1T at 36:10-52:10.
[65] McGuire, Exh. CRM-1Tr at 37:9-14 ("(1) when establishing a tracker is necessary to advance a specific public policy goal, (2) when establishing a tracker is necessary to ameliorate potential intergenerational inequities, and (3) when establishing a tracker is necessary to address variance risk that is both outside of the utility's ability to control and so high that normal cost variances could have a substantial impact on the utility's earnings.").
[66] *In the Matter of the Petition of Puget Sound Energy, Inc. and Northwest Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697, UG-121705, UE-130137 & UG-130138 (consolidated),
[67] *In the Matter of the Petition of Puget Sound Energy, Inc. and Northwest Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697, UG-121705, UE-130137 & UG-130138 (consolidated), Order 07, 38, ¶ 85; 51, ¶ 112 (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* (Nov. 4, 2010) (Decoupling Policy Statement).
[68] McGuire, Exh. CRM-1Tr at 37:9-14.
[69] *See Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc*., Docket UG-230470, Order 01, at 5, ¶ 17 (Aug. 3, 2023) ("We agree with the Company that the tariff revisions are necessary to allow the Company to begin to recover the costs of implementing the CCA, which will mitigate the impact of a ballooning future rate impact to customers.")

case was the same as Staff's proposed Criterion 2.[70] Criterion 3[71] encapsulates the Commission's decisions on power cost adjustment mechanisms. These mechanisms are intended to create incentives for the utility even under circumstances where there is high variance risk.[72] Past Commission decisions have rejected tracking mechanism proposals where the utility did not establish that the variance risk is high enough to have a substantial impact on earnings, as required by Criterion 3.[73] The Commission reaffirmed that risk sharing mechanisms (RSMs) are an important part of power cost mechanisms less than seven months ago in the 2023 PacifiCorp GRC Order.[74]

24 The Commission should reject the CGR tracker and the Decarbonization tracker because these trackers to not meet the criterion in Staff's proposed framework, and are not in the public interest. Staff does not oppose the request for a wildfire tracker. Staff disagrees with JEA and PSE that the CRG and Decarb trackers meet the criterion in Staff's proposed framework.[75] On rebuttal, PSE admits that the CGR tracker does not meet Criterion 1 when it states that "for the project costs included in the tracker, PSE does not need any additional incentive to control costs."[76] Because there is no cost control incentive that interferes with PSE's ability to meet

[70] *Id*.
[71] McGuire, Exh. CRM-1Tr at 37:9-14
[72] *See Wash. Utils & Transp. Comm'n v. PacifiCorp d/b/a Pac. Power and Light Co.*, Docket UE-050684, Order 04, p. 37, ¶ 96 (April 17, 2006) ("Deadbands and sharing bands are useful mechanisms, not only to allocate risk, <u>but to motivate management to effectively manage or even reduce power costs</u>.") Emphasis added.
[73] *Wash. Utils. & Transp. Comm'n v. PacifiCorp d/b/a Pacific Power & Light*, Docket UE- 130043, Order 05: Final Order, ¶ 9 (2013) ("We reject PacifiCorp's proposed Power Cost Adjustment Mechanism (PCAM). The Company failed to demonstrate <u>sufficient power cost variability to warrant approval of such a mechanism</u>. Moreover, the Company's proposal fails to include design elements the Commission previously has directed PacifiCorp to include in any PCAM proposal.") Emphasis added.
[74] 2023 PacifiCorp GRC Order at 123, ¶ 390. (""Without the guardrails of deadbands and sharing bands, the utility no longer has an economic stake in a major resource decision. As a result, the utility is more likely to ignore fossil fuel price volatility because it knows, regardless of price fluctuations, that it will be made whole by ratepayers. This approach creates a circumstance that one witness termed a "moral hazard" where one party is willing to engage in risky behavior or not act in good faith because it knows the other party, in this case the ratepayer, will bear the economic consequences.") (citations omitted).
[75] McGuire, Exh CRM- 10T; Free, Exh. SEF-28T at 34:2-4.
[76] Free, Exh. SEF-28T at 34:1-2

CETA requirements, the request to create this tracking mechanism should be denied. PSE's argument that the decarbonization tracker meets Staff's Criterion 1 is also flawed. At the hearing PSE admitted that if the underlying projects were approved and put into base rates, PSE would go forward with those pilots.[77]

25 The Commission should also reject the proposed decarbonization tracker because PSE has failed to establish that the tracker would serve the public interest. This tracker, which would be implemented through the proposed Schedule 141DCARB, focuses on recovering costs associated with PSE's targeted electrification strategy and pilots.[78]

26 PSE asserts that the decarbonization tracker offers advantages to both the Company and its customers by reducing resource allocation competition, allowing for the strategic allocation of resources to meet decarbonization goals, and increasing transparency and accountability related to the costs of decarbonization.[79] But these reasons do not meet any of the three criterion Staff proposes the Commission adopt in determining whether a tracker is in the public interest. PSE's incentive to electrify and accomplish the decarbonization policy objective is not in question here and does not need to be reinforced with a separate tracker. This incentive is already instilled through the statutory mandates of CETA and the CCA, as well as Commission order approving the proposed electrification efforts. Moreover, PSE has a financial incentive to increase electric load and decrease its CCA compliance costs, both of which are anticipated effects of its electrification efforts. PSE does not need a tracker in order to motivate it to strategically allocate funds to these programs. PSE has not offered any evidence or narrative explanations to indicate that the continued deferral of these decarbonization costs would create intergenerational

[77] Free, TR 267:1-8.
[78] Mickelson, Exh. CTM-1T at 60:20-22.
[79] *Id.* at 61:7-62:20.

inequities or create a variance risk that is reasonably likely to have a substantial impact on the utility's earnings. PSE does not dispute that the costs of the electrification pilot are entirely within its control and are largely predictable.

27 PSE's given reasons for establishing a tracker for these costs do not hold water. Staff does not have any reason to believe PSE will encounter issues with allocating resources to meet its electrification obligations without the aid of a tracker. Nor does PSE need a tracker in order to increase its transparency and accountability with regard to electrification costs. These goals may be easily achieved through other methods, such as communication with the Company's customers and advisory groups. In short, PSE has not identified a compelling public interest justification for the proposed decarbonization tracker and the Commission should thus reject the tracker and instead include the associated costs in base rates.

28 If the Commission does grant any of the proposed tracking mechanisms, it should account for the shift in variance risk in as part of the Commission's decision on cost of capital.[80] PSE witness Shipman agreed with this principle at the evidentiary hearing in Docket UG-230968.[81]

III. EQUITY

29 Setting aside the notable exceptions outlined below, Staff acknowledges and commends PSE's general progress and efforts to advance equity to date. However, multiyear rate plans must

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[80] *See Wash. Utils & Transp. Comm'n v. PacifiCorp d/b/a Pac. Power and Light Co.*, Docket UE-050684, Order 04, p. 37, ¶ 97 (April 17, 2006) ("Generally, the design of a sharing mechanism is an important factor in our consideration of whether a reduction in the cost of capital should accompany approval of the mechanism. We will consider the need for a reduction in the cost of capital as a part of the overall analysis of how the mechanism shifts risks between investors and ratepayers.").

[81] Exh. JLM-3Xr at 3-4 ("Q Okay. Thank you. So after the Commission approves an adjustment mechanism, assuming all else is equal, that should reduce the approved cost of capital whenever the next opportunity arises, correct? A Yes, all else being equal. ... " Q All right. So you would disagree with the argument that the approval of an adjustment mechanism has no bearing on an expert witness' recommendation on cost of capital, correct? A Yes").

demonstrate that progress on equity will be made during the rate plan.[82] In response testimony, Staff recommended a set of conditions that would ensure progress on equity over the next two years.[83] Staff was disappointed to hear that despite PSE's stated intention to work cooperatively to achieve the clean energy transition,[84] the Company was unwilling to agree with any of Staff's equity-related recommendations.[85] The Company has the ability to make progress on equity by following Staff's recommendations,[86] and the Commission should order PSE to fulfill those conditions as part of this rate plan. In cross-answering testimony JEA witnesses Thuraisingham (Front and Centered) and Thompson (NWEC) generally supported Staff's equity-related recommendations.[87] Staff appreciates the additional input JEA provided on these recommendations and does not oppose the JEA's suggested changes or amendments outlined in cross-answering testimony.[88]

A. Staff's Proposed Conditions Related to the Four Tenets of Energy Justice and Native Nations Should be Approved

30 On rebuttal, PSE opposes several of Staff's equity recommendations on the grounds that they are either duplicative, overly burdensome, or too vague.[89] Staff disagrees on all counts. Regarding the vagueness of some of Staff's recommendations, there is always a balance between a proposal or condition holding a utility accountable to take specific actions, and allowing flexibility in achieving an outcome. Based on Exhibit TAH-11 and testimony during the evidentiary hearing,[90] it appears that PSE is confident it can achieve equity outcomes despite

[82] 2021 Cascade GRC Order at 19, ¶ 58.
[83] Harmon, Exh.BLH-1T at 2-5.
[84] Steuerwalt, Exh. MS-4T at 3:1-4.
[85] Hutson, TR 195:1-4.
[86] *Id*. at 197:18-198:11.
[87] Thuraisingham/Thompson, Exh. MT-CT-6T at 5-14.
[88] *Id*.
[89] *See* Hutson, Exh. TAH-10T at 9:10-13; 12:9-15.
[90] Hutson, TR 195:16-197:13.

ambiguously stated goals. And if the Commission agrees in principle with one of Staff's recommendations but has concerns related to the phrasing, it can obviously amend the recommendation to include the preferred level of specificity. Staff's recommendations are not overly burdensome, PSE has 12 full-time employees who work exclusively on equity.[91] Staff does not believe that any of its recommendations are duplicative, but even if they were, if the Commission adopts them PSE could seek clarification to ask the Commission for permission to achieve these requirements in the method it deems most efficient. PSE's proposal to simply continue fulfilling conditions from previous orders is inadequate, particularly since PSE has been excused from filing the 2025 IRPs and CEIP.

31 Finally, Staff has concerns about PSE's Equity Investment Zone (EIZ) proposal and cannot support it at this time. The stated goal of the EIZ, as PSE articulated at the evidentiary hearing,[92] is not objectionable. However, as Staff witness Harmon notes, the proposal is fundamentally underdeveloped.[93] The example of military families identified as a community the EIZ would focus resources on is illustrative of Staff's concern. Staff does not prejudge whether in the future military families could be considered a vulnerable population under CETA standards and the CEIP's outlined process. However, the reality is that they are not currently a named community in PSE's approved CEIP. Given that there are limited resources to achieve equity-related goals, any deviation in priorities between the EIZ and the equity-related specific actions of the CEIP would ultimately mean a reduction in available resources for named communities approved in the CEIP. Staff is concerned that the EIZ is an additional concept/process that would create ambiguity and confusion when it comes to evaluating equity

[91] Hutson, TR 197:18-198:11.
[92] Hutson, TR 200:11-21.
[93] Harmon, Exh. BLH-1T at 43:1-3.

progress. The CEIP (and in the future, the ISP) already have a robust process for determining appropriate actions for the utility to take to improve and achieve equity. Should PSE be interested in pursuing the EIZ concept, it should do so through the CEIP/ISP, where the equity advisory group and other interested parties could provide input. Staff sees no reason why PSE cannot consider all equity-related regulatory compliance obligations as part of that process instead of establishing a new one.

B. Distributional Equity

32 PSE has included several decarbonization-related investments and activities in this rate case. These include PSE's acquisition of renewable and nonemitting resources and distributed energy resources, the decarbonization of its natural gas system, and its proposal to shorten the service lives for several natural gas accounts. These efforts constitute important steps in meeting the standards set by state law and Staff lauds PSE's achievements so far in that regard. That being said, Staff has serious concerns about the steps PSE has taken, or lack thereof, to ensure the equitable distribution of benefits and burdens yielded by these actions among PSE's customers, consistent with PSE's statutory and regulatory equity obligations.

33 In passing the Clean Energy Transformation Act (CETA), the Legislature stated that the public interest includes "[t]he equitable distribution of energy benefits and reduction of burdens to vulnerable populations and highly impacted communities; long-term and short-term public health, economic, and environmental benefits and the reduction of costs and risks; and energy security and resiliency" and its intent "that in achieving this policy for Washington, there should not be an increase in environmental health impacts to highly impacted communities."[94] Additionally, in complying with CETA's provisions, electric utilities must "ensure that all

[94] RCW 19.405.010(6).

customers are benefiting from the transition to clean energy."[95] Both the Climate Commitment Act (CCA) and recently passed Decarbonization Act contain similar commitments to the equitable distribution of the benefits and burdens associated with the state's transition to clean energy.[96] Building on these statutory mandates, the Commission has provided important guidance on its expectations concerning equity in prior general rate case orders:

> Recognizing that no action is equity-neutral, regulated companies should inquire whether each proposed modification to their rates, practices, or operations corrects or perpetuates inequities. Companies likewise should be prepared to provide testimony and evidence to support their position. Meeting this expectation will require a comprehensive understanding of the ways in which systemic racism and other inequities are self-perpetuating in the existing regulatory framework absent corrective intervention. It is incumbent upon regulated companies to educate themselves on topics related to equity just as it is incumbent upon the Commission to do the same.[97]

34 In this case, PSE has not sufficiently demonstrated that it understands and has planned for the equity impacts related to its decarbonization proposals. At this foundational stage in the state's transition to clean energy, it is imperative that our utilities carry out sufficient analyses of their proposed actions to ensure that the benefits and burdens of those activities are equitably distributed. Staff thus proposes that the Commission order PSE to conduct distributional equity assessments and other related actions regarding (1) its distributed solar portfolio, (2) its proposed phase two of the targeted electrification pilot, (3) the future of its natural gas system, and (4) its demand response programs, as detailed more fully below.

C. Distributed Solar Portfolio

In order to meet these equity-related standards, and consistent with the settlement reached in PSE's previous general rate case, the Commission has ordered that PSE develop a

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[95] RCW 19.405.040(8).
[96] *See* RCW 70A.65.005(7); RCW 70A.65.050(2)(c); RCW 80.86.020(12)(a).
[97] 2021 Cascade GRC Order at 19, ¶ 58.

distributional equity analysis (DEA) and apply that analysis to the 80 MW of distributed energy resources (DERs) the Company proposed in its 2021 CEIP.[98] This DEA is an important step in ensuring that PSE adheres to the standards set forth by the Legislature during this transitionary period, as it will allow the Commission, the Company, and other interested parties to examine how PSE's DER investments contribute to energy burden, access to DERs, adequacy of supporting infrastructure, exposure and vulnerability to environmental and public health impacts, service reliability, and access to economic or job benefits of the clean energy transition.[99] So far, however, PSE's progress in conducting this DEA has been insubstantial, particularly regarding the scope of its application. On July 10, 2024, Staff noted in a compliance letter that

> PSE remains in the early stages of DEA pilot implementation, with no final results available at the time of filing. . . . In the settlement approved by the Commission, PSE committed to applying these methods to the entire 80 MW distributed solar project portfolio outlined in its 2021 CEIP. Instead, PSE narrowly placed the focus on two solar projects. These projects represent 0.3% of the proposed new distributed solar capacity, significantly limiting the value of the findings to address systemic inequities across PSE's service territory.[100]

35 Staff believes that PSE's limited application of this DEA is not only inadequate to thoroughly examine the equity impacts of its DER portfolio, but is out of compliance with the Commission's 2022 GRC order. Therefore, in order to cure PSE's lackluster performance and to ensure the Company sufficiently considers and advances distributional equity through its procurement of DERs, Staff now recommends that the Commission order it to conduct a DEA on the entirety of its proposed 80 MW DER portfolio. This is crucial in the assessment of whether PSE is adequately taking equity into account in rolling out its DER portfolio. PSE cannot

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[98] 2022 PSE GRC Order at 71-72, ¶¶ 232-236.
[99] *See* Franks, Exh. WF-1T at 8:3-6.
[100] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy,* Docket UE-220066, Staff Compliance Letter at 1-2 (July 10, 2024).

sufficiently understand the equity impacts of its DER portfolio with such a limited application of the DEA.

36 PSE asserts a number of arguments as to why the Commission should reject Staff's recommendation and be satisfied by the extraordinarily diminished DEA that it has thus far completed. First, PSE asserts that there is no basis in the 2022 GRC order to require that the pilot DEA be applied to the entire 80 MW DER portfolio.[101] But the order specifically states that the parties agreed PSE would develop a pilot DEA and apply the DEA "to its proposed 80 MW of distributed energy resources" and that the Commission approved this settlement term.[102] PSE has not explained why or how its minimal DEA application thus far satisfies this condition. Moreover, at the very least, the 2022 PSE GRC order does not in any way preclude the Commission from adopting a requirement in this case specifically instructing PSE to apply the DEA to its entire DER portfolio, as Staff recommends.

37 Next, PSE asserts that "conducting a DEA on the entire 80 MW portfolio of distributed solar would be difficult, if not impossible, when 'PSE had not procured nor fully determined the customer program structure for the entire 80 MW portfolio of distributed solar that was to be in place by the end of 2025 pursuant to the Clean Energy Implementation Plan approved target.'"[103] This would be a compelling argument if PSE had applied the DEA to a substantial portion of the DER assets that are already in place or planned for. As of October 2024, PSE had procured 29 MW of the 80 MW portfolio and had already determined the programs through which it would procure the balance of the portfolio.[104] Despite this progress, PSE has not offered a reasonable explanation for why it contained its application of the DEA to only two solar projects

[101] Hutson, Exh. TAH-10T at 18:13-15.
[102] 2022 PSE GRC Order at 71, ¶ 232.
[103] Hutson, Exh. TAH-10T at 19:3-7.
[104] Hutson, Exh. TAH-16X.

totaling 0.3 percent of the portfolio. During his cross examination, witness Hutson stated that the balance of the projects in the DER portfolio will go through a general system-wide equity assessment that does not focus solely on distributional equity and that PSE would need to conduct a review to determine whether PSE had time to apply a DEA to those projects.[105] This reasoning does not explain PSE's failure to adhere to the Commission's condition that it conduct a distributional equity-specific assessment on the 80 MW of its DER portfolio. Nor does it instill confidence in PSE's distributional equity planning process if, two years after the Commission ordered PSE conduct that assessment, the Company still does not even have an idea of the time required to complete the assessment. Moreover, PSE has offered no evidence providing a basis off of which the Commission could reasonably conclude whether its general system-wide equity assessment would adequately analyze the distributional equity impacts of PSE's DER projects. PSE has not made the argument that its general assessment constitutes an acceptable substitute for the DEA it was required to complete as a result of the settlement in its last general rate case.

38 Last, and quite possibly least, PSE asserts that "applying the DEA methodology may not be applicable in all circumstances. . . . Some assets in the DER solar portfolio may be developer-sited" and that applying a DEA to such projects is not appropriate because they "provide system benefits as opposed to direct customer benefits."[106] The first issue with this argument is that PSE has failed to explain what portion of its portfolio consists of developer-sited assets. Moreover, it is not clear from Hutson's testimony why PSE believes a DEA would be inappropriate for developer-sited projects—even if PSE does not actively select the locations of these projects, it is still important to assess the projects for their impact on distributional equity. This statement also indicates that PSE does not believe a DEA is appropriately applied to assets that do not have

[105] TR 204:12-206:15.
[106] Hutson, Exh. TAH-10T at 19:8-15.

direct positive equity impacts. Such an assertion undermines the utility of a DEA and would skew the results of the assessment to make PSE's efforts seem more equity-friendly than they really are. The Commission should be clear that it makes no exception for developer-sited assets when it comes to analyzing equity impacts.

39 PSE has not offered a single legitimate reason for why it has not yet complied with the plain terms of the 2022 settlement to conduct a DEA for its DER portfolio. Nor does it challenge Staff's position that, consistent with state law and the Commission's guidance on equity, such a DEA is crucial in determining what are the distributional equity impacts of PSE's resource investments. The Commission should therefore require PSE fulfill the obligation it assumed during the 2022 rate case and explicitly command the Company conduct a DEA on its entire 80 MW DER portfolio.

D. Targeted Electrification Pilot Phase Two

40 Also, as part of the 2022 settlement agreement, PSE committed to developing a targeted electrification pilot, primarily aimed at deploying heat pump technologies to its customers.[107] PSE launched the pilot in June 2023.[108] As part of this rate case, PSE has proposed building on the targeted electrification pilot by implementing phase two of the pilot, which would "provide heat pump incentives to sustain current customer offerings, assess whether targeted electrification can alleviate the need to expand the natural gas delivery system in a capacity constrained area, and broaden the customer reach of the first phase of the Targeted Electrification Pilot."[109] PSE states that phase two of the pilot would focus on low-income customers and aims to provide insight on ways to mitigate barriers to electrification for those

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[107] 2022 PSE GRC Order at 19, ¶ 65.
[108] Mannetti, Exh. JM-1CT at 4:3.
[109] *Id.* at 15:9-12.

customers.[110] However, when asked how PSE intended to evaluate its targeted electrification programs for distributional equity, PSE only responded that it was awaiting further guidance from the Commission before conducting any further DEAs.[111]

41 As previously discussed, it is essential that PSE adequately assess its electrification efforts to ensure that the benefits and burdens of those programs are distributed equitably in compliance with CETA and Commission rules and guidance. Without a DEA to guide the rollout of PSE's electrification programs, PSE will be flying blind in terms of distributional equity and cannot effectively achieve its goal of mitigating electrification burdens faced by low-income customers. Staff therefore recommends that the Commission also order PSE conduct a DEA on the proposed phase two of the targeted electrification pilot.

42 In response to Staff's recommendation, PSE states that "[a] DEA is not needed on the Targeted Electrification Pilot because there is already an evaluation planned for Phase 1 and 2, as mentioned in John Mannetti's testimony."[112] PSE plans to publish a report on the results of the evaluation of phase one of the pilot by January 2025 and plans to evaluate phase two after 2025.[113] However, details regarding these evaluations are severely lacking. PSE stated that it planned to contract with The Cadmus Group to evaluate phase one of the pilot over the 2024-2025 period to "identify barriers to heat pump adoption methods to increase market penetration of heat pumps for low-income customers, highly-impacted populations, vulnerable populations, and customers experiencing high energy burdens" and additionally "to understand impacts of new heat pump systems on peak electricity needs during peak heating hours in areas with homes

[110] *Id.* at 21:18-22:2.
[111] Franks, Exh. WF-5.
[112] Hutson, Exh. TAH-10T at 21:12-14.
[113] *Id.* at 21:14-19.

that switch from natural gas heating to heat pumps."[114] PSE therefore asserts a DEA would be redundant. But based on this limited description, it is certainly not clear that PSE's evaluation of phase one of the pilot will achieve the same goals as Staff's recommended DEA, which is to examine the distributional equity impacts of PSE's targeted electrification investments in the context of a cost effectiveness analysis. In fact, as previously stated, PSE has already made it clear that it does not intend to conduct any further assessments of distributional equity until it receives further guidance from the Commission.[115] There is nothing to indicate that the targeted electrification pilot evaluation represents an exception to this statement.

43 Moreover, the evaluation, as described by witness Mannetti, only applies to phase one of the pilot and is therefore irrelevant to Staff's recommendation that PSE conduct a DEA on the proposed phase two. When asked for details regarding PSE's plan for its evaluation of phase two, PSE simply responded that a detailed evaluation plan would be developed once the Commission approves phase two of the pilot.[116] PSE has not explained how it has determined that a planned evaluation, the details of which have not yet been developed, would render Staff's recommended DEA redundant. On cross examination, witness Hutson again stated that a DEA was not necessary because the projects are subject to PSE's general system-wide equity assessment.[117] But Staff reiterates that PSE has not offered any further details regarding its general equity assessment, never mind any evidence that it would render a DEA unnecessary.

44 Once again, PSE has not offered any legitimate reason why it should not conduct a DEA on its decarbonization investments. Doing so would undoubtedly aid PSE's efforts to ensure that the benefits and burdens of these programs are equitably distributed, as required by CETA. Nor

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[114] Mannetti, Exh. JM-1T at 7:11-19.
[115] Franks, Exh. WF-5.
[116] Hutson, Exh. TAH-17X.
[117] TR 207:12-15.

has PSE provided any evidence to support its position that a DEA is not needed in this context. For these reasons, the Commission should also order PSE conduct a DEA on phase two of its targeted electrification pilot.

E. Natural Gas System Equity Planning

45 Staff additionally harbors concerns about the adequacy of PSE's planning for the equity impacts resulting from forecasted natural gas attrition rates. Further analysis is needed before PSE, the Commission, and other interested parties can adequately understand the potential equity consequences resulting from the decarbonization of the natural gas system. PSE must therefore conduct an examination of these potential effects before the cost-burden repercussions set in.

46 PSE forecasts natural gas consumption to decline at an average annual rate of 1.2 percent in 2024-2028.[118] This scenario creates significant danger of inequitable outcomes for populations that will possibly be left behind in the transition away from natural gas. Recognizing this, PSE has proposed to mitigate the effects of natural gas attrition by increasing depreciation rates of its natural gas assets and shortening the service lives for several natural gas accounts by ten years.[119] However, Staff does not believe this action is sufficient to address the looming equity impacts of rising natural gas rates being paid by an increasingly smaller pool of customers.

47 During discovery, PSE stated that it "has not performed a detailed analysis forecasting average residential gas bills in the context of declining customer counts."[120] But without fully accounting and quantifying the potential risk of rising rates, PSE will be unable to plan for equitable outcomes in its natural gas system. Staff has already made PSE aware that it expects

[118] Jacobs, Exh. JJJ-1T at 3:17-20. This forecast will undoubtedly be affected by the recent passage of Washington's Initiative 2066, which repeals sections of chapter 80.86 RCW and prohibits local and state entities from discouraging the use of natural gas. Nevertheless, due to the continued impact of CCA compliance costs, voluntary electrification, decreasing prices of electric appliances, and the affects of climate change, Staff agrees that PSE will continue to see a decline in natural gas customer counts.
[119] Allis, Exh. NWA-1T at 4:3-15.
[120] Franks, Exh. WF-4 at 2.

the Company to account for the effects of natural gas attrition in its comments to PSE's 2023 natural gas IRP (Integrated Resource Plan) and stated that PSE should include such analysis in its 2025 IRP.[121] However, PSE is no longer required to file its 2025 IRP and it would be inappropriate to procrastinate on the issue until 2027, when the Company files its first Integrated System Plan (ISP).

48 Any further delay in PSE's analysis of how these changes to its natural gas system will affect customers, particularly those in named communities, can only operate to perpetuate and exacerbate harm to those groups. Therefore, Staff recommends that the Commission order PSE to conduct a cost burden analysis on a range of future possible scenarios in the natural gas system based on differing inputs including changing customer counts, CCA compliance costs, and other factors relevant to forecasted natural gas rates.[122] This analysis should give particular consideration to the burdens that will be faced by named communities. The Commission should order PSE to file the results of this analysis in this docket no later than January 31, 2027 and incorporate those results into the Company's first ISP.

F. Equity in Demand Response Programs

49 PSE's decarbonization efforts also include several programs related to demand response. Staff is generally supportive of PSE's demand response programs and sees demand response as an integral resource in terms of meeting PSE's decarbonization goals, as it can be used to effectively reduce energy demand and strain on the grid. However, PSE has not provided sufficient evidence in this rate case to establish that it will meet its equity obligations associated with those programs. Staff thus also recommends the Commission order PSE engage in further

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[121] *In re Puget Sound Energy's 2023 Integrated Resource Plan*, Docket UG-220242, Staff's Comments Regarding PSE's 2023 Natural Gas Integrated Resource Plan at 10 (June 5, 2023).
[122] *See* Franks, Exh. WF-1T at 29:17-30:7.

equity planning and institute a performance incentive mechanism to ensure the equitable distribution of the energy benefits yielded by its demand response programs.

50 CETA requires that electric utilities must "pursue all cost-effective, reliable, and feasible conservation and efficiency resources, and demand response."[123] In approving PSE's 2021 CEIP, the Commission imposed several demand response-related conditions, including that PSE must increase its demand response MW target to include all cost-effective demand response bids it received in response to its 2022 RFP and designate a minimum of 30 percent of the energy benefits from its demand response programs for named communities.[124] PSE selected three proposals from the RFP, reflecting a total of 86 MW of available cost-effective demand response, provided by AutoGrid, Oracle, and Enel X.

51 Staff recommends the Commission allow PSE to recover the 2025 and 2026 costs associated with these power purchase agreements, as well as allow PSE to earn a return on the agreements calculated at the Company's authorized cost of debt. That said, PSE has not provided evidence that it has taken the necessary steps to ensure that the energy benefits of these DR agreements will be equitably distributed according to the Company's equity obligations. Staff therefore recommends that the Commission (1) order PSE to develop and institute an action plan to ensure that named communities will receive an equitable portion (30 percent) of the benefits of PSE's demand response programs and (2) adopt a performance incentive mechanism that incorporates equity into its incentive structure.

G. Named Communities Action Plan

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[123] RCW 19.405.040(6)(a).
[124] *In re Puget Sound Energy's 2021 Clean Energy Implementation Plan*, Docket UE-210795, Order 08 at 19, ¶ 86; 75, ¶ 278 (June 6, 2023) (PSE CEIP Order).

52 PSE has failed to provide any details to explain how the energy benefits yielded from the three demand response power purchase agreements included in this case will meet the 30 percent threshold, or else present an overarching plan to satisfy the condition. In describing the demand response programs provided by AutoGrid, witness Archuleta simply states that "[t]he programs are intended to provide over 30 percent of energy benefit to named communities customers," without citing to evidence to support this assertion.[125] Regarding the Oracle program, Archuleta states "[t]he program is intended to reach over 30 percent of named communities customers."[126] But even accepting this statement at face value, that the program is intended to reach 30 percent of customers from named communities is clearly not the same as designating 30 percent of the benefits of that program for named communities customers. These empty statements do little to instill confidence in PSE's ability to uphold its demand response equity obligations.

53 Archuleta points out that the contract for each of the three power purchase agreements contains terms ensuring that 30 percent of the benefits will go to named communities.[127] But closer scrutiny of the contract language yields similar concerns and reveals no discernable plan for how PSE will achieve this threshold. For instance, PSE's contract with AutoGrid merely states that AutoGrid will annually provide PSE a "Customer Benefits Plan," which will include "[h]ow [AutoGrid] is working with PSE to ensure at least 30% of the net energy benefit to customers is applied to named communities and vulnerable populations."[128] PSE's Oracle contract states that Oracle will provide "reasonable assistance" with prioritizing the participation of 'Named Communities.'"[129] Nowhere in the terms of the contracts, or elsewhere, does PSE

[125] Archuleta, Exh. GA-1T at 10:15-16.
[126] *Id.* at 11:8-9.
[127] *Id.* at 25:8-10, 31:4-5, 35:19-35:1.
[128] Archuleta, Exh. GA-9 at 49.
[129] Archuleta, Exh. GA-10 at 3.

illustrate how named communities will receive 30 percent of the benefits associated with the power purchase agreements.

54 Archuleta additionally states that PSE has prioritized the participation of named communities in its demand response offerings by implementing an "action plan" beginning in 2023, which generally makes its demand response programs available to those communities.[130] As part of the action plan, PSE states it provides demand response-friendly thermostats and hot water heaters to customers who need them to participate in its Flex Smart program and will roll out its Flex Events program to named communities.[131] But, again, the problem with these efforts is that none specifically address how PSE will increase the proportional share of demand response energy benefits enjoyed by named communities. PSE's current action plan is essentially just rolling out its demand response programs to all of its customers. And while named communities are included in this deployment, PSE has not identified any action it has taken to guarantee the satisfaction of the 30 percent threshold. None of PSE's demand response programs specifically target named communities.[132] PSE also states that it plans to engage in outreach with community-based organizations and customers in named communities, as well as its existing advisory groups, to identify barriers to participation in these programs.[133] But, as of May 2024, PSE had not yet begun these outreach efforts and its outreach plan was still under development.[134] Making its demand response programs generally available and planning to perform outreach is simply not sufficient to meet PSE's demand response equity obligations.

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[130] Archuleta, Exh. GA-1T at 16:4-20.
[131] *Id.*
[132] Koenig, Exh. PK-3.
[133] *Id.* at 17:3-13.
[134] Koenig, Exh. PK-5.

55 To cure this deficiency and ensure that PSE's named communities customers receive sufficient benefits from the demand response programs included in this rate case, Staff first recommends that the Commission order PSE develop a new action plan that is specifically targeted to reaching the 30 percent threshold for named communities customers. This action plan must include an explanation of how PSE plans to quantitatively measure this 30 percent of energy benefit requirement and how PSE will enforce this energy benefit goal on its selected third party implementors. The action plan will be submitted as a part of PSE's compliance filing for this case.

H. Performance Incentive Mechanism

56 Staff additionally proposes that the Commission adopt an alternative demand response performance incentive mechanism (PIM) that will further incentivize PSE to meet its demand response equity obligations.

57 PSE's current demand response PIM was approved in its previous general rate case and is based on a demand response target of 40 MW by 2024, with financial rewards that activate when PSE achieves 105 percent and 115 percent of the target, respectively. The total reward is limited to $1 million over the course of the MYRP.[135] In the current rate case, PSE has proposed setting the demand response target at 149 MW "by the end of the November 2026-2027 (winter season)" and raising the reward cap to $3 million over the MYRP.[136]

58 Staff has a number of concerns with PSE's proposal. First, PSE has not provided any data or narrative explanation in support of the 149 MW target, stating only that "PSE's contracted winter season DR MWs for 2026 is the basis for the proposed PIM target of 149. This represents

[135] 2022 PSE GRC Order at 25-31.
[136] Archuleta, Exh. GA-1T at 20:2-12.

a significant (73.25 percent) increase over the 86 MW 2025 CEIP target."[137] Despite being a significant increase, PSE's asserted basis being the demand response MWs it has already contracted for does not represent an appropriate target for use in a PIM and would only operate to reward PSE for actions already taken instead of incentivizing future performance. Second, PSE's proposed PIM does nothing to advance equity in its demand response programs, one of the four overarching goals of performance incentives.[138]

59 Staff therefore recommends an alternative PIM that includes a higher demand response MW target, as well as PSE's 30 percent threshold equity obligation. Staff proposes a target of 207 MWs, which is based on PSE's incremental demand response resource additions for the years 2024-2026, taken from PSE's 2023 electric progress report for its 2021 IRP. Staff's proposed PIM does not trigger an incentive reward until the Company meets this target and additionally surpasses the 30 percent energy benefit threshold for named communities. The details of Staff's proposed PIM are laid out in the testimony of witness Koenig.[139]

60 PSE takes issue with Staff's proposed target of 207 MWs because it is "based on a small subset of years pulled from PSE's 10-year Annual Incremental Resource Additions Preferred Portfolio."[140] But this "small subset" is actually PSE's own data on its forecasted demand resource additions over the course of the MYRP. PSE complains that Staff's proposal is "complicated," "premature," and "not superior to PSE's proposal, which is based on direct data for DR achievements PSE expects to reach in 2026."[141] But these are not legitimate reasons to dismiss Staff's inclusion of an equity-related metric in this PIM. The Commission has provided

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[137] *Id*. at 20:14-16.
[138] *In re a Proceeding to Develop a Policy Statement Addressing Alternatives to Traditional Cost of Service Rate Making*, Docket U-210590, Interim Policy Statement at 5, ¶ 9 (April 12, 2024) (Policy Statement on Performance Measures).
[139] Koenig, Exh. PK-1T at 17:7-20:4.
[140] Archuleta, Exh. GA-14T at 6:3-4.
[141] *Id*. at 5:18-6:6.

clear guidance that PIMs should be used to advance equity in the access to demand response programs and are an essential element of performance-based regulation.[142] Staff's proposal is consistent with this policy. Moreover, PSE's argument that its proposed demand response target is based on demand response achievements it already expects to reach underscores the meager nature of that target. A PIM should not be used to automatically reward a utility for actions already taken, but should encourage the Company to increase its demand response performance. Staff's proposed PIM establishes a reasonable target and would incent PSE to make satisfactory progress in both demand response acquisition and equity.

IV. COST OF CAPITAL

61 The Commission should authorize a two-year multi-year rate plan (MYRP) for years 2025 and 2026 with a 9.5 percent return on common equity during both years.[143] The Commission should adopt a hypothetical capital structure separated into long-term and short-term debt, as recommended by Staff Witness Parcell. In 2025, short-term debt should be set at 2.04 percent of total capital structure with a return of 5.07 percent, and long-term debt should be set at 49.46 percent of total capital structure with a return of 5.27%.[144] In 2026, short-term debt should be set at 1.18% of total capital structure with a return of 4.08%, and long-term debt should be set at 50.32% of total capital structure with a return of 5.36%.[145] Based on these calculations, PSE's total weighted cost of capital should be 7.36% in 2025 and 7.37% in 2026.[146]

A. Legal Standard

[142] *See* Policy Statement on Performance Measures at 6, ¶ 12 (identifying one of the desired outcomes of performance incentives as "[e]quitable access to all utility energy programs, including those related to energy efficiency, demand response, and distributed energy resources.")
[143] Parcell, DCP-1T, at 3:6-12 (chart).
[144] *Id.* Unless otherwise stated, dates for December 31 of the given year.
[145] Parcell, DCP-1T, at 3:6-12 (chart).
[146] Id.

62 A utility's cost of capital is the level of return it requires to service its debt and compensate its equity investors. The Commission calculates a utility's cost of capital, or rate of return, in keeping with the principles established in the *Hope*[147] and *Bluefield*[148] line of cases. To calculate a utility's cost of capital, the Commission must determine the cost of debt, the cost of equity, and the utility's capital structure.[149] A utility's rate of return (also known as the weighted cost of capital) is the sum of its cost of debt and its cost of equity, weighted according to the respective shares of debt and equity in the utility's capital structure.[150]

63 The cost of debt is typically computed based on the actual debt and cost rates of debt the utility has issued.[151] In contrast, the cost of equity is an estimate of the likely return an investor would require to invest in an enterprise with comparable risks.[152] To determine the return on equity, the Commission first identifies the range of possible returns reported by expert witnesses, and narrows that to a range of reasonable returns.[153] The Commission selects a specific ROE by weighing the results falling within that range and considering any other relevant evidence.[154]

64 The capital structure used to calculate the rate of return may be a company's actual capital structure or a hypothetical capital structure.[155] The important principal is that the capital

[147] *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944).
[148] Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n, 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923).
[149] *See Hope*, 320 U.S. at 603.
[150] *See Bluefield*, 262 U.S. at 689-90.
[151] *Id.*
[152] *See Hope*, 320 U.S. at 602; *Bluefield*, 262 U.S. at 692.
[153] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-170033 & UG-170034, Order 08, 32, ¶ 90 (Dec. 5, 2017).
[154] *Id.*
[155] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-170485, UG-170486, & UE-171222, Order 07, 39, ¶ 109 (Apr. 26, 2018) (2017 Avista GRC Order); see also *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-040640 & UG-040641, Order 06, 13, ¶ 27 (Feb. 18, 2005) (2004 PSE GRC Order).

structure that the Commission uses for setting rates must balance the "economy" of lower cost debt with the "safety" of higher cost common equity.[156]

B. Calculating Cost of Capital

65 PSE has made several claims that Staff has incorrectly calculated the proper cost of capital for the Company. These assertions, however, are either mischaracterizations of Staff's calculations or "incorrect" only insofar as PSE's calculations and Staff's use their respective litigation positions. In particular, PSE focuses on Staff's proposal to return to PSE's longstanding 48.5 percent hypothetical common equity ratio over PSE's substantial request to increase that ratio to 50 and 51 percent, above even the currently authorized 2022 settlement ratio of 49 percent.[157] Staff's position is the more realistic of these options and will result in more accurate assessments of PSE's capital needs.

66 In her rebuttal testimony, Company witness Peterman asserts that Staff witness Parcell has incorrectly used PSE's hypothetical common equity ratio as 48.5 percent instead of the 49 percent ratio used determined in PSE's last general rate case.[158] Peterman asserts that the 49 percent ratio should be regarded as supplanting the prior ratios, yet offers no rationale for why that should be so beyond the fact that it was the most recently agreed-upon ratio.[159] This argument fails for several reasons, both from a practical and policy view. First, and most simply, the 49 percent ratio was reached through a settlement, not litigation.[160] According to the final order[161] and settlement agreement,[162] the specific metrics and conclusions used to reach any

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[156] *Puget Sound Energy*, UG-040640, UE-040641, UE-031471, and UE-032043, Order 06, at 13, ¶ 27 (Feb. 18, 2005).
[157] Peterman, CGP-11CT, at 33:2.
[158] Peterman, CGP-11CT, at 35:5-15.
[159] *Id.* at 37:2-9.
[160] 2022 PSE GRC Order at 10, ¶ 46.
[161] *Id.* at 29 ¶ 99.
[162] *Id.*, Settlement Stipulation and Agreement, at 7 ¶ 21.

particular conclusion are non-precedential and hold no weight for future litigation. PSE therefore cannot use the 49 percent ratio in the settled case as a basis for claiming that that ratio should be the default moving forward.

67 PSE's argument regarding the proper equity ratio should also fail due to the evidence of the Company's actual capital structure and actions of the company since the 2022 settlement. PSE's actual equity ratio is currently 47.8 percent common equity, well below its authorized equity of 49 percent that it fought to achieve under the 2022 case.[163] Interestingly, PSE's common equity has actually decreased from 2022, despite the increase in hypothetical common equity.[164] As in the current case, PSE stated in 2022 that it required increased cash flow and needed to attract new investors to do so, which meant an increase in return on equity and common equity.[165] Yet, PSE has not expanded its common equity as a share of its total capital structure. Instead, an equivalent share of PSE investors are being compensated at an even more inflated hypothetical rate.[166] Staff's proposal simply returns PSE to the long-standing status quo, lessening the burden on ratepayers to compensate PSE for nonexistent common equity while still ensuring that PSE has flexibility in its funding requirements should it require an increase in capital investment.

68 Along this same vein, the Commission should also refuse to use the higher hypothetical common equity ratio proposed by PSE due to the policy behind hypothetical capital structures. The Commission has previously determined that hypothetical capital structures "should [] be reserved for circumstances including, but not limited to, financial hardship or tight capital market

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[163] Parcell, DCP-1T at 29:10-11.
[164] Parcell, DCP-6, at 2.
[165] 2022 PSE GRC Order at 38, ¶ 130.
[166] Parcell, DCP-6, at 2.

conditions."[167] Increases in hypothetical capital structure will inherently benefit investors at the cost of greater burden on ratepayers.[168] Moreover, the burden on ratepayers is exacerbated as hypothetical capital and actual capital structure diverge further, forcing ratepayers to pay higher premiums for the same pool of common equity.[169] Regardless of whether the Commission adopts PSE's proposal or Staff's, PSE will be getting the benefit of a hypothetical capital structure which outpaces its actual common equity ratio. The difference is that Staff's proposal reduces the gulf between the hypothetical and actual, protecting ratepayers and keeping in line with the Commission's implicit goal that the two ratios not diverge too greatly.[170] PSE's proposal, meanwhile, starts with a non-precedential settlement agreement which already widens that gap, then widens it significantly further by increasing the already inflated hypothetical ratio to even greater extremes. In short, PSE would have Washington ratepayers channel vastly increased amounts of capital to a pool of investors which already receive amounts incommensurate with their actual contributions to PSE's capital structure. Such a proposal should be rejected as incompatible with Washington's ratemaking principle of fair and just rates for ratepayers.

C. ROE, Market Data, and Credit Ratings

69 PSE's has requested a substantial increase in its ROE,[171] commensurate with past rejected or abandoned requests in rate cases before this Commission.[172] In making this request, PSE has relied on a bevy of cherry-picked data and quotes that place the company on the edge of a

[167] *Wash. Utils. & Transp. Comm'n v. Avista Corp*., UE-170485, UG-170486, UE-171221, & UG-171222, Final Order 07/02, at 39 ¶ 110.
[168] *PacifiCorp v. Wash. Utils. & Transp. Comm'n*, 194 Wash. App. 571, 581, 376 P.3d 389 (2016).
[169] *See Wash. Utils. & Transp. Comm'n v. General Telephone Co. of the Northwest, Inc.*, U-81-61, Seventh Supplemental Order, at ¶7 (May 20, 1982) ("It is always true that a change in regulatory capital structure will affect rate of return if the company's actual capital structure differs from its proper structure for regulatory purposes. The company can minimize or avoid this difference by moving towards or adopting as its own that capital structure which we find to be appropriate for regulatory purposes.").
[170] See *Id*.; *PacifiCorp*, 194 Wash. App. at 581.
[171] Bulkley, Exh. AEB-1T at 9:16-21.
[172] E.g. Puget Sound Energy, Docket UE-220066, Exh. AEB-1T at 3:19-4:5.

financial cliff. As will be shown, the reality is that PSE is healthy, and its credit outlook is positive, eliminating the necessity for the drastic increases in ROE and capital structure that it has requested.

1. PSE's Argument Relies on Outdated or Misconstrued Financial and Market Information

70 PSE claims that rising costs of capital require greater revenue potential to ensure the Company and its investors are properly compensated. However, that assertion relies on basic facts that directly contradict PSE's conclusion. In reality, PSE's actual cost of debt has *declined* since its last litigated rate case.[173] Economic forecasts are also demonstrate lowered costs and risk for PSE. Bond risk premiums have significantly declined since PSE's last litigated case in 2022.[174] Inflation, which is cited by both PSE[175] and Staff[176] as a core driver of PSE's risk factors, has slackened.[177]

71 Simply saying that inflation has slacked, though, understates the beneficial nature of the current economic forecasts for PSE. [redacted].[179] In sum, the financial outlook for the nation, and therefore PSE, is looking significantly more positive than at PSE's last rate case, despite the challenges still ahead. Both facets of this forecast are reflected in Staff's more

[173] Peterman, Exh. CGP-1CT, at 10 (Table 3).
[174] Bulkley, Exh. AEB-25 at 7 (column 3).
[175] Bulkley, Exh. AEB-1T at 23:3-7; Peterman, Exh. CGP-1CT at 48:14-17.
[176] Parcell, DCP-1T at 9:1.
[177] Bulkley, Exh. AEB-19T at 10:12-14.
[178] Bulkley, Exh. AEB-39C at 21.
[179] *Id.*

reasonable proposal. Staff is not deaf to the needs of PSE, as seen by the modest 10 basis point increase that Staff has proposed. This more modest increase will take into account the longer-term changes that have been wrought in the economy while ensuring that ratepayers are still protected and the Commission principles of gradualism and scientifically grounded decision making are upheld.

2. PSE's credit rating is not at risk under Staff's proposal

72 PSE argues that its credit rating is at severe risk of a downgrade in the immediate future absent a significant increase in its authorized ROE. Yet the assessments of PSE's credit standing by its experts simply do not line up with the empirical evidence presented by Staff and the intervenor parties. PSE, by objective measures, has a healthy disposition for future credit rating determinations.

73 PSE's arguments regarding credit rating fall into two primary categories. First, PSE claims that its current cash flow and regulatory revenue potential have been eroded over the last several years to the point of not meeting credit-rating thresholds.[180] Second, PSE claims that Staff's proposals put the company at risk of a downgrade in credit rating.[181]

74 PSE cites two primary forces as to blame for its cash flow and earnings deterioration. First, PSE blames the Tax Cuts and Jobs Act of 2017 (TCJA), which it claims caused an immediate and ongoing reduction in its cash flows, resulting in negative credit outlooks.[182] This argument fails for two reasons. First, PSE undercuts its own testimony by stating that it has accounted for the TCJA and is no longer on negative outlooks as a result of the law.[183] Second,

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[180] Peterman, Exh. CGP-11CT at 43:7-11.
[181] Peterman, Exh. CGP-1CT at 32:19-21.
[182] Peterman, Exh. CGP-11CT at 44:3-10.
[183] *Id*. at 44:7-10 ("PSE was only able to get off the negative outlooks after much work to find additional revenues through various corrections to the 2019 GRC order, the implementation of the IRS ruling on deferred taxes and filing a PCORC in 2020.").

time and intervening changes in the legal framework require the Commission to discount the effects of a law that will be eight years old by the suspension date of this proceeding. Washington has passed multiple laws affecting PSE's cash flows, business practices, and credit ratings since the passage of the TCJA, including the Clean Energy Transformation Act, Climate Commitment Act, SB 5295, MYRP and PBR regulations, much of which has been cited as "credit positive" by ratings agencies.[184] The Commission should not allow PSE to continue to use a law passed eight years ago, which by its own testimony it has accounted for in its business practices, as an excuse for cash flow problems in the face of the myriad of changes that have taken place during the intervening years.

75 PSE also blames CETA for its cash flow and earnings deterioration. While there were some credit ratings concerns with the original implementation of CETA,[185] intervening planning and regulatory frameworks in the form of MYRP, PBR, and SB 5289 have reinforced and greatly strengthened ratings agencies' confidence in PSE's credit strength.[186] As with the TCJA, PSE has tried to pin its problems on a law which the Commission and Washington legislature have already addressed. To further increase PSE's earnings potential at this time would only be an excess at the expense of ratepayers. PSE even seems to admit this, stating that PSE needs "enough cash flow to improve PSE's key credit metrics to a comfortable place with an appropriate margin of cushion."[187] Yet this does not explain why the incremental costs of CETA compliance are not adequately addressed by including CETA compliant plant additions into rate base, PSE has included new CETA compliant investments in rate base and Staff does not contest those additions. And if PSE's position is that the Company needs this cash flow to make future

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[184] Parcell, Exh. DPC-1T at 19:38-20:3.
[185] *Id*. at 19:38-43.
[186] *Id*. at 20:13-23.
[187] Peterman, Exh. CGP-11CT at 40:19-21.

investments, it could and should have proposed a longer rate plan that incorporated those planned capital additions. The Commission's mandate is to ensure "fair, just, *reasonable*, and *sufficient*" rates. The Commission should uphold that mandate and reject PSE's argument concerning CETA.

76 Finally, PSE has taken a number of selective quotes from ratings agencies to claim that it is considered a high-risk investment and at severe risk of a credit downgrade without significant supportive regulation from the Commission. The words of those credit agencies belie PSE's argument. In the words of Moody's, "Puget Sound Energy, Inc.'s (PSE) credit profile reflects its low risk regulated utility operations with a number of credit supportive cost recovery mechanisms authorized by its primary regulator, the Washington Utilities and Transportation Commission (WUTC)."[188] Standard and Poor's had a similar assessment, stating "Given the material barriers to entry, Puget Sound Energy and the regulated utility industry as a whole are insulated from competitive market challenges. This underlies our view of regulated utilities' very low industry risk compared with other industries."[189] This follows after S&P's assessment that PSE's recent regulatory outcomes have been credit positive and strengthen the Company's credit profile.[190]

77 Overall, PSE's credit rating assessments have been strong, and Staff's determination of a modest increase should be viewed as credit supportive while staying within the Commission's dual mandate of supportive regulation and consumer protection. Staff's proposals still allow for significant increases in the Company's revenue potential while not increasing ROE and capital

[188] Parcell, Exh. DCP-1T at 20:27-30.
[189] *Id*. at 21:35-22:2.
[190] *Id*. at 21:22-30.

structure by overly burdensome amounts for ratepayers. As such, the Commission should accept Staff's proposal.

D. Principles of Gradualism Also Favor Staff's Proposal

78 Gradualism, the long-standing Commission principle of measured rate changes,[191] weighs heavily in favor of Staff's proposal. The Commission has, in past cases for PSE, rejected the idea of heavy reductions in ROE under the principle of gradualism, showing not only that the Commission applied this principle in PSE's cases but that it has been used to the benefit of both the Company and ratepayers.[192] In PSE's 2017 case, the Commission rejected a 95-basis point decrease, stating that such a large change in ROE would be antithetical to the ratemaking principle of gradualism. In the instant case, PSE has requested a greater increase than that in 2017, totaling 110 basis points over the two years of the MYRP.[193] In addition to the problems detailed earlier, this recommendation flies in the face of gradualism, directly disregarding prior precedent without warrant or reason. As such, the Commission should disregard PSE's substantial increases to ROE in favor of Staff's more modest increase.

V. POWER COST

79 Staff makes several recommendations concerning PSE's power costs. First, Staff finds that PSE's proposed annual power cost review process is generally reasonable but offers a few related recommendations. Second, Staff makes three recommendations regarding CCA costs: (1) PSE's costs related to the CCA should be reviewed for prudency annually; (2) PSE should consider CCA compliance costs in dispatch of thermal resources; and (3) direct costs of compliance with the CCA should not continue in deferral. Third, Staff recommends that the

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[191] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-200900, UG-200901, & UE-200894, Order 08/05, 38 ¶ 97 (Sept. 27, 2021).
[192] Puget Sound Energy, UE-170033, Final Order 08, at 35 fn. 82.
[193] Bulkley, Exh. AEB-1T at 8:6-8.

Commission find the Chelan PSA imprudent, or in the alternative, allow it in rates but subject to a "guardrail" requiring that PSE file a special request to re-evaluate prudency if Chelan PSA production costs exceed the forecast amount by $50 million. Finally, Staff recommends the Commission carefully consider whether the new PPAs that PSE included for consideration in its rebuttal testimony are appropriate for inclusion in rates at this point.

A. Annual Power Cost Review Process

80 In this rate case, PSE is proposing that that the annual power cost updates approved in its 2022 General Rate Case for 2023 and 2024 continue for the next two years, and every year thereafter.[194] PSE also proposes certain modifications to the timing of the filings and to the update of forecast inputs and assumptions.[195] PSE's proposed power cost update process is reasonable. Staff agrees that PSE should update its power cost forecast for calendar year 2025 in a compliance filing at the end of the current rate case and Staff recommends the Commission require PSE to include in its power cost adjustment filings "the offsetting benefits of changes, any Energy Market (EIM) revenues, rate credit dividend distributions, and any other new or additional revenues."[196]

81 Staff also generally agrees with PSE's proposal to use the annual PCA compliance filing to seek prudence determinations for power purchase agreements, with some caveats. First, parties should have the option to request that prudency determinations be deferred to the next general rate case or PCA filing for new PPA resources acquisitions or proposed changes to methods for calculating power costs.[197] This is especially important for resource acquisitions with complex terms that can require extensive discovery and analysis, but Staff acknowledges

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[194] Mueller, Exh. BDM-1T at 42:18-20.
[195] Mueller, Exh. BDM-1T at 42:20-43:1-2.
[196] Wilson, Exh. JDW-1TC at 8:5-10.
[197] Wilson, Exh. JDW-1TC at 9:8-11.

that the need for additional time to perform analysis of a complex PPA resource should be balanced with the interest of minimizing the time that new resource costs spend in deferral.[198] While noting the importance of timely prudence reviews of resource decisions, PSE also agrees that it is important for parties to have sufficient time for review.[199] PSE does not oppose allowing parties additional time to review "particularly complex resource acquisition decisions."[200]

B. CCA Costs and Dispatch

82 PSE's costs associated with the Climate Commitment Act (CCA) should be reviewed on an annual basis to ensure that the Company is prudently managing its compliance obligations. Additionally, the cost of compliance should be incorporated into dispatch decisions when ramping up covered plants to meet Washington retail load. Finally, PSE should not continue to defer accounting for CCA compliance costs but should include CCA allowance costs in this general rate case.

1. CCA compliance costs should be reviewed each year in PSE's annual power cost review proceedings.

83 The Commission should order a review of PSE's CCA-related compliance costs each year to avoid issues with imprudent decision-making and rate shock from years of accumulated costs. These reviews should coincide with PSE's annual power cost review proceedings.

84 The Commission has already recognized that "[t]here are costs associated with purchasing allowances and reducing emissions in other ways to comply with the CCA."[179] Utilities qualify for no-cost allowances under certain circumstances, and the amount of no-cost allowances allocated to a utility is different dependent on whether the utility is a natural gas or

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[198] Wilson, Exh. JDW-1TC at 11:5-8.
[199] Mueller, Exh. BDM-23CT at 6:18-20.
[200] Mueller, Exh. BDM-23CT at 7:1-2.

electric utility. For both electric and natural gas utilities, no-cost allowances are distributed each year on October 24.[180]

85 For electric utilities subject to the Washington Clean Energy Transformation Act (CETA), allowances are supplied at no cost.[181] The number of no-cost allowances that an electric utility may obtain from the Department of Ecology (Ecology) depends on the cost burden of the program on the electric utility.[182] In the current iteration of the rules, Ecology has identified several methods for determining cost burden.[183] An electric utility may receive no-cost allowances for certain administrative costs, but not for all program costs.[184] The number of no-cost allowances that an electric utility receives is updated each year "no later than October 1st."[185]

86 For natural gas utilities, receipt of no-cost allowances is somewhat different. In 2023, a natural gas utility was allocated no-cost allowances for 93 percent of its baseline emissions.[186] In each subsequent year, from 2024 to 2030, the number of no-cost allowances "decreases annually relative to the previous year by an additional seven percent of the utility's allocation baseline."[187] The number of no-cost allowances allocated to a natural gas utility further decreases in the years after 2030, all the way through 2049,[188] with the ultimate result being the achievement of net zero greenhouse gas emissions in 2050 in Washington state.[189]

87 Compliance costs associated with the CCA go beyond the purchase of allowances and those allocated on a no-cost basis. While utilities may receive some no-cost allowances for program administration, those no-cost allowances may not cover the entirety of the program. Additionally, depending on Ecology's approach to allocation of no-cost allowances, there is the possibility that a utility will need to purchase allowances to meet compliance obligations. As such, Staff recommends that the Commission conduct annual reviews of PSE's allowance use

and transactions in annual power cost review proceedings.[190] These yearly proceedings will allow the Commission to determine if PSE's "purchase or sale of allowances is prudent."[191] The benefits of this recommendation are that the Commission can provide timely feedback on decision-making to assist PSE in avoiding imprudent choices over the four-year compliance period, and even out any impacts to rates to avoid potentially significant fluctuations to customer bills.

88 Public Counsel witness Earle and AWEC witness Mullins each disagree with this recommendation. Mr. Mullins agrees that the Commission should perform a prudence review for CCA costs[192] and emphasizes that the Commission has authority to "levy and appropriate remedy" for any imprudent decisions that PSE makes regarding its management of CCA cost risk.[193] However, Mr. Mullins does not recommend annual reviews based on a concern that annual reviews may ultimately put upward pressure on rates[194] and instead recommends the Commission decline to adopt any formal prudence review process.[195] Mr. Earle definitively states that annual prudence reviews are unreasonable because PSE has both the four-year compliance period plus 10 months after it to comply with CCA allowance requirements.[196] Mr. Earle declares that "the cost of compliance can only be determined after the compliance period and the 10-month balancing period is over. A prudency determination on an annual basis is like declaring a winner after only one quarter of a basketball game is over."[197]

89 Both Mr. Mullins' and Mr. Earle's positions miss the point of staff's recommendation. Staff argues that "PSE's decisions to buy, sell, hold, or use allowances are intertwined with its unit dispatch and power purchase decisions."[198] If PSE's decisions are imprudent, they should be dealt with as closely as possible to when the imprudent decisions were made so that customers can benefit as soon as possible from the Commission's corrective action. Unlike in a sports game, the costs associated with compliance are not just symbolic of one team's victory over another. These costs, if prudent, have to be paid by someone, whether it be the investors or the ratepayers.

90 Waiting until the end of the four years to review costs sets up at least one "team" for a potential massive impact. If PSE practices imprudent decision making over the four years and, in an extreme example, all costs are disallowed, then investors and the company receive a massive hit, and the company is stuck with a large cache of costs. Alternatively, if PSE prudently manages costs over the four years, but things happen (as they tend to do), and costs were just high, then after four years, ratepayers may experience a massive hit to their utility bills. Even considering no-cost allowances, those may not cover all costs, and the prudent approach here is to cautiously review behavior on a frequent basis (each year) rather than play a waiting game and seeing what happens at the end of four years. Administrative efficiency and the public interest weighs in favor of yearly reviews.

2. The cost of compliance with the CCA should be included in the cost of dispatch to ensure economic dispatch of thermal units.

91 The Commission should order PSE to include CCA costs in all dispatch of thermal units for three reasons. First, based on Staff's understanding, including the cost of the CCA in dispatch is the strategy most aligned with Ecology's intent in the execution of the CCA.[201] Staff has acknowledged there is uncertainty with respect to how Ecology will treat the true up process for no cost allowances, but recommends that the Commission, if unable to obtain clarification from Ecology, "should proceed under the assumption that Ecology will not guarantee a true up to actuals."[202] This option would be consistent with the most recent information Staff has from Mr.

[201] Wilson, JDW-1TC at 16:11-17:8.
[202] Wilson, JDW-1TC, 35:5-8.

Wilson's interview with Ecology and would therefore be most likely to reflect Ecology's decision on the matter.

92 Second, there is a greater risk to assuming that Ecology's decision will guarantee a true up to actuals than assuming it would not.[203] This is illustrated by Mr. Wilson's explanation of two hypothetical scenarios in which a wrong assumption is made regarding Ecology's true up process.[204] In the first scenario, it is wrongly assumed that at Ecology's true up mechanism will not be a one-to-one true up to actuals. Under this scenario, PSE considers CCA costs in dispatch and has lowered emissions and modified dispatch and power purchases accordingly and power costs increase as a result. However, in this scenario, PSE can sell any excess allowances it is has been granted or otherwise use them to the benefit of customers. This first scenario "has the potential to result in little or no additional cost" and is thus the safer option as compared to the second scenario.[205] In the second, and riskier, scenario, PSE wrongly assumes the Ecology process will be a true up to actuals, does not consider CCA costs in dispatch, and must pay the entire difference between forecasted and actual emissions through allowances. Given the uncertainty around Ecology's true up process, the safer option is to require PSE to include CCA costs in dispatch of thermal resources.

93 Finally, PSE should be required to include allowance prices in dispatch for all thermal resources because PSE's dispatch practices are not optimized to manage emissions. For example, PSE applies a carbon adder to dispatch of a natural gas combined cycle unit; however, PSE does not apply a carbon adder to dispatch of Colstrip units 3 and 4.[206] This different treatment is illogical and can result in uneconomic dispatch. Furthermore, because PSE distinguishes

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[203] Wilson, JDW-1TC, 35:15-37-8.
[204] Wilson, JDW-1TC at 35:17-37:8.
[205] Wilson, JDW-1TC at 37:-3-4.
[206] Wilson, Exh. JDW-1TC at 34:4-6.

between generation that serves retail load and generation serving wholesale load, PSE relies on forecasts of "load, variable, resource output, and market prices."[207] This unnecessary process can be corrected by including CCA allowance prices in dispatch decisions for all thermal resources.

94 Based on PSE's interpretation of Ecology's guidance, PSE expects that it will receive no-cost allowances for all emissions associated with supplying retail demand.[208] However, PSE witness Mueller acknowledges that if Staff is correct in its interpretation that Ecology does not intend to the CCA allowance adjustment to be a one-for-one true up to actual emissions associated with retail load and that PSE may sell allowances not needed for emissions associated with retail load, then Staff's recommendation is a reasonable one that "would minimize costs for PSE customers."[209] Ultimately, the parties disagree regarding the likely outcome of Ecology's true up process, leading to different recommendations to the Commission.

95 Mr. Mullins recommends that the Commission decline to adopt Staff's proposal to include in PSE's NPSE the forecast allowance costs associated with wholesale sales,[210] citing concerns of upward rate pressure on PSE's customers that are already facing rate impacts from multiple proceedings.[211] However, as described above, Staff's recommendations represent the safer option for ratepayers in the face of uncertainty. PSE's CCA cost risk is likely to be substantial[212]and beginning to address it now will likely benefit customers in the long run. Mr. Earle claims "there is no need to include the estimate [of allowance costs] for the purpose of dispatch and power purchases in either net power cost forecasts, or actual power costs in the annual power cost proceeding."[213] But this argument ignores the fact that not including

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[207] Wilson, Exh. JDW-1TC at 34:15-16.
[208] Mueller, Exh. BDM-23CT at 24:19-21.
[209] Mueller, Exh. BDM-23CT at 25:14-26.
[210] Mullins, Exh. BGM-6CT at 9:5-7.
[211] Mullins, Exh. BGM-6CT at 5:1-4.
[212] Wilson, Exh. JDW-1TC at 33:5-20.
[213] Earle, Exh. RLE-6T at 7:2-4.

allowance prices in dispatch changes the mix of power resources and would affect fuel use and ultimately power costs. Including the cost of CCA compliance in dispatch is the best strategy to ensure that thermal resources are not ramped up and dispatched in a manner that is uneconomical and leads to the acquisition of what would be unnecessary allowances. Not including these costs in dispatch may give these resources the appearance of "least-cost," but the costs will arise later when compliance needs to be addressed. Excluding CCA costs in thermal asset dispatch that results in power being sold at retail or imported into Washington essentially makes the resource artificially cheap. These costs are not avoided, they are just pushed down the road when the price to ensure compliance may be higher.

3. Direct CCA allowance costs should be included in rates in this general rate case rather than continuing to be deferred in Docket UE-220974.

96 Staff recommends against continuing to defer the direct costs of CCA allowances. In February 2023, the Commission granted PSE's petition for accounting orders authorizing deferred accounting treatment for PSE's electric and gas costs and proceeds associated with the company's compliance with the CCA.[214] At that time, PSE stated that "in general, the next general rate case would be the right time to discuss cost-recovery of CCA costs…"[215] Public Counsel agreed that the deferral should be short-term and stated that, ideally, such costs should be embedded in rates in PSE's next GRC.[216] Nevertheless, PSE says in this rate case that it will continue to defer such costs pursuant to the previously approved accounting petition.[217] PSE will request to collect these amounts from its customers at some unspecified future date when it better understands its "actual net CCA allowance obligation."[218]

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[214] *In re Petition of Puget Sound Energy*, Dockets UE-220974 and UG-220975, Order 01 (Feb. 28, 2023).
[215] *Id.* at 3, ¶ 11.
[216] *Id.* at 2 ¶ 8.
[217] Mueller, Exh. BDM-1T at 26:7-10.
[218] Mueller, Exh. BDM-23CT at 33:10-11.

97 Staff's previously supported PSE's deferral of CCA costs because they were not included in rates at that time.[219] The Commission now has the opportunity to include these costs in rates and it should do so for two reasons. First, PSE has previously emphasized the importance of ensuring "that customers are being charged for the costs of the CCA associated with the power they use in the period closest to when the usage occurs."[220] Including CCA costs in forecast net power costs is the method that most closely associates those costs with the customers' power usage. Second, PSE's CCA allowance costs for the electric utility are estimated at $200 million annually.[221] Staff has significant concerns about the impact of these very large deferral balances on customers when PSE ultimately requests for them to pay these costs. Mr. Mullins, while not ultimately agreeing with Staff's recommendation, shares this concern about rate impacts that would result to customers from amortization of the large balances over short period of time.[222] For these reasons, the Commission should order these costs into rates, instead of letting them grow ever larger and more unwieldy.

C. Chelan PSA

98 Staff recommends that the Commission find the Chelan PSA is imprudent, or alternatively, find the Chelan PSA prudent but subject it to a "guardrail" on allowable costs.[223] The "guardrail" should be a requirement that PSE file a special request to re-evaluate prudency if production costs exceed the forecast amount by $50 million.[224] The Commission may deny the

[219] Wilson, J Exh. DW-1TC at 12:3-4.
[220] *In re Petition of Puget Sound Energy*, Dockets UE-220974 and UG-220975, Petition of Puget Sound Energy at 5, ¶ 17 (Feb. 28, 2023).
[221] *Id*. at 5, ¶ 16.
[222] Mullins, Exh. BGM-6CT at 5:7-9.
[223] Wilson, Exh. JDW-1TC at 7:16-17.
[224] Wilson, Exh. JDW-1TC at 7:17-18.

recovery of imprudent expenditures.[225] Thus, a utility must act prudently, meaning reasonably,[226] throughout the life of a project, from its inception when assessing the need for the project to its end when incurring the final construction expense.[227] The utility bears the burden of proving that it acted prudently.[228]

99 As explained by Staff witness Wilson, the Chelan PSA does not meet the Commission's standard for prudency because the contract terms place customers at risk of "large and unreasonable cost increases."[229] The Chelan PSA price includes a fixed annual charge and a cost indexed charge.[230] Under the contract, "PSE customers bear the risk of cost-driven price increases, including capital improvements, without limitation."[231] In addition, PSE failed to negotiate contract terms that would allow it to dispute the costs or exit the contract.[232] Mr. Wilson testified that he has never seen such a contract that exposes a buyer to potentially unlimited costs without an exit right.[233] In Mr. Wilson's experience, it is more typical for "a buyer that lacks decision-making authority to negotiate terms on which it may exist the contract, such as a cost increase cap.[234] Staff argues that this is indeed what PSE should have done in order to meet the Commission's prudency standard. PSE should have negotiated a reasonable cap on the cost-based portion of the contract that would result in some reduction in the fixed annual charge for unexpectedly high costs. PSE should also have negotiated an exit clause that it could

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[225] *People's Org. for Wash. Energy Res. v. Wash. Utils. & Transp. Comm'n*, 104 Wn.2d 798, 810, 711 P.2d 319 (1985).
[226] *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Docket UE-152253, Order 12 at 33, ¶ 94-95 (Sept. 1, 2016) (2015 PacifiCorp GRC Order).
[227] *Id.* at 34, ¶ 95.
[228] *Id*. at 33, ¶ 94.
[229] Wilson, Exh. JDW-1TC at 49:2-10.
[230] Wilson, Exh. JDW-1TC at 49:14-17.
[231] Wilson, Exh. JDW-1TC at 49:16-17.
[232] Wilson, Exh. JDW-1TC at 50:1-2.
[233] Wilson, JDW-1TC at 51:6-8.
[234] Wilson, Exh. JDW-1TC at 51:8-10.

invoke if costs exceeded a predefined threshold, for the protection of its customers.

100 In PSE's rebuttal testimony, PSE witness Yanez claims that Mr. Wilson says he has never "seen a contract without a cap on expenses" even though the 2006 Chelan PSA has been in effect for eighteen years.[235] Staff wants to be clear that its issue is not simply the lack of cap on expenses. It is the lack of cap on expenses combined with the lack of an exit right that runs afoul of the prudency standard. As Mr. Wilson testified, the Chelan PSA for which PSE seeks a prudency finding in this rate case includes the fixed annual charge, which was not part of the 2006 Chelan PSE, and is "essentially a guaranteed annual revenue requirement to Chelan from PSE."[236] Under this contract, there is potential, however unlikely, that PSE's customers may bear unreasonable costs due to unforeseen relicensing or civil works (dam/earthworks repair costs).[237] The Commission should condition a finding of prudency for the Chelan PSA with a "guardrail" such as that described by Mr. Wilson to create an added a layer of protection for customers who had no hand in negotiating the unreasonable terms of this contract. In the alternative, the Commission can simply decline to make a prudency determination on the Chelan PSA in this case. While Staff believes it is appropriate to resolve this matter now, there is no reason a prudency determination on the Chelan PSA must be made in this case given that this contract does not begin until 2031.

D. New PPAs Included on Rebuttal

101 On rebuttal, PSE alters its power cost forecast to include, among other things, new PPAs.[238] As a whole, the power cost updates PSE presents in rebuttal essentially doubles the

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[235] Yanez, Exh. ZCY-5CT at 6:4-9.
[236] TR 172:9-13.
[237] *See* Wilson, Exh. JDW-1TC at 52:1-54:14 for a description of the economic risks that PSE customers bear under the Chelan PSA contract terms.
[238] Mueller, Exh. BDM-23T at 19:15-21:4.

Company's requested revenue requirement increase for the electric side in rate year one.[239] Based on PSE's rebuttal testimony, these new PPAs appear to represent $139.7 million[240] of the $192.1 million[241] increase due to updated power costs. PSE witness Mueller states that these new resources were "acquired to meet PSE's resource adequacy and/or clean energy needs."[242] He goes on to explain that these new contracts increase the power cost forecast because "the PPA price exceeds the cost of unspecified spot market purchases that the PPA displaces in PSE's power cost model."[243] PSE is forthright about the fact that the power cost model does not capture the resource adequacy or clean energy benefits of these new PPAs "as an explicit reduction in PSE's power cost forecast."[244] In total, four pages of rebuttal testimony, the six contracts included as exhibits, and the decisional materials in Exh. BDM-50HC are all that PSE has submitted in support of the $139.7 million increase to rate year one power costs that PSE asserts is the result of including these new PPAs in the updated power cost forecast.[245] Such a thin evidentiary record to support a $139.7 million dollar increase in rate year one is concerning.

102 At the evidentiary hearing, Commissioner Rendahl raised concerns about whether Staff had an adequate opportunity to review these new PPAs.[246] Staff witness Wilson explained that Staff did not have time to conduct a detailed review of the PPAs and cannot attest to the accuracy of the numbers.[247] Commissioner Rendahl raised valid concerns about Staff and other

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[239] Free, Exh. SEF-28T at 7:1-5, Table 2.
[240] *See* Mueller, Exh. BDM-23CT at 20:1-21:2.
[241] Free, Exh. SEF-28T at 7:1-5.
[242] Mueller, Exh. BDM-23CT at 19:24-25.
[243] Mueller, Exh. BDM-23CT at 21:7-9.
[244] Mueller, Exh. BDM-23CT at 21:15-16.
[245] Mueller, Exh. BDM-23CT at 19-22. Although PSE witness Free does discuss these power cost updates, the passages of her rebuttal testimony are focused on incorporating these adjustments into the overall revenue requirement and explaining the differences between the positions of other parties. They do not provide additional support for the adjustments themselves.
[246] Rendahl, TR 167:2-10.
[247] Wilson, TR 167:11-18.

noncompany parties' ability to adequately review these significant updates to power cost late in the rate case. Staff recognizes that the Commission has allowed significant power cost updates late in recent rate cases (including updates to capture new PPA contracts) and that the new PPAs at issue here would be subject to later prudence review. However, given the magnitude of the impact PSE's update to power costs has on the overall revenue requirement, Staff believes that this is a distinguishable case. Further, the new PPAs included in the rebuttal power cost forecast are but one of eight changes PSE made to the power cost forecast.[248] PSE essentially presents a whole new power cost forecast and related revenue requirement adjustment for the parties to review after the last opportunity to submit testimony has passed. The Commission stated clearly in the Used and Useful policy statement that it considers these circumstances when weighing adjustments made late in a rate case:

> The further a proposed adjustment considered in a GRC occurs from the end of the test year, the less time Staff and other parties have to review a company's supporting evidence. In light of these factors, the company's burden to demonstrate that it has met the requirements guiding adjustments to test-year data is greater. [...] The Commission also will reject requests that either cannot be audited or are unreasonably burdensome to review [249]

103 There are several unanswered questions related to these new PPAs that the Commission should consider when deciding whether to include these new contracts, even provisionally, into rates. First, has PSE adequately considered the impact these PPAs would have on the Company's forecasted CCA compliance costs? Witness Mueller testifies that these new PPAs replace unspecified spot market purchases. This replacement presumably alters the trajectory of PSE's forecasted percentage of retail load served by renewable and nonemitting resources and the forecasted CCA allowances needed for compliance during the rate plan. In general, there appears

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[248] Mueller, Exh. BDM-23CT at 18:5-19:14.
[249] Used and Useful Policy Statement at 9, ¶ 25; 10, ¶ 29.

to be a discrepancy between PSE's messaging in this rate case and in recent planning dockets regarding the Company's expected progress in the clean energy transition.[250] In planning dockets, PSE is tempering expectations and requesting lower interim targets, forecasting stalled progress on the clean energy transition during this two-year rate plan, and even into 2027.[251] The reason given in those dockets is poor hydro years and load growth.[252] But in this rate case, PSE's message is that it is taking bold steps forward in the clean energy transition, but needs extraordinary rate relief to accomplish the task.[253] It is unclear whether the load growth forecast PSE uses in its proposed revenue requirement is consistent with the forecast relied upon in PSE's planning dockets. PSE's expectations of bad hydro conditions over the rate plan[254] apparently did not discourage the Company from acquiring PPAs for hydroelectric power during the same period.[255] Staff questioned PSE about this difference in messaging at the evidentiary hearing, and PSE confirmed its belief that there will be "significant load growth" on the electric side in the near future.[256]

104 Second, what other offsetting factors, if any, did the Company account for when making these adjustments? While witness Mueller's testimony implies that the Company removed the unspecified spot market purchases that these PPAs replace, it is not clear that all potential

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[250] *See* Steuerwalt, Exh. MS-7X at 5, Table 1 (proposing interim targets for 2026 and 2027 identical to the approved interim target for 2025, which is 63 percent.); *see also* Exh. MS-6X (petitioning for a reduction in the 2025 interim target from 63 percent to 48 percent).
[251] *See generally* Steuerwalt, Exh. MS-6X and MS-7X.
[252] Steuerwalt, Exh. MS-6x at 8-10.
[253] *See generally*, Steuerwalt, Exhs. MS-1T and MS-4T.
[254] Exh. MS-6X at 13-14, *see also* Steuerwalt, TR 84:7-12; 91:4-8 (stating that the proposed reduction of the 2025 interim target to 48 percent is reasonable "in light of hydro conditions and the large increases in load").
[255] *See* Mueller, Exh. BDM-23CT at 20:7-12 (PPA for hydroelectric resource based on a percentage of output during calendar year 2025).
[256]*See* Steuerwalt, TR 77:15-19 ("we presume that load growth will continue significantly and -- on the electric side -- excuse me -- and that even holding the same percentage target produces a much larger obligation to procure renewal and non-emitting resources in the future.").

offsetting factors[257] were accounted for. If anything, PSE's statement that the benefits of these new PPAs "do not show up as an explicit reduction in PSE's power cost forecast[]"[258] underscores this concern. Staff acknowledges that it may be the case that the benefits PSE refers to here may not have any impact on the revenue requirement, but the point is that PSE does not make clear whether or not that is the case, and the noncompany parties did not have sufficient time to explore these issues. The Commission reaffirmed in the Used and Useful policy statement that pro forma adjustments must properly incorporate offsetting factors, including load growth: "Without incorporating these offsetting factors, a proposal will not be considered to be in the public interest because resulting rates would not be fair, just, reasonable, and sufficient, as required by RCW 80.28.010(1)."[259] If the Commission is not confident that this has been done, then it should consider whether these new PPAs should be in rates. While there will be a retrospective review of these contracts, once a provisional pro forma adjustment is granted a utility has very little incentive to properly account for offsetting factors. For this reason, Staff believes that estimated offsetting factors should be part of the threshold review of provisional pro forma adjustments, including power costs. If the Commission does allow these PPAs into rates, it should require PSE to provide a detailed demonstration of the offsetting factors and the resources these PPAs replaced as part of the power cost forecast.

VI. PERFORMANCE METRICS

105 In rebuttal testimony, PSE withdrew the performance metrics it originally proposed in this case (with one exception) in favor of the metrics contained in the Commission's August 2,

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[257] Used and Useful Policy Statement at 7, n.25 ("Offsetting factors include, but are not limited to, removing rate-year retirements, dispositions, and non-depreciating plant, including revenue growth, and operations and maintenance (O&M) expense offsets. Without incorporating these offsetting factors, a proposal will not be considered to be in the public interest because resulting rates would not be fair, just, reasonable, and sufficient, as required by RCW 80.28.010(1).")
[258] Mueller, Exh. BDM-23CT at 21:15-16.
[259] Used and Useful Policy Statement at 7, n.25.

2024 policy statement on performance metrics in docket U-210590.[260] PSE states that, while the policy statement does not prohibit the adoption of additional metrics, the metrics contained in the policy statement are "comprehensive" and therefore it is appropriate in this case to only report on those metrics.[261] Staff disagrees and recommends the Commission approve its recommended performance metrics in addition to those set forth in the policy statement.

106 First, the policy statement on performance metrics is quite clear that it does not represent an exhaustive list of performance metrics that are appropriately applied in all cases and the list contained therein is in fact not comprehensive, as PSE claims. The policy statement declares that "a comprehensive PBR framework cannot be established with finality at this juncture" and the Commission's "intent to adopt a more limited set of metrics."[262] The policy statement thus reflects the limited set of generally-applicable metrics that Commission endorses at this stage in the evolution of performance-based ratemaking in Washington. In this case, Staff believes that the circumstances are such that additional metrics are warranted.

107 Witness McGuire recommends the Commission order PSE report on four metrics that are not included in the Commission's policy statement. These are: (1) number and percentage of households with a high energy burden; (2) average excess burden per household; (3) number and percentage of residential electric disconnections for nonpayment by month; and (4) average connection times for new service requests associated with new construction of single family and multi-family housing.[263] All four of these metrics were among the 14 metrics the Commission ordered PacifiCorp to track in its 2023 general rate case in addition to those that the parties

[260] Steuerwalt, Exh. MS-4T at 40:16-41:12. The one exception is PSE's proposed demand response metric on total electric peak load management savings, described at Archuleta, Exh. GA-1T at 15:3-20. Staff supports this metric and its inclusion in addition to those contained in the policy statement.
[261] *Id*. at 41:15-19.
[262] *Policy Statement Addressing Initial Reported Performance Metrics*, Docket U-210590, Policy Statement at 3, ¶ 10; 6, ¶ 19 (Aug. 2, 2024).
[263] McGuire, Exh. CRM-1T at 19:16-20:9.

identified in the settlement stipulation in that case.[264] For the sake of consistency between the metrics ordered in PacifiCorp's recent general rate case and this case, Staff recommends the Commission require PSE track these four metrics, in addition to those contained in the Commission's policy statement.

108 Staff additionally notes that the interests of native nations are a notable absence from the metrics contained in the Commission's policy statement as well as the metrics initially proposed by PSE. Staff therefore recommends that PSE work with Washington's native nations and its equity advisory group to develop metrics and take specific actions within the scope of future filings that consider these interests. An inexhaustive list of considerations that these metrics and actions should take into account is contained in the testimony of witness Harmon.[265]

VII. COST OF SERVICE, RATE SPREAD, RATE DESIGN, AND BILLING DETERMINANTS

A. PSE's Electric and Natural Gas Cost of Service Studies Largely Comply with the Commission's Rules and Are Reasonable.

109 PSE presents two cost of service studies for both electric and natural gas services.[266] For each, one study strictly complies with Chapter 480-85 WAC, while PSE seeks an exception from the rules to present a second, recommended study.[267] The second study differs only slightly from the rule requirements.

110 With respect to the electric cost of service study, PSE seeks an exemption regarding the treatment of FERC Account 565 (Transmission of Electricity of Others).[268] Under WAC 480-85-060(3), Table 1, FERC Account 565 is functionalized as transmission. Staff agrees with PSE's

[264] 2023 PacifiCorp GRC Order at 68-70, ¶ 234.
[265] Harmon, Exh. BLH-1T at 37:3-38:12.
[266] Mickelson, Exh. CTM-1T at 23:7-14, Exh. CTM-5; Taylor, Exh. JDT-1T at 14:13 - 15:9.
[267] Watkins, Exh. GAW-1T at 11: 13-17 and 23:21 - 24:3.
[268] Mickelson, Exh. CTM-1T at 23:7-14, Exh. CTM-5.

request for exemption because FERC Account 565 addresses wheeling of energy costs that are not a function of peak demand. These costs relate to the supply of energy and are not incurred to meet PSE's peak load requirements.[269] As a result, it is appropriate to classify FERC Account 565 as energy and allocate those costs to variable power costs. The Commission should allow PSE an exemption for its electric cost of service study.

111 With respect to the natural gas cost of service study, PSE seeks an exemption regarding the allocation of FERC Account 870 (Distribution Supervision & Engineering – Operations).[270] Under WAC 480-85-060(3), Table 3, FERC Account 870 is classified as transmission. FERC Account 870 relates to PSE's distribution system. As a result, Staff agrees with PSE's request for exemption because FERC Account 870 is properly functionalized as distribution related.[271] The Commission should allow PSE an exemption for its natural gas cost of service study.

112 The Commission should accept PSE's recommended cost of service studies for both electric and natural gas. The Commission's rules were promulgated through a rulemaking that involved participation from utilities, Commission Staff, Public Counsel, The Energy Project, and industrial intervenor interests.[272] As Staff witness Watkins noted, the method adopted in Chapter WAC 480-85 WAC represents a compromise of various experts' opinions and analysis as considered by the Commission over a lengthy and thorough rulemaking process.[273] Both of PSE's recommended cost of service studies materially comply with the intent of the Commission's rules and provide results that are reasonable across all customer classes.[274]

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[269] Watkins, Exh. GAW-1T at 11:19 - 12:2.
[270] Taylor, Exh. JDT-1T at 14:13 - 15:9.
[271] Watkins, Exh. GAW-1T at 24:5-7.
[272] Watkins, Exh. GAW-1T at 13:20 – 14:1; *See Rulemaking Relating to Cost of Service Studies for Electric and Natural Gas Investor-Owned Utilities*, Docket UE-170002 and UG-170003, Order R-599 (July 7, 2020).
[273] *See*, Watkins, Exh. GAW-1T at 13:20 – 14:5.
[274] Watkins, Exh. GAW-1T at 13:14 - 14:17 and 24:20 - 25:7.

B. The Commission Should Decline to Adopt Recommendations from Nucor Steel and AWEC to Allocate Natural Gas Mains Based on the Size of the Pipe

113 Both Nucor Steel and AWEC argue that the Commission should allocate PSE's natural gas mains by the size of the pipe.[275] This proposal is contrary to the Commission's rules on cost of service studies, and there is no need to treat PSE's cost of service differently with regard to allocating the cost of natural gas service mains.

114 The Commission promulgated Chapter 480-85 WAC through a rulemaking in Dockets UE-170002 and UG-170003. The Commission's General Order R-599 describes the rulemaking process, the participation of stakeholders, and the compromises made. The Commission noted that cost of service has been a contentious litigation issue,[276] and that the rules were the result of "the extensive and open dialogue, as well as fair compromises made, by stakeholders and the Commission, to the credit of all involved."[277] The Commission highlighted comments at the rule adoption hearing that the rules, as a complete package, are reasonable and balance the diverse interests held by the stakeholders, "even if a stakeholder may not be completely satisfied with the selection of a particular methodology for one classification or another."[278]

115 One of those compromises included accepting the use of design day as the methodology for natural gas distribution mains. Use of design day had long been advocated by high load factor customers, and the Commission noted that it had found flaws in that proposal since at least the early 1990s.[279] In the rulemaking, however, the Commission determined that the difference between using design day and other methods that were previously more commonly accepted was

[275] Higgins, Exh. KCH-1T at 3:9-12; Kaufman, Exh. LDK-1T at 24:7-8.
[276] *See*, TR. 345:8 – 346:21.
[277] *Rulemaking Related to Cost of Service Studies for Electric and Natural Gas Investor-Owned Utilities*, Docket UE-170002 and UG-170003, Order R-599 at 16-17, ¶ 58 (July 7, 2020).
[278] *Id.*
[279] *Id*. at 17, ¶ 60.

negligible. As a result, the Commission found that the classification and allocation methods selected were “well-balanced among competing interests and reasonable.”[280]

116 In this case, Nucor Steel and AWEC advocate for large volume users to not be allocated the costs of small diameter natural gas mains. This proposal has been called the “skeletonization” of mains and large volume customers have previously advocated for this treatment.[281] During the Commission’s cost of service rulemaking, PSE asked for clarification regarding whether the main pipe diameter could be used to allocate costs. The Commission summarized and adopted Staff’s response that the rules were clear and that they did not allow for the use of main pipe diameter to allocate costs.[282] During the rule adoption hearing, AWEC echoed PSE’s request for clarification on whether pipe diameter could be used to allocate costs.[283] The Commission did not adopt PSE and AWEC’s requests for clarification to allow main pipe diameter to be used to allocate costs.[284]

117 The compromise that the Commission adopted in Chapter 480-85 WAC fairly balances stakeholders’ interests. Some components of the Commission’s methodology favor large volume users while other components favor small volume users. In this case, large volume users are accepting components that are favorable, including use of design day demands and the use of system load factor for the weighting between peak and average.[285] At the same time, large volume users wish to reject a component that is not as favorable: allocation of small mains to all customers. The Commission should not adopt this approach as the rules were developed with care and diligence, and there is no need for an exception here.

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[280] *Id*. at 17, ¶ 60-61.
[281] *See*, TR. 346:5 – 347:8.
[282] TR. 356:9-24; Higgins, Exh. KCH-1T at 6:17 – 7:12.
[283] Higgins, Exh. KCH-11X at 15 – 17.
[284] WAC 480-85-060.
[285] TR. 359:20- 363:3.

C. PSE's Rate Spread is Appropriate and Reasonable

118 Cost of service studies are only one factor the Commission considers in determining a utility's rate spread. Rate spread determines how much of the resulting revenue requirement is allocated to each of PSE's customer classes. While cost of service studies seek to determine the cost to serve each customer class, they do not represent an exact science but involve a certain degree of judgement regarding cost causation and cost allocation. As a result, the Commission also considers gradualism, rate stability, affordability, and public policies concerning economic conditions and economic development.[286]

1. Electric Rate Spread as proposed by PSE is reasonable

119 PSE proposes a rate spread for a "traditional" revenue increase and for its proposed Targeted Electrification Pilot. With respect to the traditional revenue increase, PSE followed the process it has used in prior cases of increasing Special Contracts, Retail Wheeling, and Firm Resale schedules to full cost of service.[287] PSE then used its recommended electric cost of service study to gradually move all of the rate classes closer to parity.[288] PSE allocates revenues associated with the Targeted Electrification Project based on rate schedule proportion of the total funding allocated to the program. This results in 97.97 percent of the revenues allocated to the Residential class.[289] Staff witness Watkins testifies that PSE "reasonably reflects cost of service study results and moves classes closer to parity in a gradual manner. As a result, [PSE's] approach is reasonable and consistent with sound ratemaking practices."[290]

[286] *Wash Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-140762, Order 08 at 85-86, ¶ 202 (Mar. 25, 2015) (The Commission accepted the company's proposal to move each customer class closer to parity with its cost of service, while emphasizing principles of fairness, perceptions of equity, economic conditions in the service territory, gradualism, and rate stability).
[287] Watkins, Exh. GAW-1T at 15:7-9.
[288] Watkins, Exh. GAW-1T at 15:9-17.
[289] Watkins, Exh. GAW-1T at 15:18-22.
[290] Watkins, Exh. GAW-1T at 18:17-21.

2. Natural Gas Rate Spread as proposed by PSE is reasonable

120 PSE used its recommended natural gas cost of service study results to guide how revenue responsibility should be spread across its customer classes. In doing so, customer classes received different percentages of the system average increase to spread the revenue responsibility appropriately. Some customer classes received greater than system average while others received less than system average.[291] PSE's proposed natural gas rate spread is based on normalized and forecasted usages and revenues, which results in relative increases that reasonably reflect the cost of service study results and moves customer classes closer to parity in a reasonable and gradual manner.[292] As with PSE's electric rate spread, the natural gas rate spread is reasonable and consistent with sound ratemaking practices.

D. The Commission Should Adopt Staff's Electric Rate Design and PSE's Natural Gas Rate Design

121 Rate design determines how much of PSE's revenue is collected through fixed charges and how much is collected through volumetric charges. Customer charges are the amount customers pay regardless of how much energy they use. The Commission's policy is that customer charges reflect only direct customer costs, such as meter reading and billing.[293]

122 For electric service, PSE proposes to increase the residential basic charge from $7.49 to $9.74 in the first year of the proposed rate plan and to $12.66 in the second year of the proposed rate plan. In total, the cumulative increase to the residential basic charge is a 69 percent increase over the current basic charge.[294] PSE's Small General Services customers would experience a similar 69 percent cumulative increase under PSE's proposal. PSE proposes to increase the Small

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[291] Watkins, Exh. GAW-1T at 25:11 – 28:4.
[292] Watkins, Exh. GAW-1T at 27:18 – 28:4.
[293] *Wash Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-140762, Order 08 at 91, ¶ 216 (Mar. 25, 2015).
[294] Watkins, Exh. GAW-1T at 19:3-16.

General Services basic charge from $10.21 to $13.27 in the first year of the proposed multiyear rate plan and to $17.25 in the second year.[295]

123 PSE's electric basic charge calculations include direct costs, such as the costs of meters, service drops, meter reading, meter maintenance and billing, but also include "a multitude of general and overhead expenses that are not required to connect nor maintain a customer's account."[296] In particular, PSE includes $166.4 million of general plant and $29.5 million of A&G expenses in its basic charge calculation.[297] Following the Commission's policy on including only direct customer costs in the basic charge, Staff's witness Watkins calculated that the direct Residential customer cost to be $5.98 and the direct Small General Service customer cost to be $8.11.[298] While the direct customer cost for both Residential and Small General Service customers could justify a reduction in the basic charges for those customer classes, Staff recommends maintaining the basic charges at their current levels for rate continuity.[299]

124 For natural gas service, PSE proposes to increase the residential basic charge from $12.50 to $14.86 in the first year of the proposed rate plan and to $17.67 in the second year of the proposed rate plan. Cumulatively, residential natural gas customers would experience a 41.4 percent increase over the current basic charge.[300] PSE's firm Commercial and Industrial customers would experience a 69 percent increase in the basic charge over the two-year rate plan. PSE proposes to increase the basic charge from $38.89 to $50.56 in the first year and to $65.72 in the second year.[301]

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[295] Watkins, Exh. GAW-1T at 19:18 – 20:12.
[296] Watkins, Exh. GAW-1T at 21:1-20.
[297] Watkins, Exh. GAW-1T at 22:1-5.
[298] Watkins, Exh. GAW-1T at 23:4-11; Exh. GAW-5.
[299] Watkins, Exh. GAW-1T at 23:13-16.
[300] Watkins, Exh. GAW-1T at 28:8-19.
[301] Watkins, Exh. GAW-1T at 28:21 – 29:12.

125 As with PSE's calculation of electric customer costs, PSE's calculation of natural gas customer costs include general and overhead expenses that are not required to connect nor maintain a customer's account.[302] PSE includes $84.0 million of intangible plant, $85.0 million of general plant, and $28.2 million of A&G expenses.[303] Staff witness Watkins calculates the residential customer cost to be $13.98 and the Commercial and Industrial customer cost to be $112.95.[304] As a result, Staff recommends that the Commission allow a single increase in the residential basic charge to $14.00 per month.[305] Staff accepts PSE's proposed fixed customer charges for Commercial and Industrial customers.[306]

126 Staff's recommendations for both electric and natural gas basic charges comport with the Commission's policy regarding what costs should be included in basic charges.

E. PSE's Billing Determinants Should Be Modified

127 PSE made an adjustment to the actual test year billing determinants and current base rate revenues. The adjustment is to "normalize test year sales volumes based on what PSE considers to be normal weather."[307] PSE forecasted the number of customers by general rate class. PSE also forecasted the usage per customer (either kWh or therms) by general rate class. PSE then multiplied the forecasted number of customers by the forecasted usages per customer to develop the forecasted usage billing determinants.[308]

128 Staff accepts PSE's forecasted number of customers.[309] PSE's forecasts of both electric and natural gas customers reasonably. Staff additionally determined that PSE's electric test year

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[302] Watkins, Exh. GAW-1T at 30:9-13.
[303] Watkins, Exh. GAW-1T at 30:15-22.
[304] Watkins, Exh. GAW-1T at 31:1-8; Exh. GAW-6.
[305] Watkins, Exh. GAW-1T at 31:12-15.
[306] Watkins, Exh. GAW-1T at 31:16-20.
[307] Watkins, Exh. GAW-1T at 3:11-13.
[308] Watkins, Exh. GAW-1T at 3:21 - 4:2.
[309] Watkins, Exh. GAW-1T at 4:17 – 5:4.

normalized and forecasted usage per customer is reasonable across all rate classes.[310] However, PSE's test year normalized and forecasted usage per customer for the natural gas residential class is materially understated.[311]

129 Staff witness Watkins conducted his own multivariate regression analysis to normalize and forecast PSE's usage per customer.[312] In doing so, Watkins used the same level of forecasted customers as PSE and used the same forecasted level of heating degree days, which incorporates the impact of climate change. Using five years of data, Watkins developed a data base using monthly residential usage per customer and actual heating degree days.[313] The model, across its 60 observations, resulted in an R^2 of 99.63 percent. This means that the model accounted for 99.63 percent of variation of Residential usage, and that it failed to approximate actual conditions for only 0.37 percent.[314]

130 Compared to PSE's modeling, Staff's modeling is much more accurate.[315] The table on Page 9 of Watkins' testimony illustrates the difference in accuracy between Staff's modeling and PSE's modeling.[316] Staff's normalized test year and forecasted Residential usage per customer is lower than any recent actual year, including years with similar heating degree days. Staff's analysis incorporates the climate change reduction, but is also more realistic and reasonable than PSE's analysis.[317]

[310] Watkins, Exh. GAW-1T at 4:17 - 5:18.
[311] Watkins, Exh. GAW-1T at 5:19 – 6:2. Normalized and forecasted usage per customer is reasonable across other natural gas schedules.
[312] Watkins, Exh. GAW-1T at 6:4 – 11:6.
[313] Watkins, Exh. GAW-1T at 7:6-7.
[314] Watkins, Exh. GAW-1T at 7:18-19 and footnote 4.
[315] Watkins, Exh. GAW-1T at 9:1-9.
[316] Watkins, Exh. GAW-1T at 9:14 (Table: PSE Residential (Rate 23) Gas Usage Per Customer ("UPC")).
[317] Watkins, Exh. GAW-1T at 10:1 - 11:6; Exh. GAW-4.

131 Despite Staff's accuracy, PSE criticized Staff's analysis, stating that the model "displays severe multi-collinearity" between the heating degree days and monthly variables.[318] PSE's criticism is immaterial. Staff used December as the base month, and the coefficient for each month shows how the weather would be warmer or cooler relative to December.[319] PSE's criticism of multi-collinearity is a criticism that Staff's coefficients relate to one another. Since the model evaluates weather month to month, it is reasonable that the coefficients relate. The coefficients show that the winter months of January and February are similar to December, while the non-heating months of April through October have values less than December. The model correctly shows that non-heating months are warmer than heating months, and forecasts lower usages per customer during non-heating months. Given that the R^2 is nearly 100 percent, Staff's analysis is not negatively plagued by multi-collinearity, and the Commission should disregard PSE's argument.

VIII. ACCELERATED DEPRECIATION OF GAS PLANT

132 PSE's request to accelerate the depreciation of natural gas plant should either be denied or depreciation of the plant at issue should be accelerated[320] much less than PSE's current proposal. Initiative 2066 (I-2066)[321] passed and is set to become effective December 5, 2024. The law eliminated RCW 80.86.060, which codified the section of 1589[322] that mandated accelerated depreciation of current gas plant to at least 2050. As Staff noted in response

[318] Jacobs, Exh. AEJ-1T at 6:10-13.
[319] Watkins, Exh. GAW-1T at 7:6-19.
[320] Staff acknowledges that in testimony PSE characterized its proposal as shortening the useful lives of the plant in question, not accelerating depreciation. Allis, Exh. NWA-1T at 4:11. However, in this context at least, Staff finds this to be a distinction without a meaningful difference. Shortening the useful lives of plant and accelerating the depreciation of plant has the same impact on rates, the difference lies in the rationale supporting the proposed changes in depreciation rates. Therefore, Staff will refer to this proposal as accelerating depreciation.
[321] *Available at*: https://www2.sos.wa.gov/_assets/elections/initiatives/finaltext_3177.pdf
[322] LAWS OF 2024, Ch. 351, § 7.

testimony,[323] this significantly weakens the argument in favor of approving PSE's proposal related to the useful lives of these resources. With the relevant section of 1589 repealed, PSE's request is now based only on the impact that the Company believes the CCA and other laws will have on natural gas service.[324]

133 PSE witness Allis highlights the CCA as a primary driver of the Company's request, stating: "The CCA sets stringent statewide GHG emission reduction targets, eventually resulting in Net Zero emissions by 2050. Because the combustion of methane results in GHG emissions, there will eventually have to be significant reductions in gas usage in order to meet these targets."[325] PSE also cites the impact of new building codes on the gas system as another reason to accelerate depreciation.[326] In short, PSE believes that these regulations will lead to electrification, either by customers or through some organized effort.[327]

134 Section 6 of I-2066 amends RCW 19.27A.020,[328] adding a subsection which states: "The Washington state energy code may not in any way prohibit, penalize, or discourage the use of gas for any form of heating, or for uses related to any appliance or equipment, in any building." Sections 7 through 11 of I-2066 contain similar language. These amendments to state law undercut PSE's argument that current building codes are a reason to accelerate depreciation.

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[323] McGuire, Exh. CRM-1Tr at 28:1-7. ("The Commission should be aware that there are ballot initiatives set for this year that, if passed, would significantly undermine the rationale behind PSE's proposal to shorten the service lives of its gas facilities. Specifically, if passed, Initiative 2066 would repeal provisions of ESHB 1589 relevant to accelerated depreciation of gas assets and Initiative 2117 would repeal the CCA.")

[324] Allis, Exh. NWA-1T at 11:1-7; 18:7-8 ("The primary reason for the change in depreciation rates is the need to better align with the future outlook for the Company's assets and with Net Zero by 2050.")

[325] Allis, Exh. NWA-1T at 20:1-4.

[326] *Id*. at 19:14-18.

[327] *Id*. at 20:16-21:10 ("For example, if a customer decides to fully electrify their energy usage, the infrastructure providing gas service directly to that customer would be retired. With widespread electrification, this would result in shorter service lives for assets such as gas services, meters, and meter installations . . . if, for example, portions of the gas system are electrified as a whole and specific assets are required to be removed, rather than retired in place.")

[328] RCW 19.27A.20 establishes the general authorities and duties of the State Building Code Council related to adopting a Washington state energy code, which is part of the state building code.

While the exact nature of future changes to the energy code are uncertain, it seems to Staff unavoidable that the State Building Code Council (SBCC) will need to amend the current code in order to comply with this new statutory language. Because no party has had the opportunity to fully assess the impact these amendments will have to PSE's gas plant, the current building code is not a sufficient reason to approve accelerated depreciation. Hopefully by PSE's next rate case the SBCC will adopt rules reflecting I-2066's amendments, and this will provide clarity on what impact the state building code will have on natural gas service in the future. For now though, the Commission should not consider the building code as a sufficient reason to approve accelerated depreciation.

135 The other law PSE cites is the CCA. As noted above, PSE witness Allis states that "there will eventually have to be significant reductions in gas usage in order to meet [CCA] targets"[329] The implication being that PSE will need to retire gas plant earlier than currently estimated due to reduced demand. However, while witness Allis takes this position, PSE as a whole has been far from clear about whether or not the Company believes it will need to reduce its emissions from natural gas service as a result of the CCA. In Docket UG-230968, PSE argued that it was not legally required to reduce emissions because of the CCA and that therefore the Joint Environmental Advocate's RSM proposal, which aimed to incent actual decarbonization, was inappropriate.[330] In this case however, PSE argues that accelerated depreciation is warranted because the CCA *will* lead to reduced demand. But PSE cannot have it both ways, either the CCA does, as a practical matter, require decarbonization of natural gas service, or it does not.

[329] Allis, Exh. NWA-1T at 20:1-4.
[330] *Wash. Utils. and Transp. Comm'n v. Puget Sound Energy*, Docket UG-230968, Steuerwalt, Exh. MS-3T at 6-15 (filed Sept. 12, 2024).

Staff's position on this issue has been consistent[331]: While it is true that technically speaking, the CCA does not legally mandate that any specific covered entity reduce emissions, the practical reality given the CCA's requirements is that most covered entities, including natural gas utilities, will eventually need to make substantial decarbonization efforts. Staff's position on this matter does indicate that perhaps some level of accelerated depreciation is warranted, which is why Staff would be open to some accelerated depreciation, although much less than what PSE has proposed. Unfortunately, as noted in Staff testimony, Staff did not have the resources to evaluate this proposal in detail, and therefore cannot provide a specific recommendation regarding the reduced level of accelerated depreciation that would be appropriate.

136 As with the state energy code, the passage of I-2066 raises serious questions about the impact of the CCA on gas plant and gas service. Prior to I-2066, there was a clear pathway for PSE to take steps to decarbonize their gas service; Chapter 80.86 RCW (HB 1589) established a process wherein cost effective decarbonization and electrification efforts were encouraged as part of the Company's resource planning and ratemaking. Under RCW 80.86, PSE had an obvious pathway to long term compliance with the CCA: The Company would implement Commission-approved electrification efforts that would reduce demand from its gas service customers, thus lowering CCA compliance costs from the Company's natural gas retail services. While it would not be appropriate for Staff to provide detailed statutory analysis of I-2066's amendments prior to the Commission providing guidance, suffice it to say that these amendments create uncertainty about the Company's ability to enact similar measures now.[332] Staff therefore believes that the Commission should exercise patience and caution when it comes

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[331] *See In re Puget Sound Energy's 2023 Integrated Resource Plan*, Docket UG-220242, Staff's Comments Regarding PSE's 2023 Natural Gas Integrated Resource Plan at 9-10 (June 5, 2023).
[332] *See* I-2066 sections 2, 4, & 5.

to approving accelerated depreciation of gas plant. It may be the case that the CCA ultimately still does necessitate accelerated depreciation of the plant in question. But prior to approving accelerated depreciation on that basis, the Commission should have a clear understanding of the impacts of I-2066 on the Company's compliance options for the CCA, and the Company's plans for the future of its natural gas service. Staff therefore recommends that the Commission deny PSE's request, at least until the next rate case. Staff does recognize, as it did in testimony, that this recommendation entails tradeoffs.[333] If the Commission does deny accelerated depreciation in this case, but in a future case grants it, those increases would be spread out over a smaller period, causing higher increases. Given current uncertainty however, Staff believes this calculated risk is justified in light of the current uncertainty the Commission faces.

IX. CONCLUSION

137 Staff's overall revenue requirement creates a necessary balance. It provides the Company with reasonable rates that allow it to pursue the clean energy transition over the course of this rate plan, while not overcompensating investors for PSE taking required steps to comply with existing law. Requests for extraordinary rate relief need to be paired with PBR mechanisms that ensure goals are achieved and ratepayers receive the benefits commensurate with the rate increases they are asked to bear. The flaw in PSE's proposals is that they do not meet the Commission's current ratemaking standards, but are not paired with PBR mechanisms that would assure optimal performance either. This is why the Commission must reject these proposals.

[333] McGuire, Exh. CRM-1Tr at 26:18-27:18.

Respectfully submitted this 4th day of December, 2024.

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