Exhibit No.___(MCD-08T)
Docket Nos. UE-121697/UG-121705 and UE-130137/UG-130138
Witness: Michael C. Deen

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondent.	)	Dockets UE-121697 and UG-121705 *(Consolidated)* Dockets UE-130137 and UG-130138 *(Consolidated)*

RESPONSE TESTIMONY OF MICHAEL C. DEEN

ON BEHALF OF

THE NORTHWEST INDUSTRIAL GAS USERS

April 26, 2013

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael C. Deen, and my business address is 900 Washington Street, Suite 780, Vancouver, Washington 98660. I am employed by Regulatory and Cogeneration Services, Inc. ("RCS"), a utility rate and consulting firm.

Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.

A. I have been involved in the electric utility industry for over 6 years. During that time, I have served as an analyst and expert on a variety of power supply, cost, ratemaking, and policy topics—primarily regarding the Bonneville Power Administration and Pacific Northwest utilities. I provided testimony on behalf of the Industrial Customers of the Northwest Utilities ("ICNU") before the Washington Utilities and Transportation Commission in cases regarding Puget Sound Energy, Avista, and PacifiCorp. I have also provided testimony in natural gas matters regarding Avista on behalf of the Northwest Industrial Gas Users ("NWIGU"). A further description of my educational background and work experience can be found in Exhibit No.___ (MCD-09).

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. I am testifying on behalf of NWIGU. NWIGU is a non-profit trade association whose members are large users of natural gas throughout the Pacific Northwest, including customers served by Puget Sound Energy ("PSE" or the "Company"). I am also providing separate testimony in these proceedings on behalf of ICNU regarding electricity rate matters.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of this testimony is to address the proposed Multiparty Settlement of issues related to PSE's Petition for Reconsideration and Motion to Reopen the Record filed on January 22, 2013 ("Petition For Reconsideration") in response to the Final Order entered by the Commission in Docket UE-121373 as well as open dockets regarding a joint petition for decoupling in Dockets UE-121697 and UG-121705 and PSE's Expedited Rate Filing ("ERF") in Dockets UE-130137 and UG-130138. This settlement proposal is also referred to as the "Global Settlement."

Q. PLEASE DESCRIBE IN SUMMARY TERMS WHAT THESE DOCKETS MEAN FOR NATURAL GAS CUSTOMERS.

In general terms for natural gas customers, these dockets represent an Expedited Rate Filing which updates natural gas margin revenues from the last general rate case to a test year ending June 2012 and a decoupling proposal that includes annual 2.2% increases for delivery related costs (i.e. non- purchased gas costs) for the two to three year duration of the proposed settlement. Issues related to PSE's proposed acquisition of Coal Transition Power are also addressed in the Global Settlement but those issues are strictly related to electricity service and have no significance for natural gas customers.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THESE PROCEEDINGS.

A. At the broadest level, NWIGU has found that the Global Settlement as proposed is not in the public interest and would not produce fair, just, and reasonable rates for natural gas service from PSE to its gas customers. The proposed changes in rates are very substantial and not based on cost of service, the proposed decoupling mechanism does not alleviate issues related to conservation programs, and the proposed resolution of the outstanding

Petition for Reconsideration lacks any value for gas consumers and has no substantive relationship to the other issues in the Global Settlement.

Further, the process by which the proposed Global Settlement has been reached as well, as the features of the settlement itself, form a radical departure from historic WUTC practice and undermine foundational aspects of regulation in the state of Washington to the detriment of customers**.**

For these reasons, NWIGU recommends that the Global Settlement and its constituent parts should be rejected in their entirety. However, if the Commission wishes to continue with the Global Settlement construct, and in addition to the recommendations contained in the testimony of NWIGU witness Edward Finklea, NWIGU has a number of recommendations to make the proposal more balanced for consumers:

- Cost of capital should be considered as an issue in the Global Settlement.
- Consumer protections under the proposal should be strengthened such that the 3% soft cap becomes a hard cap with no additional deferrals and PSE's earnings should be strictly limited to the authorized level.
- The K-Factor rate plan increases should be the full limit on increases for delivery-related costs to natural gas customers. Any additional investment costs for which the Company seeks special recovery during the settlement period should be used as an offset against the K-Factor increases.

II. ANALYSIS OF ERF AND RATE PLAN IMPACTS

Q. WOULD THE PROPOSED SETTLEMENT, IF IMPLEMENTED, CREATE RATES THAT ARE JUST, FAIR, REASONABLE, AND SUFFICIENT?

A. No. PSE and Staff have made clear that the decoupling, rate plan, and ERF mechanisms promoted by the Global Settlement are meant to work together to cumulatively set rates between 2013 until at least February 2016, possibly until February 2017, and could involve rate increases of up to nearly $117 million over that time span for natural gas customers. This three-part rate regime breaks from the Commission's cost-based rate methodology, meaning that there is no way of knowing whether these increases will reflect PSE's actual revenue needs—or, as appears more likely, simply act as an annual rate increase and a substantial shift of risk to ratepayers.

Q. PLEASE EXPLAIN WHAT YOU MEAN BY A BREAK FROM COST-BASED METHODOLOGY.

A. A fundamental principle of Commission ratemaking has been that a test year matches expenses and revenues in a fixed period, and projects that historic relationship into the rate year, subject to known and measurable adjustments. As the Commission stated in its Final Order in UE-111048, "the relationship between rate base, expenses and revenues is used to represent the future and to set prospective rates adequate to allow a reasonable return."[1] Here, PSE and Staff have abandoned that approach, and propose rate increases that pick and choose from multiple time periods, while ignoring known and measurable adjustments.[2]

To explain, if the Global Settlement is accepted as proposed, PSE's permitted cost of capital and power costs will be set based on the 2010 test year that was used in PSE's last rate case. PSE's rate base and non-power costs will be set on a hybrid test year created specifically for this case—a 12 month period ending on June 30, 2012. For the purposes of this discussion, matching these hybrid 2011/2012 costs to select 2010 assumptions violates the matching principle and the fundamental ratemaking principle

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[1] WUTC v. PSE, Docket Nos. UE-111048 and UG-111049, Order 08 ¶ 490 (May 7, 2012) ("Order 08" or, for other filings in these dockets, "PSE 2011 GRC").

[2] WUTC v. Avista Corp., Docket Nos. UE-090134/UG-090135, Order 10 ¶ 45 (Dec. 22, 2009).

that a test year should match contemporaneous costs and revenues to create an accurate rate relationship.[3]

PSE's request for a one-time ERF attrition adjustment and yearly K-Factor attrition adjustments are included in the "rate plan." PSE requests these adjustments based on an assertion that it is chronically under-earning.[4] This is problematic, because both PSE and Staff fail to provide a cost-based attrition study to quantify that claim; rather, they justify these unprecedented rate increases on the basis that PSE failed to reach target ROE, primarily during 2008, 2009, and 2010.[5] This means that rather than adjusting a test year for demonstrated attrition, and providing evidence that such uncontrollable attrition will continue during the rate years, Staff and PSE rely on reduced financial returns from up to five years ago—during the heart of the "Great Recession"—when few if any companies were posting robust earnings. On this basis, they ask the Commission to allow substantial increases in the present and future.

In sum, rather than using a test year to set rate relationships and adjusting for known and measurable changes (or even using an attrition adjustment to create evidence-based projections), PSE and Staff pick and choose among results of operations from 2008, 2009, 2010, 2011, and part of 2012. In so doing, PSE and Staff have created a "rate cocktail" having little to do with the cost of service for 2013, let alone 2014, 2015, 2016, and potentially 2017, when this plan will still be burdening customers with yearly increases.

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3 See Order 08 ¶ 490.

4 WUTC v. PSE, Docket Nos. UE-121373, UE-121697 and UG-121705, and UE-130137 and UG-130138, Exhibit No. __ (KJB-1T), 4:19-22.

5 Exhibit No. __ (TES-1T), 12:18-13:5; Exhibit No.__(TES-3); Exhibit No.__(KJB-1T), 5:3-7.

Q. WHAT DOES THIS MEAN FOR THE VALIDITY OF THE RATES UNDER THIS "RATE PLAN"?

A. It means that the rates proposed are arbitrary and not cost-based. Any customer group could pick and choose elements from the five years used by PSE and Staff and produce any number of combinations, which, in turn, would produce much different results than those advocated by PSE. For example, combining PSE's current appropriate capital costs with a 2010 test year would likely lead to a significant rate decrease. Likewise, Staff's justification for a yearly attrition adjustment—that PSE is chronically "under-earning"—is driven by reported financial results from 2008-2010.[6] If, instead, PSE's reported earnings were subject to a trend analysis, with PSE's 2012 results included, a more likely conclusion would be that PSE is on course to significantly over-earn during the rate plan period because PSE's ROE is dramatically rising without the help of any Rate Plan.

The point, however, is that none of these methods are properly cost-based, and none of them, particularly that chosen by PSE, will produce evidence-based rates. PSE and Staff propose a method of ratemaking that makes up the rules as it goes along. And, while the evidence presented does not demonstrate the rates will be fair, just, reasonable and sufficient in 2013, there is absolutely no evidence that the rate increases the Rate Plan will cause in 2016 (and potentially in 2017) would be fair, just, or reasonable.

Q. PLEASE DESCRIBE THE PROPOSED RATE AND VALUE COMPONENTS OF THE GLOBAL SETTLEMENT.

A. The Global Settlement is composed of a variety of disparate parts. The core elements are the ERF, the "Rate Plan", the joint decoupling proposal, and resolution of issues in the coal transition power PPA order from the Commission.

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6 Exhibit No. __ (TES-1T), 12:18-13:5; Exhibit No.__ (TES-3).

The ERF serves to provide an updated baseline for the delivery-related portion of PSE's revenue requirement based on the 12 month period ended June 30th, 2012. The costs included in this proposed rate increase are PSE's remaining costs after property taxes and commodity costs are removed. PSE's filing calculates a slight revenue surplus of $1.2 million for natural gas service.

The rate plan component of the settlement establishes a base Revenue Per Customer ("RPC") from the ERF for delivery revenues and then applies a 2.2% increase immediately and then another 2.2% annual increase for each year the rate plan is in effect.

The decoupling proposal represents a revised joint proposal by the Northwest Energy Coalition ("NWEC") and PSE. Under this proposal, the delivery RPC for a given year is multiplied by actual customers in that year to give a total amount of delivery revenue that PSE is allowed to recover for that year. Any variation from actual allowed delivery revenues is deferred with interest for recovery from customers in the following year.

The last central component of the settlement is the resolution of PSE's Motion for Reconsideration regarding the Commission's order on the acquisition of coal transition power. However the issue of the Coal Transition PPA is strictly an issue related to electric service and has no value to or impact on natural gas customers.

Q. WHAT IS THE FINANCIAL IMPACT TO CUSTOMERS OF THE PROPOSED AGREEMENT?

A. The full potential impact of the settlement for natural gas customers is likely to be between approximately $75 and $117 million, relative to current rates and depending on the length of the term. However, the precise impacts are impossible to quantify given the uncertainty of the amounts of potential deferrals under the decoupling mechanism, the uncertain length of the rate plan, and the potential for additional infrastructure investment not accounted for under the K-Factor adjustments.

Q. IS THERE POTENTIAL FOR ADDITIONAL COSTS OF THE SETTLEMENT?

A. Absolutely. Deferral adjustments from the decoupling mechanism could also result in substantial rate increases beyond those contemplated in the Rate Plan. Further, as stated in paragraph 13 of the settlement document, "PSE is not precluded from seeking a cost recovery mechanism as set forth in the Commission Policy on Accelerated Replacement of Pipeline Facilities with Elevated Risk, Docket UG-120715." In other words, PSE may incur potentially substantial costs of infrastructure replacement beyond those accounted for in the K-Factor adjustments.

Q. IS THE POTENTIAL FOR THESE ADDITIONAL INFRASTRUCTURE INVESTMENT COSTS APPROPRIATE?

A. No. The stated intent of the K-Factor is to provide an escalation to account for increases in all delivery-related costs, including costs related to increased levels of investment. Carving out a special category of delivery-related investment for which the Company can seek recovery beyond the K-Factor undermines the fundamental premise of the mechanism. More specifically, it is my understanding that the development of the K-Factor included the pattern of historical escalation in all types of investment costs, including the types of pipe replacement for safety purposes contemplated in the Commission's policy statement from Docket UG-120715. It is NWIGU's position in this proceeding that the K-Factor includes more than adequate headroom to accommodate delivery infrastructure replacement for safety purposes without the need for the Company to seek additional special rate treatment for certain investments.

Q. WHAT IS NWIGU'S RECOMMENDED MODIFICATION TO THE GLOBAL SETTLEMENT TO CORRECT THIS PROBLEM?

A. If PSE should seek a Special Pipe Replacement Program Cost Recovery Mechanism ("CRM") pursuant to the Commission's policies during the terms of the Global Settlement, any charges associated with that CRM should be used as a reduction to the rate plan increases. This will ensure that natural gas customers are not effectively double charged for the Company's investment in delivery-related infrastructure.

Q. ARE THERE ANY CONSUMER PROTECTIONS INCLUDED IN THE SETTLEMENT?

A. The Global Settlement includes two alleged consumer protections. The first of these is a 3 percent "soft cap" on overall rate increases in a given year. The second is an earnings test that would cap PSE's earning at 25 basis points above the authorized level and allows PSE to retain 50% of any such earning above the cap level.

Q. DO THESE CONSTITUTE MEANINGFUL CONSUMER PROTECTIONS?

A. No. The proposed earnings test would allow PSE to earn significantly over its authorized level and retain a large portion of over-earnings to the detriment of customers. The 3% soft cap on revenue increases is without any significant merit to customers. This is because any amounts in excess of the 3% are deferred by the Company for later collection from customer with interest. Therefore, in effect there is no limit on the amount of increased revenue that PSE could collect from customers in a given year. To make matters worse, the deferral collection does not end at the conclusion of the rate plan. Any amounts left in the deferral account at the end of the rate plan would continue to be collected in addition to whatever rate increases PSE seeks at that time.

Q. HOW DOES NWIGU RECOMMEND THAT THESE CONSUMER PROTECTIONS BE IMPROVED?

A. At a minimum, the soft cap should be made a hard cap in each year, and any amount of revenue increases in excess of the cap should not be deferred for future collection. I also recommend that the true-up be capped at the allowable ROR, not 25 basis points above the ROR. Similarly, PSE should not be permitted to withhold 50% of its excess earnings from customers, whatever the cap level.

Q. DO THE RATE MECHANISMS CONTEMPLATED UNDER THE GLOBAL SETTLEMENT PROPERLY CONSIDER THE RELATIONSHIP BETWEEN PSE'S COSTS AND RATE REVENUES?

A. Absolutely not. The Global Settlement is a calculated attempt to subvert the regulatory process by not providing the Commission and customer groups an opportunity to consider the full picture of PSE's costs and revenues, particularly PSE's cost of capital.

Q. PLEASE DESCRIBE STAFF'S POSITION REGARDING THE SETTLEMENT.

A. Staff's support of the Global Settlement agreement is presented in the testimony of Mr. Schooley, Exhibit No. ___(TES-1T). Staff's general position is that the settlement produces fair and reasonable results, including the plan for "minor" increases over the next 2-3 years. Staff also asserts that the Global Settlement will support Commission policy goals to streamline the regulatory process to break the cycle of constant rate case filings by the Company, remove throughput incentives to the Company, and resolve issues related to the Transition Coal Power PPA in a manner that is "fair and timely."

Q. WHAT ANALYSIS SUPPORTS STAFF'S POSITION REGARDING THE PROPOSED GLOBAL SETTLEMENT?

A. As supported by numerous data responses from Staff as well as deposition of Staff witnesses in these proceedings, Staff appears to have conducted very limited independent analysis of elements of the elements of the proposed Global Settlement and has instead relied heavily on the Company's analysis.[7]

Q. FROM A RATEPAYER PERSEPECTIVE, WHAT BENEFITS DOES STAFF BELIEVE THE SETTLEMENT WILL ACHIEVE?

A. In response to ICNU Data Request 4.7, Staff provided the following description of benefits to customers resulting from the Global Settlement:

> Benefits to PSE's customers include relative bill certainty through 2015, annual increases through 2015 that are roughly equal to, or less than, increases in gas and electric rate provide in recent general rate cases, a decoupling regime that ensures PSE's rates reflect the impact of mandatory conservation , and energy from the Centralia coal plant at costs that are lower than what PSE had originally proposed through the reduced equity adder.

Q. WILL THE RATE ELEMENTS OF THE GLOBAL SETTLEMENT DELIVER THE BENEFITS PURPORTED BY STAFF?

A. No. NWIGU is extremely skeptical of Staff's analysis of benefits to customers under the settlement proposal.

Q. PLEASE DISCUSS THE ALLEGED BENEFIT OF BILL CERTAINTY DURING THE PERIOD OF THE GLOBAL SETTLEMENT.

A. As discussed above, the Global Settlement does not provide significant bill certainty to customers during the period of the settlement. The length of the settlement period itself is uncertain and as currently proposed would allow PSE to make significant infrastructure investments and pass those costs on to customers over and above the planned K-Factor increases.

[7] Exh. No. __ (MCD-4) at 1, 14 (Deposition of Thomas E. Schooley at 32:19-23, 84:22-85:4).

Q. WILL THE PROPOSED DECOUPLING MECHANISM ACHIEVE COMMISSION POLICY GOALS RELATED TO CONSERVATION?

A. No. The extensive problems with the proposed decoupling for natural gas customers are addressed in the testimony of NWIGU witness Edward Finklea.

Q. DOES THE RESOLUTION OF ISSUES RELATED TO THE COAL TRANSITION POWER PPA PROVIDE SUBSTANTIAL BENEFITS TO GAS CUSTOMERS?

A. No. Issues related to the Coal Transition PPA have absolutely no relevance or value to PSE's natural gas customers.

Q. WHY IS IT APPROPRIATE TO ADDRESS PSE'S COST OF CAPITAL IN THE PRESENT DOCKETS?

A. There are a number of important reasons why PSE's cost of capital should be addressed at this time. As a simple factual matter, the test year basis on which PSE's currently authorized ROR is set is now significantly out of date. Equally important on a policy level, the settlement terms as proposed have allowed PSE to address all other issues related to its costs in a piecemeal fashion, while avoiding adjustments to its authorized cost of capital, which as shown by the testimony of ICNU witness Michael Gorman, are significantly too high. In the rules related to PSE's ability to file a PCORC, it states that PSE must file a general rate case within 3 months of filing a PCORC that increases rates. The entire purpose of this provision is to prevent PSE from filing expedited rate mechanisms that address portions of its costs without giving full consideration to the relationship between all important components of the Company's costs and revenues needed to ensure the establishment of fair, just and reasonable rates. This is exactly the situation that will occur under the Global Settlement if customers are not allowed to present evidence regarding cost of capital. Finally, without cost of capital evidence as part of the Global Settlement proposal, it will be difficult to make an appropriate adjustment to the Company's cost of capital to reflect the significant decrease in risk as a result of the proposed decoupling mechanism.

Q. IF THE COMMISSION SHOULD DEEM FOR SOME REASON THAT IT IS NOT APPROPRIATE TO ADDRESS COST OF CAPITAL IN THE CURRENT PROCEEDINGS, DOES NWIGU HAVE A RECOMMENDED ALTERNATIVE?

A. Yes. A simple solution would be for the Commission to make PSE's cost of capital an open issue in the upcoming PCORC filing and make the results of that determination effective retroactively on all of PSE's costs. Although natural gas costs are not typically addressed in a PCORC proceeding, an exception for cost of capital issues could easily be made under the present circumstances.

Q. HOW WAS THE PROPOSED GLOBAL SETTLEMENT AT ISSUE IN THESE PROCEEDINGS DEVELOPED?

A. It was developed by Staff, NWEC and PSE in settlement meeting or "technical workshops" without the inclusion of any other parties.

Q. WAS THE PROCEDURE USED TO DEVELOP THE GLOBAL SETTLEMENT AGREEMENT AND ITS CONSTITUENT PARTS EQUITABLE TO RATE PAYERS?

A. Conducting settlement negotiations in secret do not result in a balanced result as no party was exclusively representing ratepayers' interests.

Q. DID NWIGU SUPPORT A RATE PLAN AS PART OF AVISTA'S LAST GENERAL RATE CASE?

A. Yes. NWIGU is not inherently adverse to rate plans. However, the circumstances between the Avista proposal and the current proceedings are extremely different. The two year rate plan came as part of a general rate case which considered all elements of Avista's costs, including cost of capital, on a consistent basis. The Avista rate plan had a definite period, customer support, was developed with the inclusion and knowledge of all parties, and provided a much higher degree of rate certainty. Additionally, the Avista settlement did not include a decoupling proposal with substantial deviations from the Commission's Policy Statement regarding decoupling.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE ERF AND RATE PLAN.

A. As currently proposed, the ERF and Rate Plan elements of the Global Settlement will not produce cost based rates. Also, the benefits to ratepayers alleged by Staff are at best drastically overstated. If the Commission wishes to continue with the Global Settlement construct, to address the flaws identified in this section of testimony the Commission should make cost of capital an issue in the Global Settlement proceedings, include more meaningful customer protections, and not allow additional costs of delivery-related investment such as a CRM for pipeline safety replacements beyond the K-Factor increases.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.