

**EXH. JAP-54T
DOCKETS UE-170033/UG-170034
2017 PSE GENERAL RATE CASE
WITNESS: JON A. PILIARIS**

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

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

**PREFILED SUPPLEMENTAL REBUTTAL TESTIMONY
(NONCONFIDENTIAL) OF**

JON A. PILIARIS

ON BEHALF OF PUGET SOUND ENERGY

AUGUST 15, 2017

PUGET SOUND ENERGY

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1 **PUGET SOUND ENERGY**

2 **PREFILED SUPPLEMENTAL REBUTTAL TESTIMONY**
3 **(NONCONFIDENTIAL) OF**
4 **JON A. PILIARIS**

5 **I. INTRODUCTION**

6 **Q. Are you the same Jon A. Piliaris who submitted prefiled direct testimony on**
7 **January 13, 2017, prefiled supplemental direct testimony on April 3, 2017,**
8 **and prefiled rebuttal testimony on August 9, 2017 on behalf of Puget Sound**
9 **Energy (“PSE”) in this proceeding?**

10 A. Yes.

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

12 A. This supplemental rebuttal testimony responds to the prefiled supplemental
13 testimony of Mr. Jason Ball, witness for the Staff of the Washington Utilities and
14 Transportation Commission (“Staff”), filed on August 7, 2017. Specifically, this
15 supplemental rebuttal testimony responds to Staff’s recommendation that the
16 Commission impute revenue for PSE’s natural gas Special Contract class
17 sufficient to recover 100 percent of its allocated costs, including the authorized
18 return on rate base allocated to serving these customers, and to allow any shortfall
19 in revenue flow to shareholders.¹ This supplemental rebuttal testimony also
20 responds to Staff’s alternative proposal that recommends that the Commission

¹ Ball, Exh. JLB-8T at 4:8-12.

1 order an increase in rates to the Special Contract class sufficient to produce an
2 approximate 2.0 percent return on rate base for the class.²

3 **Q. Please summarize your supplemental rebuttal testimony.**

4 A. This supplemental rebuttal testimony recommends that the Commission reject
5 Staff's proposal related to PSE's Special Contract class for the following reasons:

- 6 1. Staff misinterprets the Commission's rules related to special
7 contracts,
- 8 2. Staff's own analysis shows that PSE's Special Contract class is
9 contributing to the recovery of a substantial amount of fixed costs,
- 10 3. Staff's proposal relies too heavily on one contested analysis of the
11 cost to serve the Special Contract class and ignores the wide
12 difference of opinion on that issue that could produce drastically
13 different results,
- 14 4. Staff has failed to raise these issues before despite having multiple
15 opportunities over many years, particularly when it had
16 opportunities to do so in more appropriate proceedings,
- 17 5. Staff's proposal to require the recovery of the fully allocated cost
18 to serve the Special Contract class is contrary to the Commission's
19 policies related to special contracts and to the public interest,
- 20 6. Staff's proposal to disallow the recovery of costs associated with
21 providing service under an approved special contract is without
22 precedent, and
- 23 7. Staff's alternative proposal is arbitrary, difficult to enforce and
24 could negatively impact customers outside of the Special Contract
25 class.

26 For the foregoing reasons, all of which will be explained more fully below, PSE
27 recommends that the Commission reject Staff's proposal to unfairly shift an

² Ball, Exh. JLB-8T at 6:3-4.

1 arbitrary amount of costs onto PSE shareholders for a contract that it has
2 supported, the Commission has approved and that provides benefits to PSE's
3 other customers.

4 **II. STAFF MISINTERPRETS THE COMMISSION'S SPECIAL**
5 **CONTRACT RULES**

6 **Q. What portion of Commission rules does Staff rely upon for their**
7 **supplemental proposal?**

8 A. Staff points to WAC 480-80-143(5)(c), which states as follows:

9 Demonstrate, at a minimum, that the contract charges recover all
10 costs resulting from providing the service during its term and, in
11 addition, provide a contribution to the gas, electric, or water
12 company's fixed costs.³

13 Staff goes on to assert that "the Commission rule clearly requires that special
14 contracts"⁴ must follow this section of the Commission rule.

15 **Q. Does PSE agree with Staff's interpretation?**

16 A. No. PSE disagrees with Staff's interpretation of this section of the Commission's
17 rule to the extent that it suggests that PSE must demonstrate at any given time
18 subsequent to the contract's approval, and on an ongoing basis, that it meets this
19 standard. Staff fails to note, or rather quote, the immediately preceding preamble
20 to the quoted section which reads "[e]ach application filed for commission

³ WAC 480-80-143(5)(c).

⁴ Ball, Exh. JLB-8T at 2:25-26.

1 approval of a contract must...”⁵ Therefore, the section quoted by Staff is
2 specifically dealing with the initial application for approval of the contract.
3 Indeed, all of the other sections in part (5) of this rule have to do with the various
4 elements of the application filed with the Commission. It is not explicitly an
5 ongoing condition, subject to continuing evaluation during the term of the
6 contract. Even if it were, the question would need to be answered over the totality
7 of the term of the contract, not based on a given point estimate in any given rate
8 proceeding.

9 **Q. Is it useful to monitor cost recovery over the term of the contract?**

10 A. Yes. It is appropriate to monitor how well, and to what extent, the Special
11 Contract class is contributing to the recovery of PSE’s overall fixed costs. This is
12 part of the reason why this class is included in each cost of service analysis filed
13 as part of PSE’s general rate cases. As the term of the contract is nearing its end,
14 that historical information can then help determine whether the pricing allowed
15 under the contract indeed met the WAC’s expectations over the term of the
16 contract and whether it may continue to provide benefits prior to approval of any
17 further extension of the contract.

⁵ WAC 480-80-143(5).

1 **III. PSE SPECIAL CONTRACT IS CONTRIBUTING TO A**
2 **SUBSTANTIAL PORTION OF FIXED COSTS**

3 **Q. Does Staff believe that the Special Contract class is contributing to PSE’s**
4 **fixed gas distribution costs?**

5 A. No. Staff presents an analysis, using its proposed gas cost of service analysis,
6 intended to show that PSE’s Special Contract class is not contributing to the
7 recovery of the utility’s fixed costs. Specifically, Staff calls out a negative rate of
8 return and concludes that such a result proves that these customers do not cover
9 their full level of allocated expenses and contribute less than nothing towards
10 return on rate base. Based on that, Staff concludes that PSE’s Special Contract
11 class is not in full compliance with WAC 480-80-143(5)(c).⁶

12 **Q. Does PSE agree with Staff’s conclusions?**

13 A. No. Staff’s conclusion relies on a faulty assumption that to provide a contribution
14 to PSE’s fixed costs necessarily implies the need for a positive rate of return. This
15 is not correct. PSE’s fixed costs include more than just its return on rate base.
16 From a ratemaking perspective it also includes, at a minimum, PSE’s
17 depreciation, income tax expense and a substantial portion of other taxes that are
18 indirectly related to the recovery of fixed costs. Realistically, it should also
19 include a substantial portion of PSE’s other operation and maintenance (“O&M”)

⁶ Ball, Exh. JLB-8T at 3:6-10.

1 expenses that are relatively fixed in nature, at least in the short run, and unaffected
2 by the presence or absence of the Special Contract class.⁷

3 **Q. Is PSE's Special Contract class contributing to a more correct definition of**
4 **fixed costs?**

5 A. Yes. Even using Staff's figures, which as discussed later, are highly contested,
6 PSE's Special Contract class can be shown to be contributing to the recovery of
7 its fixed costs. As noted in Table 10 of Mr. Ball's prefiled supplemental
8 testimony, the revenues associated with these customers are approximately
9 \$1.37 million.⁸ Conservatively assuming that the incremental cost of serving the
10 Special Contract class is equal to the fully allocated share of embedded O&M
11 expenses, that would amount to a little over \$800,000. This leaves approximately
12 \$570,000 to contribute towards the recovery of PSE's fixed costs. Again, this is a
13 conservative estimate using a liberal interpretation of the costs necessary to
14 provide service to this class and using Staff's contested methodology for
15 allocating costs within its cost of service study.

⁷ Ideally, only the "incremental" cost of providing service would be included here. However, this is a challenging and relatively controversial figure to determine.

⁸ Ball, Exh. JLB-8T at 3.

1 **Q. Does recovering less than one hundred percent of allocated costs from the**
2 **Special Contract class necessarily frustrate PSE's ability to earn its**
3 **authorized rate of return?**

4 A. No. In each rate case, rates are set to recover a certain amount of costs primarily
5 in relation to their loads. This is part of the so-called matching principle. As will
6 be shown later in this testimony, the Commission has routinely approved rates
7 that contemplated recovering less revenue from the Special Contract class than
8 their fully allocated costs. So long as the relationship between the approved rates
9 and the partial recovery of fully allocated costs holds (i.e., PSE's recovery of
10 costs in the future is no better or worse than the relationship set when rates were
11 approved), then the Special Contract class does not impact PSE's ability to earn
12 its authorized return.

13 **IV. STAFF RELIES TOO HEAVILY ON ONE ESTIMATE OF**
14 **COST TO PROVIDE SPECIAL CONTRACT SERVICE**

15 **Q. Does Staff consider whether its conclusion remains valid under alternative**
16 **cost allocation assumptions?**

17 A. No. PSE could find nowhere in Staff's analysis where it considered alternative
18 cost allocation results presented in this case.

19 **Q. What would such an analysis have shown?**

20 A. It would have shown that, again using the conservative use of O&M expenses as a
21 surrogate for the incremental cost of service, the Special Contract class is
22 contributing to even more of PSE's fixed production costs. For example, the gas

1 cost of service study supporting my supplemental direct testimony showed the
2 Special Contract class being allocated approximately \$670,000 in O&M expense.
3 Compared with \$1.37 million in revenue, this leaves approximately \$700,000 to
4 contribute to the recovery of PSE's fixed costs. The gas cost of service model
5 supporting the prefiled response testimony of Mr. Brian Collins, witness for the
6 Northwest Industrial Gas Users ("NWIGU"), showed an allocation of
7 approximately \$390,000 in O&M expenses,⁹ leaving \$980,000 for fixed cost
8 recovery. In fact, using NWIGU's cost allocation assumptions, the Special
9 Contract class is shown to recover 100 percent of its allocated fixed costs at PSE's
10 requested 7.74 percent rate of return.

11 **Q. What should be made of this wide range of results?**

12 A. This wide range of results illustrates the caution that should be taken before
13 putting too much faith in any one set of cost of service results. These results are
14 far too unstable to be making recommendations with the level of precision of
15 Staff's proposal. Indeed, the Commission typically eschews direct application of
16 cost of service results in ratemaking applications, contrary to Staff's proposal
17 here.

⁹ As with Staff, and as discussed in my prefiled rebuttal testimony, PSE contests NWIGU's cost allocation methodology.

1 **V. STAFF HAS HAD MULTIPLE OPPORTUNITIES TO**
2 **RAISE THIS ISSUE IN THE PAST, INCLUDING IN MORE**
3 **APPROPRIATE FORUMS**

4 **Q. Are the circumstances that give rise to Staff's issue new?**

5 A. No. The special contract in question in this proceeding was originally approved in
6 Docket UG-950392. Since that time, PSE has filed multiple rate cases, all of
7 which were reviewed by Staff and which resulted in rates charged to the Special
8 Contract class that recovered less than their fully allocated costs, including
9 allocated fixed costs as being proposed by Staff in this case. The table below
10 illustrates the revenues, allocated O&M expenses and parity ratios resulting from
11 the final rates approved in each case since PSE's 2007 general rate case for the
12 Special Contract class, as well as the results using PSE's proposal in this case.

Docket	Revenue (\$ millions)	O&M Expense (\$ millions)	Parity Ratio
UG-072301	\$1.60	\$0.40	95%
UG-090705	\$1.63	\$0.46	78%
UG-101644	\$1.65	\$0.42	79%
UG-111049	\$1.66	\$0.45	72%
UG-170034	\$1.37	\$0.67	59%

13 In all of the completed rate cases, the rate spread issues were settled and Staff was
14 a party to all of these settlements. In all cases, Special Contract class revenues
15 exceeded their allocated O&M expense (i.e., the Special Contract class was
16 contributing to fixed costs). However, in all cases, their parity ratios were also all
17 well below 1.0 (i.e., the Special Contract class was not covering its fully allocated

1 costs). None of these results, approved in prior cases, are substantially different
2 than being proposed by PSE in this case.

3 **Q. Has Staff had more appropriate opportunities to raise this issue before the**
4 **Commission?**

5 A. Yes. On May 4, 2009, PSE filed in Docket UG-950392 to extend the term of its
6 gas special contract. This term extension was approved by order of the
7 Commission on June 11, 2009 and went into effect the next day. If Staff had any
8 concerns about the contribution this class was making to the recovery of PSE's
9 fixed delivery costs, the filing to extend the term of the contract would have been
10 the appropriate time to raise these issues.

11 **Q. Is this proceeding the appropriate place to raise the issues related to cost**
12 **recovery from the Special Contract class?**

13 A. No. PSE has not filed any amendments to its contracts in this case and, therefore,
14 proposed changes are outside the scope of this proceeding. At best, the Special
15 Contract class rates are only tangentially relevant in that they are partly tied to the
16 rates charged for service under gas Schedule 87T.

17 **VI. STAFF PROPOSAL IS CONTRARY TO COMMISSION**
18 **RULE AND THE PUBLIC INTEREST**

19 **Q. What are the typical circumstances under which the Commission approves a**
20 **special contract?**

21 A. Speaking very broadly, the Commission usually only approves special contracts
22 in instances where the customer either requires substantially different service than

1 otherwise provided by the utility under standard tariffs or where the customer has
2 a viable alternative that may be less costly or otherwise preferable to the
3 customers (i.e., a “bypass” opportunity).

4 **Q. What situation was applicable for PSE’s gas Special Contract class?**

5 A. Customers receiving service within PSE’s gas Special Contract class had an
6 opportunity to completely bypass service from the utility and instead take gas
7 deliveries directly from the interstate pipeline.

8 **Q. In this situation, is it reasonable to assume that the utility can retain such a**
9 **customer under a standard tariff?**

10 A. Of course not. This is why the customer was seriously considering the alternative.
11 This is also why Commission rules provide utilities the flexibility to negotiate
12 prices that do not recover 100 percent of fully allocated and embedded costs.
13 These rules only require the recovery of “all costs *resulting from providing the*
14 *service* during its term”¹⁰ (i.e., the incremental cost of providing the service) and
15 “provide a *contribution* to the....company’s fixed costs.”¹¹ In other words, so long
16 as the customers served under the Special Contract are covering the costs that
17 would not otherwise exist in its absence, any additional recovery from the Special

¹⁰ WAC 480-80-143(5)(c) (emphasis added).

¹¹ *Id.* (emphasis added).

1 Contract customer helps to spread the utility's fixed costs more broadly, to the
2 benefit of other customers.¹²

3 **Q. Does Staff's proposal meet the spirit or the letter of WAC 480-80-143(5)(c)?**

4 A. No, on both accounts. This section of the WAC is intended to allow for a certain
5 degree of flexibility in the pricing of service while ensuring that existing
6 customers continue to benefit by the presence of the customers taking service
7 under the special contract. Staff's proposal removes all flexibility in the pricing
8 for the special contract by requiring full recovery of all costs, which is far more
9 than the "contribution" required under Commission rules.¹³

10 **Q. If Staff's proposal recovers more costs from Special Contracts customers
11 than under the current contract, isn't this in the public interest?**

12 A. No. Staff's proposal puts PSE into the position of either (a) entering into a
13 contract and incurring a disallowance of otherwise prudently incurred expenses to
14 the extent that it does not recover 100 percent of the customers' allocated
15 embedded cost of service,¹⁴ or (b) letting the customer(s) pursue their alternative

¹² This, of course, does not mean that the customer simply needs to pay for little more than its incremental cost of service. The Commission must also satisfy itself that the customer is not paying significantly less than had it pursued its service alternative.

¹³ Staff's alternative proposal discussed later in testimony is only slightly better in that it provides the possibility for offering rates that do not fully recover all allocated costs. However, it still ignores the realities that must be acknowledged at the time the contract is approved. That is, the customers served within this class had a bypass opportunity and setting an artificial return threshold could have resulted in the exercising of the bypass option to the detriment of remaining PSE customers.

¹⁴ Worse still is the uncertainty as to how to determine exactly what constitutes "full" recovery of costs, given the widely varying opinions on that matter.

1 supply arrangements and deprive PSE's remaining customers of the potential to
2 share in the recovery of the utility's existing fixed costs that they will now have to
3 pay alone. Contrary to Staff's assertions that PSE would "reap the rewards" and
4 customers would be held "harmless" under its proposal,¹⁵ there is no upside for
5 the utility and its customers. Either PSE pursues a contract and loses money, or it
6 lets the customer(s) go and its remaining customers have higher rates as a result.
7 Neither result is in the public interest.

8 **VII. STAFF PROPOSAL TO DISALLOW RECOVERY OF**
9 **COSTS ALLOCATED TO AN APPROVED SPECIAL CONTRACT**
10 **IS WITHOUT PRECEDENT**

11 **Q. Is PSE aware of any precedent where the Commission disallowed recovery of**
12 **costs allocated to an already approved special contract?**

13 A. No. PSE is unaware of any such precedent.

14 **Q. Did Staff point to any precedent supporting its proposal to disallow**
15 **otherwise recoverable costs due to the presence of a special contract?**

16 A. No, it did not.

¹⁵ Ball, Exh. JLB-8T at 5:5-7.

1 **VIII. STAFF'S ALTERNATIVE PROPOSAL IS ARBITRARY**
2 **AND DIFFICULT TO ENFORCE**

3 **Q. Please summarize Staff's alternative proposal to disallowing allocated costs**
4 **not fully recovered from the Special Contract.**

5 A. If the Commission does not accept Staff's primary proposal to disallow all
6 allocated costs not recovered from PSE's Special Contract class, it offers an
7 alternative that the rates for the Special Contract class be increased to produce a
8 2.0 percent return on allocated rate base.¹⁶

9 **Q. Does Staff support the basis for its recommended alternative?**

10 A. No. Staff simply asserts that its proposal would bring the contract into compliance
11 with the applicable WAC.¹⁷ However, it provides no basis for evaluating the
12 veracity of this assertion. Moreover, Staff's assertion that its alternative proposal
13 meets the requirements of the WAC undercuts its primary proposal to fully
14 disallow all costs below those necessary to fully recover the allocated costs to the
15 Special Contract class. If earning a 2.0 percent rate of return is sufficient to be
16 compliant with the applicable WAC, how then could the Commission justify
17 disallowing an additional \$680,000, in Staff's estimation,¹⁸ required to fully
18 recover the allocated costs from this class? Staff does not say.

¹⁶ Ball, Exh. JLB-8T at 6:3-4.

¹⁷ *Id.* at 6:4-6.

¹⁸ Ball, Exh. JLB-8T at 6. Difference between \$1.49 million at 7.37 percent return versus \$0.81 million at 2.0 percent return.

1 **Q. Did Staff explain how its proposed rate increases for the Special Contract**
2 **class under its alternative proposal would be implemented?**

3 A. No.

4 **Q. Can PSE or the Commission unilaterally implement Staff's alternative**
5 **proposal?**

6 A. No. The pricing for the Special Contract class is governed by the terms of the
7 contract under which service is taken. It is only indirectly impacted by changes to
8 rates charged for service under gas Schedule 87T, specifically through the linkage
9 in demand and customer charges.

10 **Q. Could PSE or the Commission implement Staff's alternative proposal**
11 **through rate changes for Schedule 87T?**

12 A. This would be technically possible. However, Staff's alternative proposal would
13 then of course impact far more than just the Special Contract customers. It would
14 impact the rates charged to customers served under Schedule 87T, and most likely
15 Schedule 87, as well. Indeed, given Staff's proposed increase of upwards of
16 approximately \$1.5 million, the demand charges for these customers would need
17 to be dramatically increased, many multiples of their current levels.

18 **Q. Has Staff justified whether the rates charged to Schedules 87 or 87T should**
19 **be dramatically changed merely to implement its alternative proposal to**
20 **increase the rates of customers served in the Special Contract class?**

21 A. No. Staff has provided no such justification.

IX. CONCLUSION

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Q. Does this conclude your supplemental rebuttal testimony?

3

A. Yes.