

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

DOCKETS UE-170033/UG-170034

INITIAL BRIEF ON BEHALF OF COMMISSION STAFF

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REDACTED VERSION

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	COST OF SERVICE, RATE SPREAD, AND RATE DESIGN	2
A.	The Generic Cost Of Service Proceeding Is The Best Forum For Determining Cost Of Service Policy	2
B.	Commission Staff's Proposed Rate Spread Best Reflects Cost Causation Principles And The Balance Of All Customers' Interests	3
C.	PSE Is Violating The Plain Language Of Its Filed Special Contract	5
1.	The Commission has the statutory duty both to enforce the terms of the Special Contract and to amend it if its terms are not fair, just, reasonable, and sufficient	5
2.	The Special Contract, if properly implemented, would preserve the relative economic benefit of the Special Contract compared to tariffed transportation service	7
3.	PSE has failed to charge the Special Contract Customer the filed rate	9
4.	PSE's failure to properly administer the Special Contract has harmed customers, but not its shareholders	13
D.	Residential Rate Design	15
1.	Commission precedent establishes five goals for residential rate design	16
2.	PSE's electric residential rate structure does not adequately address the five goals of residential rate design	16
a.	Residential rates should include a basic charge coupled with a minimum bill so that every customer is billed at least their total customer related costs	17
b.	Seasonal rates provide a more accurate price signal that reflects the reality of customer behavior	20
III.	DECOUPLING	27
A.	Decoupling Should Continue, But Should Not Be Permanent	27

B.	Remove Certain Schedules, Regroup The Others	30
C.	A Five Percent Soft Cap Is Appropriate To Reduce And Prevent The Buildup Of Decoupling Deferral Balances	37
D.	Earnings Sharing Modifications Should Be Rejected	42
IV.	ELECTRIC COST RECOVERY MECHANISM (ECRM)	44
A.	The Overview: Staff Opposes PSE’s ECRM Because Such A Mechanism Is Unnecessary And Unreasonable	44
B.	The Relevant History Of Cost Recovery Mechanisms (CRM) And The Gas CRM	45
1.	Public Safety was an important reason for the Commission’s approval of Gas CRMs	46
2.	Commission has the necessary in-house expertise to conduct substantive review for the Gas CRM, but no equivalent group exists for an ECRM	47
C.	Staff Favors Traditional Ratemaking Over The Proposed ECRM Because The ECRM Would Lead To Preapproval And Unnecessary Accelerated Recovery	48
1.	The ECRM would functionally become preapproval for certain distribution-related investments	48
2.	The ECRM is unnecessary because PSE has not identified a public safety concern or some other pressing justification for alternative ratemaking	49
3.	The ECRM is unnecessary because the Company already controls capital allocation for distribution-related investment and can re-prioritize certain projects at any time	50
D.	Summary Of Staff’s Recommendation For Rejection Of The ECRM	51
V.	CONCLUSION	52

TABLE OF AUTHORITIES

Cases

<i>Gen. Tel. Co. of Nw. v. City of Bothell</i> , 105 Wn.2d 579, 585, 716 P.2d 879 (1986)	5
<i>Nat'l Union Ins. Co. of Pittsburgh, Pa. v. Puget Sound Power & Light</i> , 94 Wn. App. 163, 171, 972 P.2d 481 review denied, 138 Wn.2d 1010 (1999)	6
<i>People's Org. for Wash. Energy Res. v. Wash. Utils. & Transp. Comm'n</i> , 104 Wn.2d 798, 808, 711 P.2d 319 (1985)	1
<i>State v. McGinty</i> , 80 Wash. App. 157, 160, 906 P.2d 1006 (1995).....	6
<i>U.S. W. Commc'ns, Inc. v. City of Longmont</i> , 924 P.2d 1071, 1079 (Colo. App. 1995)	6

Administrative Cases

<i>In the Matter of the Policy of the Washington Utilities and Transportation Commission Related to Replacing Pipeline Facilities with an Elevated Risk of Failure</i> , Docket UG-120715, Commission Policy on Accelerated Replacement of Pipeline Facilities with Elevated Risk (Dec. 31, 2012) ("Commission Policy Statement")	45-47
<i>In the Matter of Puget Sound Energy, Inc.'s Pipe Replacement Program</i> , Docket PG-131839, Order 01 (Oct. 30, 2013)	45, 47, 48
<i>In the Matter of Puget Sound Energy's Pipe Replacement Program Plan</i> , Docket PG-160294, Open Meeting Memo, (April 7, 2016)	47, 48
<i>In re WUTC Investigation into Energy Conservation Incentives</i> , 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) ("2010 Decoupling Policy Statement")	16, 25, 28-30
<i>MCI Telecommunications Corp. v. GTE Northwest, Inc.</i> , Docket UT-970653, 2nd Supp. Order, (Oct. 22, 1997)	41
<i>Wash. Utils. & Transp. Comm'n. v. Avista Corp.</i> , Docket UE-011595, Fifth Supp. Order (June 18, 2002)	45

<i>Wash. Utils. & Transp. Comm'n v. Avista Corp.</i> , Dockets UE-140188 and UG-140189, Order 05 (Nov. 25, 2014)	16
<i>Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.</i> , Docket UE-152253, Order 12 (Sept. 1, 2016) (“2016 PacifiCorp Order”)	39, 40
<i>Wash. Utils. & Transp. Comm'n. v. Puget Sound Energy, Inc.</i> , Dockets UE-011570 &UG-011571, Twelfth Supp. Order (2002)	45
<i>Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.</i> , Dockets UE-111048 and UG-111049, Order 08 (May 7, 2012)	16
<i>Wash. Utils. & Transp. Comm'n. v. Puget Sound Energy, Inc.</i> , Docket UG-110723. Order 07 (May 18, 2012)	45
<i>See Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.</i> , Dockets UE-121697, UG-121705, UE-130137, and UG-130138, Order 07, (Jun. 25, 2013) (“2013 PSE Decoupling Order”)	25, 26, 31, 32, 34, 36, 38, 42, 43
<i>Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.</i> , Dockets UE-130583, UE-130617, UE-131099, UE-131230, Order 11 (Aug. 7, 2015) ...	30
<i>Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.</i> , Docket UE-141368 (Jan. 29, 2015)	4
<i>Wash. Utils. & Transp. Comm'n v. Puget Sound Energy</i> , Docket UE-161123, Order 06 (July 13, 2017)	5, 6
<i>Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.</i> , Dockets UE-170033 & UG-170034, Multiparty Settlement Stipulation and Agreement (Sept. 15, 2017)	2
<i>Wash. Utils. & Transp. Comm'n v. Wash. Nat'l Gas Comp.</i> , Dockets UE-940034 and UG-940814, Fifth Supplemental Order (Apr. 1, 1995)	16
<i>Wash. Utils. & Transp. Comm'n v. Wash. Water Power Comp.</i> , Docket UG-901459, Third Supplemental Order (Mar. 9, 1992)	16

Statutes and Regulations

RCW 80.01.040	6
RCW 80.04.130(4)	29
RCW 80.28.010	1, 7

RCW 80.28.020	1, 7
RCW 80.28.050	5
RCW 80.28.080	6
RCW 80.28.090	1
RCW 80.28.100	1
WAC 480-80-143(1)	6
WAC 480-80-143(3)	5, 6
WAC 480-80-143(5)(b)	6
WAC 480-80-143(5)(c)	6, 15

Other Authorities

The National Association of Regulatory Utility Commissioners, Grant & Research Department, <i>Decoupling For Electric & Gas Utilities: Frequently Asked Questions</i> <i>(FAQ)</i> (Sept. 2007)	25
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I. INTRODUCTION

1 The Washington Utilities and Transportation Commission’s (“Commission”) “paramount objective . . . [is] to secure for the public safe, adequate, and sufficient utility services at just, fair, reasonable, and sufficient rates.”¹ Rates also cannot be unjustly discriminatory or unduly preferential.² Each of these ratemaking objectives is equally important in the eyes of the law.³ In rate cases, the Commission achieves these ratemaking objectives by determining the aggregate cost that comprises the utility’s allowed revenue requirement and based thereon establishes the “rates the utility can charge for its products to each class of customers.”⁴ In the current Puget Sound Energy (“PSE” or “Company”) 2017 general rate case, Commission Staff (“Staff”) has attempted to provide an evidentiary record and a series of recommendations to follow those ratemaking objectives.

2 First, Staff supports the multiparty settlement currently before the Commission because that settlement resolves the vast majority of issues in a very reasonable and balanced manner. Predictably, Staff’s recommendations for the remaining, unsettled issues also focus on reasonable and balanced resolutions to a series of contentious issues. For the unsettled portions of rate spread and rate design, Staff’s recommendations emphasize concepts such as rate class parity, fair and compensatory rates for special contracts, removal of cross subsidies, and a residential rate design that adheres to stated Commission principles. For the unsettled portions of decoupling, Staff’s recommendations also best balance the various competing interests. The resulting Staff-sponsored decoupling mechanism is

¹ *People’s Org. for Wash. Energy Res. v. Wash. Utils. & Transp. Comm’n*, 104 Wn.2d 798, 808, 711 P.2d 319 (1985); RCW 80.28.010.

² RCW 80.28.020, .090, .100.

³ See *People’s Org. for Wash. Energy Res.*, 104 Wn.2d at 808.

⁴ *Id.* at 809.

partially in support, partially opposed, and partially modifying the Company's proposal. Lastly, Staff recommends the Commission reject the Company's proposal for an electric cost recovery mechanism as unreasonable and unnecessary. The ECRM would depend on an inherently undependable review process and provide what Staff views as an unnecessary economic incentive to PSE. With an overarching emphasis on reasonableness and the goal of achieving the Commission's ratemaking objectives, Staff's recommendations fairly and reasonably resolve the remaining, unsettled issues in this case.

II. COST OF SERVICE, RATE SPREAD, AND RATE DESIGN

3 In this case, all parties except Public Counsel have settled on the appropriate change to PSE's revenue requirements for its electric and gas services. The Settling Parties agreed to a net increase of approximately \$20 million for electric operations and a net decrease of approximately \$35 million for gas operations. The Settling Parties, however, were not able to fully agree on how these revenue requirements should be allocated amongst customers or on how rates should be designed.⁵

A. The Generic Cost Of Service Proceeding Is The Best Forum For Determining Cost Of Service Policy.

4 Cost of service studies identify the costs incurred to service particular classes of customers, and inform how to allocate the revenue requirement amongst customers.⁶ Perspectives on how best to perform cost of service studies can vary widely, leading to a broad range of possible cost of service study results.

⁵ *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-170033 & UG-170034, Multiparty Settlement Stipulation and Agreement, 25-27, ¶¶ 93-100 (Sept. 15, 2017) ("Multiparty Settlement Agreement").

⁶ Ball, Exh. JLB-1T at 6:8-10.

5

The Commission has instituted generic proceedings to review electric and gas cost of service methodologies for all IOUs in Washington. Staff believes that “the generic proceedings are the best forums for establishing uniform cost of service policies for both gas and electric service.”⁷ The generic proceedings also allow for a more diverse and richer discussion of cost of service issues because a larger number of stakeholders and all of the IOU’s can participate.⁸ Staff hopes the generic proceedings will produce a coherent and consistent cost of service study approach that will simplify rate case filings and better inform the Commission’s review of rate spread proposals. In this case, the Commission should consider cost of service issues for the limited purpose of informing how to allocate the revenue requirement amongst customers, and reserve any cost of service policy determinations for the generic proceeding.

B. Commission Staff’s Proposed Rate Spread Best Reflects Cost Causation Principles And The Balance Of All Customers’ Interests.

6

PSE proposes to allocate the change in revenue requirement for both electric and gas service based on a rate spread methodology that is inextricably linked to the results of its cost of service studies. The Company presented a “fully allocated embedded cost of service study” that relies on the same historic accounting costs used to determine the revenue requirement to support both its electric and gas rate filings.⁹ The Company’s cost of service studies produced parity percentages for each customer class that reflect the relative relationship between costs and revenue as they exist in the rate year.¹⁰ Most of the parties to this proceeding, including Staff, disputed some discrete aspect of how the Company

⁷ Ball, Exh. JLB-1T at 7:6-7.

⁸ Ball, Exh. JLB-1T at 13:2-4.

⁹ Piliaris, Exh. JAP-1T at 23:6-15, 35:6-14.

¹⁰ Ball, Exh. JLB-1T at 6:17-20; Piliaris, JAP-1T at 25:5-11.

performed its cost of service studies, and provided alternative recommendations that result in different parity percentages.

7 The parties various cost of service proposals each impact the results of the Company's rate spread proposal because the Company's rate spread methodology is linked to the parity percentages produced by the cost of service studies. Specifically, the Company's proposed rate spread methodology seeks to move the various customer classes closer to full parity by: (1) applying an adjusted average rate increase to retail classes within five percent of full parity; and (2) applying a rate increase that is 65 percent (adjusted down from 75 percent by the Settlement) of the adjusted average to the retail classes that are more than five percent above full parity.¹¹ Staff supports PSE's proposed rate spread methodology because it serves to reduce the cross-subsidization occurring between customer classes.¹² However, Staff does not support PSE's proposed rate spread results because they are informed by the Company's underlying cost of service studies, which Staff disputes.

8 For the purposes of this case only, the Commission should accept Staff's cost of service studies to inform the rate spread. For electric, Staff adopted the Company's electric cost of service study because it was developed in accordance with the settlement from the 2014 Electric Cost of Service and Rate Design Collaborative.¹³ For gas, Staff had to adjust the Company's gas cost of service study because it used an inappropriate demand allocation factor.¹⁴ The Commission should use Staff's gas cost of service study for three reasons: (1) it relies on a demand allocation factor that is consistent with Commission precedent; (2) it

¹¹ Piliaris, Exh. JAP-1T at 52:9-53:12.

¹² Ball, Exh. JLB-1T at 14:6-16:2.

¹³ Ball, Exh. JLB-1T at 7:11-8:14; *see also Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Docket UE-141368 (Jan. 29, 2015).

¹⁴ Ball, Exh. JLB-1T at 8:16-12:8.

was developed using recent historical data to better reflect how the gas system is used to serve customers; and (3) it most fairly balances the interests of all customer classes.¹⁵

9 While Staff continues to support the generic cost of service proceeding as the best forum for establishing cost of service policy, the Commission should resolve rate spread issues in this case based on the cost of service studies supported by Staff.

C. PSE Is Violating The Plain Language Of Its Filed Special Contract.

1. The Commission has the statutory duty both to enforce the terms of the Special Contract and to amend it if its terms are not fair, just, reasonable, and sufficient.

10 As the Commission recently confirmed, PSE’s special contracts are subject to its ongoing enforcement, supervision, regulation, and control.¹⁶ “A tariff establishes the rates, terms, and conditions under which a regulated [gas] company provides service and is legally binding on the company and its customers once the Commission has approved the tariff or allowed it to become effective.”¹⁷ Subject to Commission approval, a regulated gas company may include rates, terms, and conditions of service provided to specific customers in special contracts, but the essential terms of such contracts are considered part of the company’s “filed tariffs and are subject to enforcement, supervision, regulation, control, and public inspection as such.”¹⁸

11 Like tariffs, special contracts must be filed with the Commission and are legally binding on the company and its customers once the Commission has approved them or

¹⁵ Ball, Exh. JLB-1T at 8:16-13:6; Ball, Tr. at 349:20-351:8.

¹⁶ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy*, Docket UE-161123, Order 06, at 26 (July 13, 2017).

¹⁷ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy*, Docket UE-161123, Order 06, at 26 (July 13, 2017) (citing RCW 80.28.050); *Gen. Tel. Co. of Nw. v. City of Bothell*, 105 Wn.2d 579, 585, 716 P.2d 879 (1986) (“Once a utility’s tariff is filed and approved, it has the force and effect of law.”).

¹⁸ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy*, Docket UE-161123, Order 06, at 26 (July 13, 2017)(citing WAC 480-80-143(3)).

allowed them to become effective.”¹⁹ Each application filed for Commission approval of a special contract must show that the contract is not unduly preferential or discriminatory as well as “[d]emonstrate, at a minimum, that the contract charges recover all costs resulting from providing the service during its term, and, in addition, provide a contribution to the . . . company’s fixed costs.”²⁰

12 The only legal rate that a regulated gas company may collect is the filed rate currently in effect.²¹ The Commission has the authority to enforce filed rates, terms, and conditions.²² Under Washington law, “standard principles of statutory construction apply to the interpretation of the tariff.”²³ In determining the meaning of the tariff, the Commission “must give effect to the intent of the legislative body, *i.e.*, the [Commission], by looking first at the language of the tariff.”²⁴ When a tariff’s language “is plain and unambiguous, its meaning must be derived from the words themselves without . . . construction or interpretation.”²⁵ The same is true for a special contract because the special contract is an extension of the utility’s tariff.²⁶

¹⁹ WAC 480-80-143(1), (3).

²⁰ WAC 480-80-143(5)(b), (5)(c).

²¹ RCW 80.28.080.

²² *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy*, Docket UE-161123, Order 06, at 26 (July 13, 2017)(citing RCW 80.01.040).

²³ *Nat’l Union Ins. Co. of Pittsburgh, Pa. v. Puget Sound Power & Light*, 94 Wn. App. 163, 171, 972 P.2d 481, 484 (1999)(citing *U.S. W. Commc’ns, Inc. v. City of Longmont*, 924 P.2d 1071, 1079 (Colo. App. 1995), *aff’d*, 948 P.2d 509 (Colo. 1997; *accord State v. McGinty*, 80 Wash. App. 157, 160, 906 P.2d 1006 (1995) (noting that statutory rules of construction “apply equally to administrative rules and regulations”).

²⁴ *U.S. W. Commc’ns, Inc. v. City of Longmont*, 924 P.2d 1071, 1079 (Colo. App. 1995)(*see above footnote*), (“standard principles of statutory construction apply to the interpretation of the tariff. Hence, we must give effect to the intent of the legislative body, *i.e.*, the PUC, by looking first at the language of the tariff.”);

²⁵ *Nat’l Union Ins. Co. of Pittsburgh v. Puget Sound Power & Light*, 94 Wn. App. 163, 171, 972 P.2d 481 (internal quotation marks omitted), *review denied*, 138 Wn.2d 1010 (1999).

²⁶ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy*, Docket UE-161123, Order 06, at 26 (July 13, 2017)(citing WAC 480-80-143(3)).

13 In addition to its statutory duty to enforce filed rates, the Commission must also ensure that rates are fair, just, reasonable, and sufficient.²⁷ If the Commission finds, after a hearing, that a utility’s rates, practices, or contracts “are unjust, unreasonable, unjustly discriminatory or unduly preferential . . . or that such rates or charges are insufficient to yield a reasonable compensation for the service rendered” it must “determine the just, reasonable, or sufficient rates, charges, regulations, practices or contracts to be thereafter observed and in force” and must “fix the same by order.”²⁸

2. The Special Contract, if properly implemented, would preserve the relative economic benefit of the Special Contract compared to tariffed transportation service.

14 In this case, PSE presented a “fully allocated embedded cost of service study” that relies on the same historic accounting costs used to determine the revenue requirement to support its rate filing.²⁹ The gas cost of service study identifies the costs the Company incurred to serve each customer class.³⁰ One of the customer classes identified in the fully allocated embedded cost of service study is the “Special Contracts” class.³¹ This class is comprised of one special contract (the “Special Contract”) for a single customer (the “Special Contract Customer”).³²

15 The Special Contract is a Transportation Service Agreement that replaces transportation service under the Company’s tariff. It was originally executed between PSE

²⁷ RCW 80.28.010.

²⁸ RCW 80.28.020.

²⁹ Piliaris, Exh. JAP-1T at 35:6-14.

³⁰ See Piliaris, Exh. JAP-1T at 18:10-21.

³¹ See Piliaris, Exh. JAP-1T at 4:9.

³² Piliaris, Exh. JAP-65CX at 2.

and the Special Contract Customer on February 27, 1995, for a 20 year term.³³ In 2009, in Docket UG-950392, the Commission approved extending the agreement through 2035.³⁴

16

[REDACTED]

³³ Piliaris, Exh. JAP-65CX at 2.

³⁴ Piliaris, Exh. JAP-65CX at 2.

³⁵ Piliaris, JAP-65HCX at 10-11 (Section 6).

³⁶ Piliaris, Exh. JAP-65HCX at 13-14.

³⁷ Piliaris, Exh. JAP-65HCX at 14-18.

³⁸ Piliaris, Exh. JAP-65HCX at 14-18 (examples of how to perform these calculations are provided in Exhibits B and C of the Special Contact. *See* Exh. JAP-65HCX at 41-48.).

³⁹ Piliaris, Exh. JAP-65HCX at 14.

17

Importantly, the plain language of the Special Contract also establishes a price floor.

Section 10 of the Special Contract expressly provides:

[REDACTED]

40

Accordingly, [REDACTED]

[REDACTED]

[REDACTED]

3. PSE has failed to charge the Special Contract Customer the filed rate.

18

PSE has failed to charge the Special Contract Customer the filed rate pursuant to the plain language of the Special Contract. As illustrated by the fact that the Special Contract class's parity ratio has fallen by approximately 40 percent over the last decade, the Special Contract has not produced revenue sufficient to [REDACTED]

[REDACTED] nor to remain above the Special Contract's express price floor.⁴¹ The Special Contract is currently producing a negative rate of return, meaning the Special Contract Customer does not cover its full level of allocated expenses and is contributing less than nothing toward return on rate base.⁴²

19

At hearing, PSE acknowledged that the Special Contract is producing significantly deficient revenues based on the Company's fully allocated cost of service; however, the Company contends that the Special Contract should be interpreted to address the incremental costs of serving only the Special Contract Customer, in which case the revenue

⁴⁰ Piliaris, Exh. JAP-65HCX at 14-15.

⁴¹ Piliaris, Exh. Exh. JAP-54T at 9:12; Piliaris, Tr. at 279:17-22.

⁴² Ball, Exh. JLB-8T at 3:7-9.

produced by the Contract would be sufficient.⁴³ The difference between fully allocated cost and incremental cost—and thus Staff’s interpretation and the Company’s interpretation—is significant.⁴⁴

20 The Commission should reject PSE’s “incremental cost” interpretation because, as Staff testified at hearing, “nothing . . . in the record or off the record or in [any data request responses]” supports PSE’s “incremental cost” interpretation.⁴⁵ The Company’s “incremental cost” interpretation fails for three reasons.

21 First, PSE’s “incremental cost” interpretation contradicts the plain language of the Special Contract. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

22 PSE’s application for approval of the Special Contract—which would have informed the Commission’s understanding of the Special Contract at the time of approval—also contradicts the Company’s “incremental cost” interpretation. [REDACTED]

[REDACTED]

⁴³ Piliaris, Tr. at 280:24-281:12; 286:12-25.

⁴⁴ See Piliaris, Tr. at 278:9-12.

⁴⁵ Ball, Tr. at 355:3-5; see generally 353:16-355:19.

⁴⁶ Piliaris, Exh. JAP-65HCX at 14.

[REDACTED]

[REDACTED]⁴⁷ Docket UG-940814 was a “cost of service case” that produced a fully allocated embedded cost of service study.⁴⁸ A special rate that reflects the incremental cost of providing transport service to only the Special Contract Customer would not track the fully allocated cost of providing transport service to customers throughout the system.

23 Moreover, PSE’s “incremental interpretation” finds no support in the plain language of the Special Contract because the words “incremental” and “marginal” do not appear anywhere in the Special Contract.⁴⁹ In contrast, the Special Contract explicitly establishes a price floor at the [REDACTED]

[REDACTED]

[REDACTED]⁵¹ Without any qualifier limiting its scope, the Special Contract plainly address the fully allocated costs of PSE’s gas system.

⁴⁷ Piliaris, Exh. JAP-65HCX at 53 (emphasis added).
⁴⁸ See *Wash. Utils. & Transp. Comm’n v. Wash. Natural Gas Co.*, Docket UG-940814, Fifth Supplemental Order (April 11, 1995).
⁴⁹ Piliaris, Exh. JAP-65HCX.
⁵⁰ Piliaris, Exh. JAP-65HCX at 6.
⁵¹ Piliaris, Exh. JAP-65HCX at 4 (emphasis added).

Second, PSE has never produced a cost of service study to support a rate based on the incremental cost of serving only the Special Contract Customer.⁵² Instead, PSE justified the Special Contract based on a [REDACTED]

[REDACTED]⁵³ At hearing Staff testified that, according to the Break-even Analysis, as long as the rate of return is below approximately 2 percent on a fully allocated basis, it is uneconomic for the Special Contract Customer to by-pass the Company's system.⁵⁴ It would be completely arbitrary and capricious to disregard the plain language in order to interpret the Special Contract to include rates based on incremental costs when the Company has never produced an incremental cost of service study to provide an evidentiary basis to justify an incremental cost based rate.

Finally, PSE, in this case, presented a "fully allocated embedded cost of service study" that identifies the costs the Company incurred to serve each customer class.⁵⁵ That cost of service study included the "Special Contracts" class,⁵⁶ which is comprised of only the Special Contract Customer.⁵⁷ Therefore, the Company's filing identified the Special Contract Customer as an integrated part of its total system, and it identified the costs of serving that customer on a fully allocated basis. This is consistent with how the Company always conducts its cost of service studies. But, it is inconsistent with how the Company has administered the Special Contract for at least the last decade, over which time the parity ratio has decline by approximately 40 percent.⁵⁸

⁵² Ball, Tr. at 354:3-12.

⁵³ Piliaris, Exh. JAP-65HCX at 61-65.

⁵⁴ Ball, Tr. at 357:20-25.

⁵⁵ See Piliaris, Exh. JAP-1T at 18:10-21.

⁵⁶ See Piliaris, Exh. JAP-1T at 4:9.

⁵⁷ Piliaris, Exh. JAP-65CX at 2.

⁵⁸ Piliaris, Exh. JAP-54T at 9:9-10:2.

4. PSE's failure to properly administer the Special Contract has harmed customers, but not shareholders.

26 Importantly, PSE's dramatic under recovery from the Special Contract Customer has not affected the Company's bottom line because the rest of its gas customers have made it whole. As Staff testifies:

Continuing to allow these customers to pay such drastically low rates is blatantly unfair to other customers, results in other classes subsidizing these customers, violates the principle of cost causation, [and] does not provide PSE with an economic incentive to negotiate favorable contracts.⁵⁹

This cross-subsidization has also enabled the Company to take a self-serving interpretive approach to its administration of the Special Contract in which it dramatically undercharges the Special Contract Customer and makes up the shortfall from all other customers, thereby not affecting its total revenues.

27 The Commission's statutory responsibilities require it to end the unauthorized and "blatantly unfair" subsidy of the Special Contract Customer that has been occurring for many years. Of note, Staff does not recommend that the Commission pursue penalties or refunds in this instance. Rather, Staff recommends that the Commission: (1) declare that the Special Contract is properly interpreted to include rates that are calculated based on the Company's fully allocated cost of service, not the incremental cost of serving only the Special Contract Customer; (2) order the Company to charge the Special Contract Customer according to the proper interpretation of the Special Contract; and (3) order PSE to impute revenues for the Special Contract class sufficient to achieve recovery of its fully allocated cost of service, including the authorized return on rate base allocated to serve the Special Contract Customer.

⁵⁹ Ball, Exh. JLB-8T at 4:1-4.

Imputing revenues for the Special Contract class sufficient to achieve its fully allocated cost of service will both correct a significant inequity that has been occurring for many years and establish an important policy precedent. As Staff testified: “Setting revenues at the class’ cost of service allows any shortfall (or excess) in the actual revenues from these customers to flow to shareholders while the general ratepayer population is held harmless.”⁶⁰ This proposal eliminates any cross-subsidization that exists between the Special Contract Customer and other ratepayers, and generally provides the parties negotiating special contracts the incentive to negotiate the best possible service terms that the market offers.⁶¹ In Staff’s view:

PSE should be encouraged and allowed to negotiate and compete for customers who do not wish to be served on a general tariff. PSE is in the best possible position to negotiate and serve these special contracts as well as to determine what a reasonable contribution to fixed costs may be. Allowing PSE to negotiate these contracts, and reap the rewards, provides PSE additional flexibility in how it manages and operates its utility service while holding other ratepayers harmless.⁶²

After the Commission declares the proper interpretation of the Special Contract and orders PSE to impute revenues for the Special Contract class sufficient to achieve its fully allocated cost of service, if the Special Contract Customer and PSE together wish to renegotiate the Special Contract, they are free to do so, and file for its approval with adequate support in accordance with WAC 480-80-143.

If the Commission declines to impute revenues for the Special Contract class sufficient to achieve its fully allocated cost of service, Staff alternatively recommends that the Commission, at a minimum, order a rate increase sufficient to achieve a two percent

⁶⁰ Ball, Exh. JLB-8T at 4:10-12.

⁶¹ Ball, Exh. JLB-8T at 4:12-16.

⁶² Ball, Exh. JLB-8T at 5:2-7.

return for the class. This recommendation would bring the contract into compliance with the spirit of WAC 480-80-143(5)(c). It would also fix the Special Contract rate at the approximate economic breakeven point for the Special Contract Customer to remain on PSE's system according to the By-pass Analysis that accompanied the Special Contract.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]⁶³

D. Residential Rate Design

30 Staff reviewed Commission precedent and undertook an extensive analysis of PSE's actual operations, usage, and customer data to evaluate PSE's residential rate design. Based on its analysis, Staff recommends that the Commission make several important changes to the Company's residential rate structure. For electric residential customers, Staff recommends that the Commission increase the basic charge, create a minimum bill to fully recover customer-related costs, and establish a two-block seasonal rate structure. For natural gas, Staff recommends that the Commission increase the basic charge as proposed by the Company. Making these changes to the Company's residential rate design will more effectively address and balance the goals of residential rate design.

⁶³ Piliaris, Exh. JAP-65HCX at 35.

1. Commission precedent establishes five goals for residential rate design.

31 Staff began its residential rate design analysis by reviewing Commission decisions that address residential rate design. Staff's review identified five goals that the Commission has articulated for the residential rate structure:⁶⁴

1. Appropriately reflect the cost of energy consumption during peak periods;⁶⁵
2. Send proper price signals about long-term portfolio supply costs;⁶⁶
3. Actively encourage conservation;⁶⁷
4. Allow the company some certainty of fixed cost recovery;⁶⁸ and
5. Minimize rate shock to individual customers.⁶⁹

While these goals are not necessarily in contradiction, they are challenging to balance.⁷⁰

2. PSE's electric residential rate structure does not adequately address the five goals of residential rate design.

32 In this case, PSE proposes to maintain its electric residential rate structure, which has two-blocks separated at 600 kWh, and it proposes to increase its basic charge from \$7.49 to 9.00.⁷¹ Staff found that this rate structure does not adequately address each of the five goals of residential rate design. Staff generally determined:

⁶⁴ Ball, Exh. JLB-1T at 17:3-11.

⁶⁵ *Wash. Utils. & Transp. Comm'n v. Wash. Nat'l Gas Comp.*, Dockets UE-940034 & UG-940814, Fifth Supplemental Order, at 5 (Apr. 1, 1995).

⁶⁶ *Wash. Utils. & Transp. Comm'n v. Wash. Water Power Comp.*, Docket UG-901459, Third Supplemental Order, at 5 (Mar. 9, 1992).

⁶⁷ *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-140188 and UG-140189, Order 05, ¶ 28 (Nov. 25, 2014).

⁶⁸ *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).

⁶⁹ *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049, Order 08, 124-25, ¶ 350 (May 7, 2012).

⁷⁰ Ball, Exh. JLB-1T at 17:12.

⁷¹ Piliaris, Exh. JAP-1T at 59:1-2 (Table 8, Two-Block Rate Structure); Ball, Exh JLB-1T at 17:16-18.

1. The current structure does not effectively reflect costs of peak usage because it does not delineate between seasons;
2. The current structure does not send proper price signals about long-term portfolio supply costs because the lack of seasonal variation does not reflect long-term portfolio supply costs, which are based on expected peak usage;
3. The current structure does not effectively encourage conservation because the lack of seasonal variation functions to decreased the conservation incentive during the higher-use winter period when it is most needed;
4. The low basic charge does not adequately provide the Company with certainty of fixed cost recovery because it reduces the amount of fixed monthly revenue the Company receives; and,
5. The current structure's low basic charge is so far below cost of service study results that increasing this charge to the appropriate level would have too large of a bill impact on the lowest-usage customers.⁷²

As discussed in greater detail below, Staff recommends that the Commission establish a higher basic charge and a minimum bill with a seasonal rate two-block structure for both summer (April – September) and Winter (October – March) to more effectively address and balance each of the residential rate design goals.

- a. **Residential rates should include a basic charge coupled with a minimum bill so that every customer is billed at least their total customer related costs.**

33

PSE and Staff agree that the basic charge should be set to recover the full level of customer related costs. When fixed customer-related expenses are not included in the basic

⁷² Ball, Exh. JLB-1T at 18:4-20.

charge they are recovered through the volumetric delivery charge, which results in higher-usage customers paying for the fixed costs of serving low-usage customers.⁷³ As Staff testified, “an inadequate basic charge establishes inappropriate price signals to customers because their rates reflect the costs of serving a different customer.”⁷⁴ Moreover, any cost included in the volumetric energy charge is automatically subject to decoupling, which increases the volatility of the decoupling mechanism.⁷⁵

34 In 1992, the Commission adopted the Basic Customer Method for establishing the basic charge, which recovers only the meter, service drop, and associated expenses. PSE and Staff agree that the Basic Customer Method should also include line transformers because they are customer dedicated facilities. Staff testified: “Line transformers are a customer dedicated facility that are required to provide service for each customer and they have more in common with meters than overall distribution plant.”⁷⁶ For residential customers, line transformers are not usage sensitive, exist regardless of whether any energy is consumed, and stand ready to serve when the customer “flips the switch.”⁷⁷ They are also directly related to the customer count because they are necessary for each customer to receive service from the distribution system.⁷⁸

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⁷³ Ball, Exh. JLB-1T at 24:15-18.

⁷⁴ Ball, Exh. JLB-1T at 25:1-3.

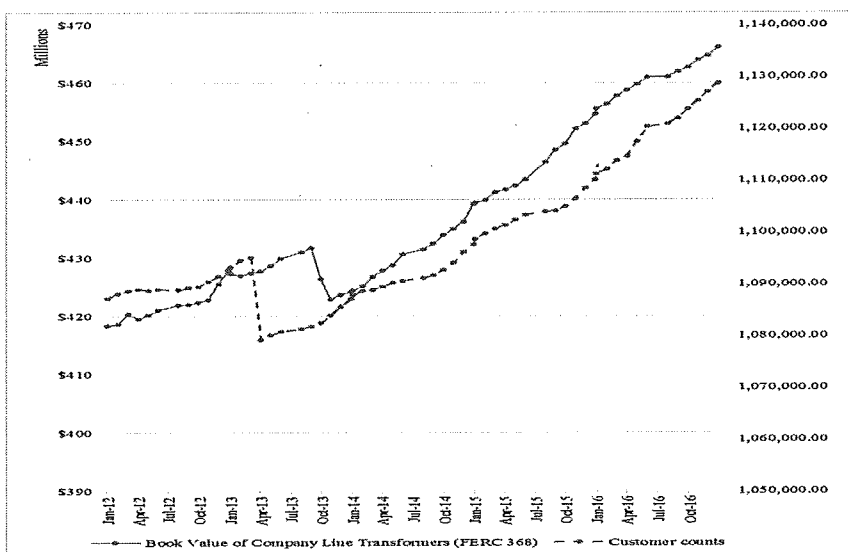
⁷⁵ Ball, Exh. JLB-1T at 30:6-8.

⁷⁶ Ball, Exh. JLB-1T at 26:2-4.

⁷⁷ Ball, Exh. JLB-1T at 26:10-11.

⁷⁸ Ball, Exh. JLB-1T at 26:12-27:2.

Comparison of Transformer Plant Balances with Customer Counts



35 While the basic charge should ideally be set to recover the full level of customer related costs, the bill impacts of a full basic charge increase are too high and affect too many customers.⁷⁹ Staff, therefore, recommends a basic charge coupled with a minimum bill such that every residential electric customer is billed at least their total customer related costs.

36 Staff recommends setting the basic charge to reflect the 35 kWh of minimum usage, which would result in the minimum bill affecting *only 1.15 percent* of all residential customers.⁸⁰ Importantly, 35 kWh is a small amount of energy, which is equivalent to four LED lightbulbs running 24 hours a day for a month.⁸¹ Customers that use this little energy are likely seasonal vacation homeowners, customers with significant alternative energy sources, distributed generation customers, or customers experiencing metering issues.⁸²

⁷⁹ Ball, Exh. JLB-1T at 30:12-14.

⁸⁰ Ball, Exh. JLB-1T at 29:4-9.

⁸¹ Ball, Exh. JLB-1T at 39:3-4.

⁸² Ball, Exh. JLB-1T at 38:4-7.

Importantly, even if a customer uses zero kilowatt-hours, that customer received a service by virtue of having access to any level of electricity at any time.⁸³

b. Seasonal rates provide a more accurate price signal that reflects the reality of customer behavior.

37 In addition to a minimum bill, Staff recommends a two-block seasonal rate structure for two seasons: summer (April – September) and winter (October – March). The first rate block for usage up to 600 kWh would remain the same throughout the entire year. The second rate block for usage in excess of 600 kWh would change between seasons based on the difference in average dollar per megawatt-hour costs between seasons.⁸⁴

38 Staff's seasonal rate structure more effectively addresses several residential rate design goals than the current rate structure because the seasonal rates reflect the actual costs difference between seasons. As a result, the seasonal rate structure serves to both reflect the cost of energy use during peak periods, and send proper price signals about long-term portfolio supply costs.⁸⁵ The seasonal rate also enhances the conservation incentive by maintaining higher volumetric rates in the second block while amplifying the conservation incentive during the time of the year when demand is higher, and thus, conservation is most needed.⁸⁶

39 Importantly, Staff's seasonal rate structure provides a price signal that reflects the reality of customer behavior. While customers value some sort of price signal when consuming electricity, they tend to respond to their total bill rather than the marginal price signal contained in the volumetric energy rate for two reasons. First, they do not know what

⁸³ Ball, Exh. JLB-1T at 39:1-2.

⁸⁴ Ball, Exh. JLB-1T at 32:12-16; Exh. JLB-4 provides a technical appendix with detailed calculations for these rates.

⁸⁵ Ball, Exh. JLB-1T at 32:15-21.

⁸⁶ Ball, Exh. JLB-1T at 31:1-5.

their usage or associated bill will be at the “point of sale”—i.e., when a decision is made to use electricity or not. Second, they are unable to apply a marginal rate in making a decision to engage in a specific use for electricity (e.g. turning on a light, leaving on a computer, increasing the temperature of a water heater, etc.) because few customers accurately understand the quantity of energy consumed by each electric device in their household.⁸⁷ Accordingly, a seasonal rate structure provides a more appropriate cost signal based on customers’ current behavior and the information currently available to them.

c. The objections to Staff’s electric rate design do not justify maintaining PSE’s current rate structure.

40

Several parties urge the Commission to reject Staff’s proposed rate design, but their arguments are unpersuasive. PSE generally agrees with the basis for Staff’s proposal, but it is hesitant to support Staff’s electric rate design due to practical considerations. Specifically, PSE agrees that transformers are customer-related costs, that rate design should reduce cross-subsidization, and it supports Staff’s attempt to better reflect cost-causation in concept; however, it argues that Staff’s rate structure would not create a significant enough change to outweigh the challenges of implementing and communicating the change to customers’ bills.⁸⁸ The Company’s practical concerns include the costs of an educational campaign that could offset some of the benefits of Staff’s proposal, the potential for an increase in customer calls, and the challenges of reforming its billing system. While Staff appreciates these challenges, they do not justify maintaining the current rate structure. Educating and engaging with customers is an opportunity that the Company should embrace, not shy away from. It is also a competency that PSE must better develop if it wishes to

⁸⁷ Ball, Exh. JLB-1T at 33:9-34:3.

⁸⁸ Piliaris, Exh. JAP-46CT at 42:1-10; 52:3-12.

embrace smart technologies. To work through the challenge of reforming its billing system, Staff recommends that the Company be allowed to implement the new rate structure at the beginning of the summer season.

41 Public Counsel expressed support for a residential seasonal rate structure in its response testimony:

[I]n the interest of sending pricing signals that are both cost-based and efficient in terms of resource conservation, the Commission may want to consider studying the establishment of seasonal rates for the Residential class. While I have not developed specific seasonal rates, I would envision a rate structure comprised of an inverted two-block summer rate and an inverted two-block winter rate wherein the winter tail-block rates are priced higher than the summer tail-block rates.⁸⁹

However, Public Counsel never responded to Staff's seasonal rate proposal in its cross-answering testimony; it merely expressed opposition to the minimum bill concept. Public Counsel's objection demonstrated its lack of understanding of how the minimum bill would function and its policy basis for its objection was unclear.⁹⁰

42 The Energy Project and the Environmental Coalition also each oppose Staff's residential rate structure, but provide no data to support their positions. Of note, The Energy Project opposes both a seasonal rate structure and a minimum bill while the Environmental Coalition only opposes the minimum bill—it never responded to the seasonal rate proposal. Their general concerns are that Staff's proposal would harm low-income customers and reduce customers' incentives to save energy. These concerns are unfounded for three reasons.

43 First, as a threshold matter, residential rate design should be based on actual residential customer data, not conjecture about low-income customers. Addressing the needs

⁸⁹ Watkins, Exh. GAW-1T at 62

⁹⁰ See Watkins, Exh. GAW-13T at 4:1-514.

of PSE's low-income customers is important, but their needs should be addressed by developing a robust low-income program, not through residential rate design. In this case, the Settling Parties did just that. The Settlement improves the structure and funding for PSE's low-income assistance programs by committing PSE's shareholders to provide a \$2 million one-time contribution to fund low-income weatherization projects in addition to its commitment to continue their annual \$100,000 contribution. The Settlement further provides for a consultation process between PSE, The Energy Project, and affected community action agencies regarding PSE's bill assistance and weatherization programs. In addition, PSE offers a Budget Billing Program that enables customers to avoid the highs of winter heating bills with fixed monthly payments on their bill year round.⁹¹

44 Second, The Energy Project and the Environmental Coalition objections are not supported by any data. Staff issued several data requests to PSE, Public Counsel, and The Energy Project for data regarding low-income customers and their energy usage regardless of their participation in an electric subsidy program; however, these parties provided virtually no information specific to PSE's service territory.⁹² Staff, nevertheless, cross-referenced billing information with median income in relevant billing zip-codes, and determined that its rate design proposal would only affect a small fraction of low-income customers that have a usage at or near zero kilowatt-hours per month.⁹³

45 The Energy Project and the Environmental Coalition did not even acknowledge Staff's low-income or bill impact analyses, let alone respond to them. Instead, the two parties offered speculative information about low-income customers that is not supported by

⁹¹ See Ball, Exh. JLB-1T at 34:18-35:13.

⁹² Ball, Exh. JLB-1T at 43:1-6.

⁹³ Ball, Exh. JLB-1T at 42:7-44:11.

any data. Both parties speculate that many low-volume customers are low-income.⁹⁴ Staff's minimum bill, however, is designed to only affect *1.15 percent* of all residential customers who use less than 35 kWh per month.⁹⁵ As Staff notes, these customers are likely seasonal vacation homeowners, customers with significant alternative energy sources, distributed generation customers, or customers experiencing metering issues.⁹⁶

46 The Energy Project also contradicts its testimony that many low-volume customers are disproportionately low-income. It testifies: “[low-income customers] have a higher energy burden . . . than the general residential customer population” as well as that “low-income electric customers receiving bill assistance have higher average usage in the winter months than residential customers.”⁹⁷ These statements are supported by PSE data: bill-assisted customers show a pattern of higher energy usage in winter months, suggesting higher space heating costs.⁹⁸ Therefore, Staff's proposal will actually benefit these customers because it serves to eliminate high-use customers' subsidization of low-use customers.

47 Finally, The Energy Project and the Environmental Coalition contend that Staff's rate design will reduce the conservation incentive; however, they conflate a minimum bill with an increased basic charge. They argue that higher fixed charges diminish the volumetric charge and thus reduce the conservation incentive. To the extent that this is true of a basic charge, it is not true of a minimum bill. A minimum bill maintains a higher volumetric charge than an equivalent basic charge would, and only applies if customers use so little energy that they do not meet the minimum bill through their volumetric rate.

⁹⁴ Collins, Exh. SMC-3T at 6:5-6; Levin, Exh. AML-13T at 4:5-6.

⁹⁵ Ball, Exh. JLB-1T at 39:3-4.

⁹⁶ Ball, Exh. JLB-1T at 38:4-7.

⁹⁷ Collins, Exh. SMC-3T at 3:17-19; 4:2-4 (citing Piliaris, Exh. JAP-29 at 64).

⁹⁸ Piliaris, Exh. JAP-29 at 64.

Moreover, their arguments completely ignore that Staff's seasonal rate enhances the conservation incentive by maintaining higher volumetric rates in the second block while amplifying the conservation incentive during the time of the year when demand is higher, and thus, conservation is most needed.⁹⁹

48 Ultimately, the Commission should reject the various objections to Staff's proposed rate design because they are either insufficient and/or unsupported. Staff reviewed Commission precedent and undertook an extensive analysis of PSE's actual operations, usage, and customer data to evaluate PSE's residential rate design. As a result of this analysis, Staff recommends that the Commission establish a higher basic charge and a minimum bill with a seasonal two-block structure for both summer (April – September) and winter (October – March) to more effectively address and balance each of the residential rate design goals.

III. DECOUPLING

49 Decoupling separates “a utility's recovery of costs and return from the amount of energy it sells.”¹⁰⁰ This helps remove a utility's throughput incentive and any disincentive to undertake greater conservation efforts.¹⁰¹ Through refunds or surcharges to customers, decoupling aids the customer when revenue per customer increases but aids the company when revenue per customer decreases.¹⁰² Essentially, decoupling does two things: it creates

⁹⁹ Ball, Exh. JLB-1T at 31:1-5.

¹⁰⁰ *In the Matter of the Wash. Utils. And Transp. Comm'n's Investigation into Energy Conservation Incentives, Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, To Encourage Utilities To Meet Or Exceed Their Conservation Targets*, Docket U-100522, 4, ¶ 7 (Nov. 4, 2010) (“2010 Decoupling Policy Statement”) (citing The National Association of Regulatory Utility Commissioners, Grant & Research Department, *Decoupling For Electric & Gas Utilities: Frequently Asked Questions (FAQ)*, at 2 (Sept. 2007).

¹⁰¹ *See Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-121697, UG-121705, UE-130137, and UG-130138, Order 07, 38, ¶ 85 (Jun. 25, 2013) (“2013 PSE Decoupling Order”).

¹⁰² *Id.*

revenue stability for the utility; and, it removes the utility's throughput incentive and in turn decreases any disincentive towards conservation.

50 PSE's decoupling mechanism has operated for nearly four years.¹⁰³ Currently, the decoupling mechanism includes only delivery revenues, but not fixed production costs.¹⁰⁴ PSE wants to continue its decoupling mechanism, but it proposes a number of changes that have been met with mixed responses from the Parties.

51 The Parties clamor loudly in opposition to many of the Company's proposed changes to its decoupling mechanism. Amidst this cacophony of opinions, Staff offers a calm voice of reason; finding that delicate balance between the Company's interests and those of its ratepayers, which Staff believes results in the most appropriate improvements to PSE's decoupling mechanism. While Staff recommends the Commission reject three of PSE's proposals and modify two others, Staff supports the Commission approving the other five of PSE's proposals.¹⁰⁵

52 Staff has taken thoughtful and reasonable positions on the issue of decoupling. In the multiparty settlement agreement in this case, the settling parties agreed to Staff's proposal for the treatment of fixed production costs in the decoupling mechanism, setting "the total Allowed Revenue for fixed production costs recovery per decoupled group at the level the Commission authorizes in this general rate proceeding."¹⁰⁶ Staff's position was the position of compromise in the middle of polar positions including the exclusion of fixed production costs from the decoupling mechanism altogether¹⁰⁷ (even in the event that decoupling

¹⁰³ 2013 PSE Decoupling Order at 95.

¹⁰⁴ Piliaris, Exh. JAP-1T at 107:6-7.

¹⁰⁵ Liu, Exh. JL-1CT at 29:5-7.

¹⁰⁶ Multiparty Settlement Agreement at 31, ¶ 113.

¹⁰⁷ See e.g. Higgins, Exh. KCH-1T at 15:1-3.

continued) and linking the recovery of fixed production costs in the decoupling mechanism to customer counts.¹⁰⁸ Similarly, the Commission should see the rest of Staff's recommendations for the balanced and reasonable positions that they are.

A. Decoupling Should Continue, But Should Not Be Permanent

53 Staff agrees with the Company that the decoupling mechanism should continue.¹⁰⁹ PSE's decoupling mechanism has been a success: the Company has achieved higher levels of conservation and has experienced revenue stability.¹¹⁰ PSE commits itself to continuing its conservation achievement of five percent above its biennial conservation target, or suffer the consequence of penalties.¹¹¹ Additionally, PSE proposes a natural gas conservation achievement of five percent above that contained in its integrated resource plan, coupled with a penalty for failure to meet this target.¹¹²

54 However, many parties believe that decoupling should cease. Mr. Gorman, witness for the Industrial Customers of Northwest Utilities ("ICNU"), argues that decoupling should be discontinued altogether.¹¹³ Mr. Al-Jabir, witness for the Federal Executive Agencies ("FEA"), also argues that decoupling should be discontinued.¹¹⁴ But if it continues, Mr. Al-Jabir argues that it should only be approved for a specified amount of time.¹¹⁵ Only one party, other than PSE, believes that it is appropriate to make decoupling permanent.¹¹⁶ But

¹⁰⁸ See Piliaris, Exh. JAP-1T at 128:16 - 129:7; Liu, Exh. JL-1CT at 48:1-21 and 51:11 - 53:8.

¹⁰⁹ Liu, Exh. JL-1CT at 27:7-8.

¹¹⁰ Liu, Exh. JL-1CT at 26:4 - 27:4.

¹¹¹ Piliaris, Exh. JAP-1T at 144:17-21.

¹¹² Piliaris, Exh. JAP-1T at 145:7-20.

¹¹³ Gorman, Exh. MPG-1T at 30:1-3; TR 255:24 - 256:1.

¹¹⁴ Al-Jabir, Exh. AZA-1T at 5:14-21; 17:19-23; TR 187:8-10.

¹¹⁵ Al-Jabir, Exh. AZA-1T at 15:4. This is consistent with Staff's recommendation that decoupling be approved for a specified amount of time.

¹¹⁶ The North West Energy Coalition ("NWECC"). TR 164:20-22.

even that party would find value in reevaluating parts of the decoupling mechanism after a specified amount of time.¹¹⁷

55 On the spectrum of opinions from ceasing decoupling to making decoupling permanent, Staff lies in the middle. Staff advocates that the Commission approve the continuation of PSE's decoupling mechanism, but should only approve it for four years. Staff's position is consistent with the Commission's guidance on decoupling.

56 In its 2010 Decoupling Policy Statement, the Commission stated that it:

[W]ill generally approve a full decoupling mechanism for the period required to achieve its objectives or until the filing of a utility's next general rate case. Under either circumstance, the burden is upon the utility to demonstrate the continued need for the mechanism.¹¹⁸

This limits the longevity of any decoupling mechanism to, at longest, the interval between rate cases, at which it must be reapproved by the Commission. The time period for decoupling could be shorter than the interval between rate cases: the Commission may approve decoupling for, e.g., four years and absent any intervening rate case the Commission's guidance would require reapproval within that four year time frame. Doing otherwise would result in a shifting of the burden to disprove the need for decoupling.

57 In this case, the Company initially argued for permanent decoupling – that the mechanism continue until the Company proposes that it cease.¹¹⁹ Consistent with this sentiment, it later argued that “Staff and other parties” could raise concerns and challenge the decoupling mechanism in PSE's “annual Schedule 142 decoupling true-up filings.”¹²⁰ This is an argument to shift the burden away from the Company, and is directly opposite of

¹¹⁷ Levin, Exh. AML-1T at 24:19-21; TR 164:23 - 165:5; TR 166:12-17.

¹¹⁸ 2010 Decoupling Policy Statement at 19, ¶ 28.

¹¹⁹ Piliaris, Exh. JAP-1T at 146:8-14.

¹²⁰ Piliaris Exh. JAP-46CT at 6:3-6.

the Commission's guidance that would require the utility to demonstrate the need for the continuation of decoupling. The Company's position would require Staff and other parties to prove decoupling should cease. This is antithetical to utility regulation, wherein the Company has the burden of proof.¹²¹

58 PSE faced near unanimous opposition to their proposal for a permanent decoupling mechanism, with only one other party in support.¹²² PSE, however, appears responsive to concerns and aware of its obligation to carry the burden of proof. In its rebuttal, the Company agreed that "the utility has the burden of proof in its rate filings before this Commission, including the continuation of PSE's decoupling mechanism."¹²³ It also agreed that it would "submit evidence in future rate case filings showing that its proposed decoupling mechanisms conform with the Commission's policy guidance."¹²⁴ It appears, then, that the Company agrees with Staff: if the Company agrees to conform to the Commission's policy guidance (like it has testified it will do), then it agrees that it must "demonstrate the continued need for the mechanism" going forward.¹²⁵ The Commission should accept PSE's willingness to comply with its guidance, and instruct PSE that its decoupling mechanism is approved, but only for a specified amount of time, at which point it will be the Company's burden to prove the need to continue the decoupling mechanism.

59 Staff recommends a time limit of four years, but it believes any time period within the range of three to five years is appropriate. This is consistent with the Commission's

¹²¹ See RCW 80.04.130(4).

¹²² NWECC. TR 164:20-22.

¹²³ Piliaris, Exh. JAP-46CT 5:10-12.

¹²⁴ *Id.* at 5:18-20.

¹²⁵ 2010 Decoupling Policy Statement at 19, ¶ 28.

guidance and offers symmetry of evaluation: the Company's current decoupling mechanism has been in effect for nearly four years, another evaluation within four years is appropriate.

60

The settling parties have agreed on the treatment of fixed production costs in the decoupling mechanism.¹²⁶ Staff supports the inclusion of these fixed production costs in the Company's decoupling mechanism, as it agreed in a recent settlement including PSE and Public Counsel.¹²⁷ The inclusion of fixed production costs would only apply, however, to those schedules for which decoupling will continue. For those schedules that Staff recommends discontinuing decoupling, fixed production costs of serving those schedules would, of course, not be included since there would be no applicable decoupling mechanism. Those fixed production costs would be recovered, as proposed by Staff, through an updated or modified rate structure.¹²⁸ Staff's recommendation to discontinue decoupling for certain schedules is explained below.

B. Remove Certain Schedules, Regroup The Others

61

In its 2010 Decoupling Policy Statement, the Commission provided guidance for when a utility's decoupling mechanism may exclude some customer classes. The Commission stated that

Generally, a full decoupling proposal should cover all customer classes. However, where in the public interest and not unlawfully discriminatory or preferential, the Commission will consider a proposal that would apply to fewer than all customer classes.¹²⁹

In this case, Staff believes it is in the public interest and is not unlawfully discriminatory or preferential to exclude certain schedules from the decoupling mechanism. Staff recommends

¹²⁶ Multiparty Settlement Agreement at 31, ¶ 113.

¹²⁷ *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-130583, UE-130617, UE-131099, UE-131230, Order 11, Appendix A: Settlement Stipulation, at 8, ¶ 9 (Aug. 7, 2015).

¹²⁸ See *supra* Section 2.

¹²⁹ 2010 Decoupling Policy Statement at 18, ¶ 28.

that the Commission discontinue the decoupling mechanism for large industrial and farm irrigation customer groups, specifically, electric Schedules 12/26, 10/31, 29, 35, 40, 43, 46 and 49, and natural gas Schedules 86/86T. PSE is the only party to voice opposition to Staff's recommendation,¹³⁰ while several parties have espoused support for Staff's proposal.¹³¹

62 In its initial filing, the Company proposed regrouping the schedules in the decoupling mechanism to split the non-residential group into three separate groups in order to address cost shifting among the schedules.¹³² Staff agrees that cost shifting, or cross subsidization, is a problem of the current decoupling mechanism that is occurring (in particular, in the non-residential decoupling group), but disagrees that the Company's proposal is sufficient to address cross subsidization as well as the other problems arising from including large industrial customers in decoupling.¹³³

63 Currently, all electric non-residential customers (except Schedules 12/26 and 10/31) are included in a single decoupling group.¹³⁴ The Commission has recognized that decoupling may not be suitable for these non-residential customers. In its 2013 PSE Decoupling Order, the Commission stated that

There undoubtedly is significant heterogeneity in the non-residential customer class. Members of this customer class have different—in some instances vastly different—levels of demand. Some non-residential customers have the capability to react nimbly to changed economic conditions, ratcheting their demand for power or gas up or down as general market conditions improve or deteriorate. Others have less flexibility. Some customers are more weather sensitive than others. Many non-residential customers undertake their own conservation efforts and are not even eligible to participate in Company conservation programs and initiatives. These

¹³⁰ Piliaris, Exh. JAP-46CT at 16:12 - 21:10; TR 296:18-22.

¹³¹ See *infra* notes 149 - 155 and accompanying text.

¹³² Piliaris, Exh. JAP-1T at 119:1 - 120:22; Liu, Exh. JL-1CT at 32:11-15.

¹³³ Liu, Exh. JL-1CT at 32:11-15.

¹³⁴ Liu, Exh. JL-1CT at 32:22-24.

factors raise questions about the suitability of decoupling that relies exclusively on average revenue per customer.¹³⁵

64 Ms. Liu, witness for Staff, confirms the heterogeneity of the non-residential customer class¹³⁶ and provides analysis explaining that decoupling does not add conservation value for large industrial and farm irrigation customers, does not provide rate stability or stop cross subsidization for these customers, and does not adequately recover fixed costs from these customers.¹³⁷ Decoupling actually disincentivizes conservation for these large customers. While these customers, in particular, are already motivated to conserve, the more they conserve the greater their decoupling surcharge will be the following year.¹³⁸ This is the opposite of decoupling's intended effect.

65 Both Mr. Al-Jabir and Mr. Higgins, witnesses for FEA and The Kroger Co. ("Kroger"), respectively, see eye to eye with Staff's assessment of the conservation disincentive that decoupling has on these large customers. Mr. Al-Jabir states that decoupling "penalizes customers for undertaking successful, voluntary energy efficiency efforts by increasing their distribution charges when their retail consumption levels decline between base rate cases."¹³⁹ Mr. Higgins reasons that when "customers reduce usage in response to economic conditions or otherwise practice self-funded energy conservation, these behaviors are captured in the decoupling adjustment and unduly increase rates to customers."¹⁴⁰

¹³⁵ 2013 PSE Decoupling Order at 56, ¶127.

¹³⁶ Liu, Exh. JL-1CT at 38:13-17, 40:8-10, and 41:10-13.

¹³⁷ Liu, Exh. JL-1CT at 35:16 - 36:4, 36:10 - 37:6; 38:19 - 40:8, and 40:17 - 41:16.

¹³⁸ Liu, Exh. JL-1CT at 36:20 - 37:6.

¹³⁹ Al-Jabir, Exh. AZA-1T at 7:3-5.

¹⁴⁰ Higgins, Exh. KCH-1T at 15:19-21.

These characteristics do not exist to the same extent for residential and small non-residential customers.¹⁴¹ So while residential and small non-residential customers receive benefits from the conservation incentive created by decoupling, large industrial and irrigation farm customers receive very little benefit, if any.¹⁴² It is in the public interest to remove disincentives to conservation and to avoid cross-subsidization within groups.

Additionally, Staff has explained how decoupling is not an adequate solution for fixed cost recovery from these large customers.¹⁴³ Ms. Liu's analysis shows that decoupling is not suited for large industrial and farm irrigation schedules with relatively few customers and a wide variation in usage.¹⁴⁴ Mr. Ball, Staff's witness for cost of service, rate spread, and rate design issues, conducted a detailed cost of service study and proposed a sizable increase on demand charges for Schedules 46 and 49 to address fixed cost recovery concern due to these customers' declining usage per customer.¹⁴⁵ These two proposals do not guarantee PSE's revenue because doing so would reduce the Company's incentives to achieve more cost efficiency, but they do work hand in hand to greatly reduce PSE's revenue volatility. Additionally, excluding these schedules from decoupling would not be unlawfully discriminatory: the rate design applicable to each of these schedules, including those that Staff proposes to modify, will recover the costs that would have been recovered through the decoupling mechanism. This is how Staff's decoupling recommendation complements and intricately relates to its rate structure recommendation. Taken together,

¹⁴¹ Liu, Exh. JL-1CT at 40:1-5.

¹⁴² Liu, Exh. JL-1CT at 36:12-17.

¹⁴³ Liu, Exh. JL-1CT at 40:17 - 41:16.

¹⁴⁴ Liu, Exh. JL-1CT at 41:9-16.

¹⁴⁵ Ball, Exh. JLB-1T at 54:3-10.

Staff's recommendations offer a better approach to fixed cost recovery than the current decoupling mechanism and rate structure.

68 With its analysis, Staff offers the evidentiary support and record that the Commission lacked when it issued its 2013 PSE Decoupling Order. In that order, the Commission stated:

It may be that there are alternatives for some, or all, non-residential customers that are better suited to meeting decoupling's goals than are the current decoupling mechanisms. The Commission remains open to hearing fully supported alternative proposals for fixed cost recovery from the non-residential class of customers, or subsets of the class.¹⁴⁶

Against these factors we consider what alternatives [to decoupling] the record supports. Including these customers in the decoupling mechanisms should better enable PSE to recover its fixed costs, but we have one example in the record of a utility for whom this theory did not prove out in practice. Generally, the Commission is receptive to changes in rate design that might better enable PSE to recover its fixed costs from non-residential customers by including in demand and customer rates more of the fixed costs of providing them service. These sorts of changes, however, should be supported by a detailed cost of service study and such other evidence as may be needed to protect both the company and its customers. We have no such evidence in the current record."¹⁴⁷

69 The Commission has the benefit in this rate case of detailed analysis and evidence regarding PSE's decoupling mechanism and cost of service, for which the Commission expressed some desire. The Commission should take this opportunity to use the full record in this case to craft a decoupling mechanism and rate design that will better suit the circumstances presented. Staff, therefore, recommends that the Commission discontinue the delivery decoupling mechanism on large industrial and farm irrigation customer groups: electric Schedules 12/26, 10/31, 29, 35, 40, 43, 46 and 49; and gas Schedules 86/86T.¹⁴⁸

¹⁴⁶ 2013 PSE Decoupling Order at 56-57, ¶129.

¹⁴⁷ 2013 PSE Decoupling Order at 56, ¶128.

¹⁴⁸ Liu, Exh. JL-1CT at 45:16-22.

Several other parties offer support for Staff's recommendation and rationale.

Mr. Higgins, witness for Kroger, finds Staff's rationale that "rate design is a better tool than revenue decoupling to address the concern of fixed cost recovery for large customers" persuasive and fully supports the recommendation to exclude Schedules 12/26, 10/3 1, 29, 35, 40, 46 and 49 from the decoupling mechanism.¹⁴⁹ Mr. Al-Jabir, witness for FEA, also agrees with Staff's recommendation to remove certain schedules from decoupling.¹⁵⁰ Mr. Al-Jabir argues – consistent with Staff's outlook on decoupling's unsuitability for fixed cost recovery from these large customers and its recommendation for rate design modifications – that fixed cost recovery is appropriate through a "demand charge or customer charge" for these large customers.¹⁵¹ Mr. Gorman, witness for ICNU, supports "Staff's proposal to exclude Schedules 46 and 49 from" decoupling and rate design recommendations, as a better approach to fixed cost recovery, but only as an alternative to his primary recommendation that decoupling be discontinued altogether.¹⁵² Mr. Gorman argues that this is better for both the Company and these large customers, explaining that "revenue stability can be accomplished through rate designs on those schedules,"¹⁵³ instead of through decoupling.¹⁵⁴ While Mr. Gorman's testimony focuses on Schedules 46 and 49, he also offered his opinion that decoupling may also not be necessary for the other schedules that Staff proposes be removed.¹⁵⁵

¹⁴⁹ Higgins, Exh. KCH-4T at 9:15-21.

¹⁵⁰ TR 186:16-18.

¹⁵¹ Al-Jabir, Exh. AZA-1T at 11:22 - 12:2.

¹⁵² Gorman, Exh. MPG-7Tr at 2:9-20.

¹⁵³ TR 257:20-24.

¹⁵⁴ Gorman, Exh. MPG-7Tr at 4:20 - 5:4.

¹⁵⁵ TR 257:25 - 258:6.

It is possible to remove schedules from the decoupling mechanism.¹⁵⁶ Once decoupling is discontinued for those schedules Staff recommends, an issue will remain as to how to fairly draw down the deferral balance for these formerly decoupled groups. The Company has received recommendations on how to do this.¹⁵⁷ The Company also has experience removing certain schedules from decoupling, having already excluded large natural gas customers on Schedules 85, 85T, 87 and 87T from decoupling for reason that their exclusion did not negatively affect the Company's conservation achievement.¹⁵⁸ These schedules were originally included in the decoupling mechanism (as of June 25, 2013) but were removed after reconsideration by the Commission (on December 12, 2013) after only six months.¹⁵⁹ PSE did not require specific guidance in how to exclude these schedules from decoupling then.¹⁶⁰ Now, Staff does not believe it would be difficult for PSE, with its expertise, to devise a reasonable procedure to remove certain schedules as it did when Schedules 85, 85T, 87, and 87T were removed from the decoupling mechanism. The Commission should order the Company to do so in this instance. Staff, as always, is willing to assist the Company in doing so, consistent with the Commission's order.

Finally, Staff recommends that the remaining electric decoupling groups comprised of small residential and non-residential customer groups continue to be included in decoupling, but be divided into three decoupling groups.¹⁶¹ Staff also recommends three

¹⁵⁶ See TR 308:4-7.

¹⁵⁷ See TR 304:16 - 308:3; Exh. JAP-60CX.

¹⁵⁸ Liu, Exh. JL-1CT at 35:8-11.

¹⁵⁹ See 2013 PSE Decoupling Order at 93, ¶ 237; *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-121697, UG-121705, UE-130137, & UG-130138, Order 09, at 32, ¶ 77, 33, ¶80 (Dec. 12, 2013) ("2013 PSE Reconsideration Order").

¹⁶⁰ See 2013 PSE Reconsideration Order at 32, ¶ 77, 33, ¶80.

¹⁶¹ Liu, Exh. JL-1CT at 30:18-20 and 45:16-22.

decoupling groups for natural gas.¹⁶² Staff recommends placing all of these remaining schedules – electric and natural gas – into separate, individual decoupling groups.¹⁶³ For electric, the first group would consist of Schedule 7, the second would consist of Schedules 8/24, and the third would consist of Schedules 7A, 11/25.¹⁶⁴ For natural gas, the first group would consist of Schedule 23, the second would consist of Schedule 31, and the third would consist of Schedule 41.¹⁶⁵ This regrouping will ensure that each group’s distinctive usage pattern is similar and better aligns responsibility with cost causation.¹⁶⁶ This regrouping will also address concerns for cross subsidization within decoupling groups, which was one of the primary concerns for PSE’s desire to regroup the schedules. Staff’s recommendations for regrouping take those of PSE and improves upon them to better serve the public interest.

C. A Five Percent Soft Cap Is Appropriate To Reduce And Prevent The Buildup Of Decoupling Deferral Balances

73 The decoupling rates calculation used by PSE includes a deferral element and a “K-factor” element.¹⁶⁷ PSE did not request a “K-factor” element, or rate plan, in this case. A decoupling deferral is the “difference between the Allowed Revenue and the Actual Revenue collected for decoupled schedules.”¹⁶⁸ This can be to the benefit of either ratepayers or the Company in any given year.

74 In the event that actual revenue collected exceeds the allowed revenue, ratepayers would see a reduced rate the following year. There is no limit to the amount that rates could

¹⁶² Liu, Exh. JL-1CT at 31:11-14.

¹⁶³ Liu, Exh. JL-1CT at 30:16 - 31:2 and 31:11-14.

¹⁶⁴ Liu, Exh. JL-1CT at 30:18-20.

¹⁶⁵ Liu, Exh. JL-1CT at 31:11-14.

¹⁶⁶ Liu, Exh. JL-1CT at 30:20 - 31:2 and 31:11-14.

¹⁶⁷ Liu, Exh. JL-1CT at 23:14-18.

¹⁶⁸ Liu, Exh. JL-1CT at 23:14-18.

be reduced.¹⁶⁹ In the opposite circumstance, where actual revenue falls below allowed revenue, ratepayers would see an increased rate the following year. The Commission limited the amount that this rate could increase from year to year in this circumstance to three percent.¹⁷⁰ This three percent is a “soft cap” because any deferral rate increase exceeding three percent would “carry over as a deferred balance and will be recoverable in the subsequent rate period subject” to the same soft cap limitation.¹⁷¹ While the soft cap functions to protect ratepayers from too large of a rate impact, it also allows the Company to recover any decoupling deferral in excess of the soft cap in subsequent rate periods. This is the balance that the Commission struck in approving the design of the soft cap (or “rate test,” as the Company refers to it in its initial filing¹⁷²).

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An unforeseen problem has arisen with the soft cap since the decoupling mechanism began: due to the three percent limitation of the soft cap, “significant deferred balances [] have accumulated for certain decoupling rate groups”¹⁷³ The Commission contemplated in its 2013 PSE Decoupling Order that these deferred balances would “be recoverable in the subsequent rate period,”¹⁷⁴ but the accumulation of deferred balances indicates that these balances have not been resolved within a single subsequent rate period and are creating rolling deferral balances. These rolling deferral balances need resolution for two reasons: they are inconsistent with decoupling; and, they create concerns for intergenerational inequity.

¹⁶⁹ 2013 PSE Decoupling Order at 11, ¶ 27.

¹⁷⁰ 2013 PSE Decoupling Order at 11, ¶ 27.

¹⁷¹ 2013 PSE Decoupling Order at 11, ¶ 27.

¹⁷² Piliaris, Exh. JAP-1T at 115:11 - 116:14.

¹⁷³ Piliaris, Exh. JAP-1T at 116:4-8.

¹⁷⁴ 2013 PSE Decoupling Order at 11, ¶ 27.

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In its Final Order in Docket UE-152253, the Commission addressed this same soft cap issue for Pacific Power & Light Company (“PacifiCorp”).¹⁷⁵ There, the Commission stated that

Setting the rate adjustment cap too low may result in a rolling and substantial deferral balance, which is inconsistent with the goals of decoupling. To mitigate against this possibility we adopt the Staff recommendation to limit the annual rate increase from decoupling adjustments to 5 percent for each decoupled rate class.¹⁷⁶

Here, in this rate case, we see the manifestation the problems the Commission speculated could arise.¹⁷⁷

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Intergenerational inequity occurs when future ratepayers are burdened with the cost of servicing current ratepayers or vice-a-versa.¹⁷⁸ Intergenerational inequity would occur in this case if the current deferral balances are allowed to carry forward into the future as to burden future ratepayers with balances owed to the Company for servicing current ratepayers.¹⁷⁹ Mr. Piliaris, witness for PSE, acknowledged the need for a balanced approach to reasonably address concerns for increasing deferrals and the possibility of intergenerational inequity.¹⁸⁰

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Staff advocates for that balanced approach, consistent with the purpose of decoupling, to resolve these issues. Staff supports PSE’s proposal to increase the soft cap

¹⁷⁵ *Wash. Utils. & Transp. Comm’n v. Pacific Power & Light Co.*, Docket UE-152253, Order 12 (Sept. 1, 2016) (“2016 PacifiCorp Order”).

¹⁷⁶ 2016 PacifiCorp Order at 46, ¶ 131.

¹⁷⁷ Piliaris, Exh. JAP-1T at 116:1-16; *see* Doyle, Exh. DAD-3.

¹⁷⁸ 2016 PacifiCorp Order at 19, ¶ 53.

¹⁷⁹ *See* Liu, Exh. JL-1CT at 64:9-15.

¹⁸⁰ TR at 325:19 - 326:4.

from three to five percent for all decoupled rate classes.¹⁸¹ Doing so is also consistent with the five percent soft cap recently approved for PacifiCorp.¹⁸²

79 Increasing the soft cap from three to five percent does not introduce a price spike or cause rate shock.¹⁸³ Rather, it prevents deferral balances from snowballing. PSE’s proposal will balance the ratepayers’ need for a limitation upon the increase that they could potentially incur with the needs to allow near-term recovery of these amounts and prevent intergenerational inequity from snowballing deferral balances. With the introduction of fixed production costs into the decoupling mechanism, rolling deferral balances will only become more of a concern if the soft cap is not raised because fixed production costs “will almost double the allowed revenue recovered through the electric [decoupling] mechanism.”¹⁸⁴

80 The evidence supports an increase of the soft cap for all decoupled customers. The evidence presented should be interpreted to show the principle that a three percent soft cap is insufficient at this time, for this company. PSE has presented ample evidence for the Commission to determine that a three percent soft cap is unable, in this circumstance, to allow near-term recovery and guard against intergenerational inequity. This can be seen in the evidence provided by PSE regarding its natural gas residential customers.¹⁸⁵ The Commission need not place its head in the sand and ignore the general applicability of this evidence to the overarching concerns of rolling deferral balances. These concerns are not limited to one decoupled group or the other, they are presented to all. Instead, the Commission can – and should – exercise its knowledge and expertise in assessing the causes

¹⁸¹ Liu, JL-1CT at 64:2.

¹⁸² See 2016 PacifiCorp Order at 46, ¶ 131.

¹⁸³ Liu, Exh. JL-1CT 64:13-16.

¹⁸⁴ Piliaris, Exh. JAP-1T at 136:1-19.

¹⁸⁵ Piliaris, Exh. JAP-1T at 116:1-16; see Doyle, Exh. DAD-3.

of the deferral balance problem currently presented and approve PSE's proposal to proactively prevent any such problem from arising with other decoupling groups.

81 Lastly, decoupling is not single-issue ratemaking and increasing the soft cap to five percent will not result in single issue ratemaking. The Commission has long denounced single-issue ratemaking. In 1997, it explained that

The Commission generally will not engage in single issue or "piecemeal" ratemaking. The ultimate determination to be made by the Commission in a rate proceeding is whether the proposed rates and charges are fair, just, reasonable, and sufficient. The Commission has consistently held that these questions are resolved by a comprehensive review of the company's rate base and operating expenses, determining a proper rate of return, and allocating rate changes equitably among ratepayers.¹⁸⁶

Here, in PSE's general rate case, the Commission will make its determination as to what rates are fair, just reasonable, and sufficient. The Commission is faced with dozens of issues to consider, including PSE's rate base and operating expenses, rate of return, cost of service, and decoupling.¹⁸⁷ Decoupling is only one of those many issues. It is not possible, therefore, for decoupling to be single-issue ratemaking, given the context of its presentation during a general rate case. Additionally, decoupling does not set the revenue that a utility is allowed to recover, decoupling is instead focused on *how* the utility recovers the allowed revenue approved by the Commission in a general rate case.

82 The proposal to increase the soft cap from three to five percent should be viewed as an element of decoupling that describes *how* PSE is allowed to recover the allowed revenue as determined by the Commission in this general rate case. This increase will not change the allowed revenue that the Commission sets as a result of its consideration in this case, it will

¹⁸⁶ *MCI Telecommunications Corp. v. GTE Northwest, Inc.*, Docket UT-970653, 2nd Supp. Order, 6 (Oct. 22, 1997) (internal citations omitted).

¹⁸⁷ Some of these issues have been presented within the Multiparty Partial Settlement, which the Commission has before it for consideration.

only affect the timing of the recovery.¹⁸⁸ The deferral balance can be understood as an amount owed by ratepayers to the Company – an increase to the soft cap merely changes the means to recoup that amount. The soft cap increase will permit PSE to recover its allowed revenue while addressing concerns for increasing deferral balances and intergenerational inequity. Staff supports increasing the soft cap to address these concerns.

D. Earnings Sharing Modifications Should Be Rejected

83 The Company makes a number of proposals to adjust the earnings sharing, including the creation of a twenty-five basis point dead band prior to any sharing with ratepayers and also the removal of all normalizing adjustments in the earnings sharing mechanism. Staff recommends that the Commission reject both of these proposals.

84 In its 2013 PSE Decoupling Order, the Commission addressed the same proposal as PSE puts forward now, regarding a twenty-five basis point dead band prior to sharing. In its order, the Commission described it as follows:

PSE proposes that if the Company earns more than 25 basis points (*i.e.*, 0.25 percent) above its overall authorized return of 7.8 percent (*i.e.*, 8.05 percent), it will return one-half of the excess revenue collected in rates to ratepayers. We modify this in our Order by requiring that the 50/50 sharing with ratepayers begin at the point PSE exceeds its authorized return by any amount.¹⁸⁹

The Commission should, again, summarily reject PSE's re-proposal to include a twenty-five basis point dead band in the earnings sharing mechanism. The cost of capital issues, including return on equity and authorized return, are included in the multiparty settlement in this case.¹⁹⁰ As Staff testifies, the return on equity and authorized return that the Commission will ultimately determine in this rate case will sufficiently compensate the

¹⁸⁸ Liu, Exh. JL-1CT at 64:6-7.

¹⁸⁹ 2013 PSE Decoupling Order at 10-11, ¶ 26.

¹⁹⁰ Multiparty Settlement Agreement at 3, ¶¶ 7 - 10.

Company, an additional dead band within which the Company keeps all of the excess earnings is unnecessary, especially in light of the multiparty settlement's proposed return on equity of 9.50 percent and authorized rate of return of 7.60 percent.¹⁹¹ The status quo of sharing between the Company and ratepayers maintains the incentive for the Company to strive for excess earnings, but is fair to ratepayers by allowing an immediate 50/50 sharing in excess earnings.

85 The Commission should also reject the Company's proposal to remove all normalizing adjustments from the earnings sharing mechanism.¹⁹² The foundations of the earnings sharing mechanism are the Commission Basis Reports ("CBRs").¹⁹³ The CBRs use normalizing adjustments. The Commission recognized this critical link between the CBR and the earnings sharing mechanism when it approved decoupling for the Company and established the guidelines for the earnings sharing mechanism, stating:

The Commission Basis Report provides PSE's actual and restated results of operations, including operating revenues, rate base, net operating income and restating adjustments and is the foundation for the earnings sharing mechanism that is proposed to provide balanced and appropriate safeguards against excessive overearning during the stay-out period.¹⁹⁴

Removing the normalizing adjustments from the earnings sharing mechanism would disassociate this mechanism from the CBRs, such that the Commission could no longer have confidence that the earnings sharing mechanism was actually providing ratepayers with any share of excess earnings.¹⁹⁵ This proposal must, therefore, be rejected.

¹⁹¹ Liu, Exh. JL-1CT at 60:5 - 61:4; Multiparty Settlement Agreement at 3, ¶ 10.

¹⁹² Doyle, Exh. DAD-1T at 20:16-18.

¹⁹³ See 2013 PSE Decoupling Order at 89, ¶ 213.

¹⁹⁴ 2013 PSE Decoupling Order at 89, ¶ 213.

¹⁹⁵ Liu, Exh. JL-1CT at 59:2-11.

IV. ELECTRIC COST RECOVERY MECHANISM (ECRM)

A. The Overview: Staff opposes PSE's ECRM because such a mechanism is unnecessary and unreasonable.

86 Staff witness Mr. Schooley testified that rate cases are about reasonable outcomes.¹⁹⁶ From Staff's perspective, PSE's proposed Electric Cost Recovery Mechanism (ECRM) is not a reasonable outcome. The ECRM replaces traditional ratemaking with what Staff sees as a flawed and unnecessary process. First, the proposed ECRM review process is flawed because Staff does not have the internal expertise to substantively review distribution-related engineering plans.¹⁹⁷ Without that necessary expertise, the Company's suggested review process would have little functional value and serve more or less as a preapproval.¹⁹⁸ Second, the ECRM seems unnecessary because PSE's testimony lacks an overriding public safety concern or some other unique justification to move away from traditional ratemaking.¹⁹⁹ PSE's witnesses note numerous times that the ECRM is focused on the Company's ability to meet obligations to provide reliable service rather than address any specific, impending public safety concern.²⁰⁰ PSE also acknowledged the Company has control over the internal scoring system and capital allocation for distribution system improvements.²⁰¹ Therefore, Staff's conclusion is that the ECRM departs from traditional ratemaking in exchange for incenting PSE to do something the Company is already statutorily obligated to do and over which the Company has complete control.²⁰² Traditional

¹⁹⁶ Schooley, Exh. TES-1T at 10:14-15

¹⁹⁷ Schooley, Exh. TES-1T at 27:11-13

¹⁹⁸ Schooley, Exh. TES-1T at 27:13-15.

¹⁹⁹ Schooley, Exh. TES-1T at 26:10-17. *See also* Gilbertson, Exh. BKG-1T at 34 *and* Koch, CAK-1CT.

²⁰⁰ *E.g.*, Gilbertson, Exh. BKG-1T at 34; Koch, Exh. CAK-1CT at 2-3. *See also* Schooley, TES-1T at 26:15-17.

²⁰¹ Koch TR. 220:18 – 226:11 (questioning from the bench during August 30, 2013, evidentiary hearing)

²⁰² Schooley, Exh. TES-1T at 27:17-28:6.

ratemaking is the better, more reasonable practice.²⁰³ Staff thus recommends the Commission reject the ECRM proposal.

B. The Relevant History of Cost Recovery Mechanisms (CRM) and the Gas CRM.

87 Cost recovery mechanisms and trackers are a common tool in the Commission's regulatory toolbox. In recent years, the Commission has approved pass through cost recovery mechanisms for power and natural gas costs.²⁰⁴ The Commission also initiated and approved a cost recovery mechanism for the accelerated replacement of gas pipeline facilities with elevated risk, more commonly known as the Gas CRM.²⁰⁵

88 The Gas CRM has its roots in another PSE case, Docket UG-110723.²⁰⁶ In that case, PSE proposed a Pipeline Integrity Program to inspect and replace older, riskier pipeline assets.²⁰⁷ That program included financial incentives for accelerated cost recovery.²⁰⁸ The Commission rejected PSE's proposed Pipeline Integrity Program and initiated an investigation for the purpose of determining whether gas companies should be required to improve the safety of natural gas distribution systems.²⁰⁹ The Commission then issued a policy statement inviting gas companies to submit a pipeline replacement program and accompanying cost recovery mechanism subject to certain terms and conditions.²¹⁰

²⁰³ Schooley, Exh. TES-1T at 28:14-18.

²⁰⁴ *E.g.*, *Wash. Utils. & Transp. Comm'n. v. Puget Sound Energy, Inc.*, Dockets UE-011570/UG-011571, Twelfth Supp. Order (2002) (authorizing the Power Cost Only Rate Case or PCORC and Power Cost Adjustment or PCA); *Wash. Utils. & Transp. Comm'n. v. Avista Corp.*, Docket UE-011595, Fifth Supp. Order (June 18, 2002) (authorizing the Energy Recovery Mechanism or ERM);

²⁰⁵ For PSE, the Commission approved the first gas pipeline replacement program (PRP) in 2013, but approved the first Gas CRM in 2014. *In the Matter of Puget Sound Energy, Inc.'s Pipe Replacement Program*, Docket PG-131839, Order 01 (Oct. 30, 2013) and Docket UG-141212 (Gas CRM approved as a consent agenda item in the Oct. 30, 2014 Open Meeting).

²⁰⁶ *See Wash. Utils. & Transp. Comm'n. v. Puget Sound Energy, Inc.*, Docket UG-110723. Order 07 (May 18, 2012).

²⁰⁷ *Id.*

²⁰⁸ *Id.*

²⁰⁹ *Id.*

²¹⁰ *In the Matter of the Policy of the Washington Utilities and Transportation Commission Related to Replacing Pipeline Facilities with an Elevated Risk of Failure*, Docket UG-120715, Commission Policy on

In this case, the Company argues that the proposed ECRM is analogous to the now-approved Gas CRM.²¹¹ As Mr. Schooley testified, the Company's analogy overlooks two key features of the Gas CRM that do not exist for the proposed ECRM. First, public safety concerns were a central reason for the Commission's guidance on Gas CRMs, and, second, the Commission itself has internal experts capable of reviewing gas pipeline engineering plans and specifications. Neither of those conditions exist for PSE's proposed ECRM.

1. Public Safety was an important reason for the Commission's approval of Gas CRMs

The Commission's policy statement is clear that public safety is a primary reason for the Pipeline Replacement Program (PRP) and associated Gas CRM. First, the document is titled as "Commission Policy on Accelerated Replacement of Pipeline Facilities with Elevated Risk."²¹² Next, one of the goals of the Commission's investigation was an understanding of the pipes in service and replacing those pipes for the purpose of enhancing safety.²¹³ The policy statement also walks through the safety of pipeline infrastructure, discussing then-recent accidents tied to pipe failures, and the federal and state regulatory responses to those incidents.²¹⁴

The policy statement goes on to identify types of elevated risk pipelines and their prevalence in Washington state.²¹⁵ The Commission did acknowledge that Washington state's gas infrastructure is relatively modern and regulated gas utilities had very little of the

Accelerated Replacement of Pipeline Facilities with Elevated Risk (Dec. 31, 2012) ("Commission Policy Statement").

²¹¹ Koch, Exh. CAK-1CT at 1:20-2:1. *See also* Koch TR. at 195:23-25, at 197-205 *and* Barnard TR. at 241, at 246-249, (comparing the proposed ECRM to the Gas CRM multiple times)

²¹² Commission Policy Statement, Docket UG-120715.

²¹³ Commission Policy Statement, Docket UG-120715 at 4 ¶14.

²¹⁴ Commission Policy Statement, Docket UG-120715 at 5-6.

²¹⁵ Commission Policy Statement, Docket UG-120715 at 6-8.

highest risk and dangerous pipe in service.²¹⁶ As a result, the Commission's policy statement chose the term "elevated risk" rather than "high risk" gas infrastructure.²¹⁷ The underlying emphasis on safety, however, was clear.²¹⁸

2. Commission has the necessary in-house expertise to conduct substantive review for the Gas CRM, but no equivalent group exists for an ECRM.

92 The Pipeline Replacement Program and Gas CRM review processes rely heavily on the Commission's in-house Pipeline Safety experts. The Commission's 2012 Policy Statement requires gas companies to list technical details such as the particular type of pipe, physical qualities of the manufactured pipe, pipe conditions relative to other pipe, and analysis and explanations for the degree to which a certain pipe or type of pipe has an elevated risk.²¹⁹ The Commission also highlighted the importance of data associated with a gas company's Distribution and Transmission Integrity Management Plans (DIMPs and TIMPs).²²⁰

93 In practice, the Commission's pipeline engineering staff conduct the review of pipeline replacement plans and associated technical details.²²¹ Commission pipeline engineers have reviewed both of PSE's completed pipeline replacement plans since 2012 and recommended approval at open meetings before the Commission in both instances.²²²

²¹⁶ Commission Policy Statement, Docket UG-120715 at 6 ¶20.

²¹⁷ Commission Policy Statement, Docket UG-120715 at 6 ¶21.

²¹⁸ See Commission Policy Statement, Docket UG-120715 at 13 ¶51 ("a gas company's failure to know where elevated risk pipe is located may itself present a safety risk."); and at 14 ¶54 (emphasizing the importance of prioritizing replacement by safety impact - "gas company should replace pipe located near a school, hospital or in a heavily populated area before it replaces pipe located in a sparsely populated area.")

²¹⁹ Commission Policy Statement, Docket UG-120715 at 12 ¶¶45-46.

²²⁰ Commission Policy Statement, Docket UG-120715 at 12 ¶47.

²²¹ See *In the Matter of Puget Sound Energy's Pipe Replacement Program Plan*, Docket PG-131839, Open Meeting Memo, (Oct. 30, 2013); *In the Matter of Puget Sound Energy's Pipe Replacement Program Plan*, Docket PG-160294, Open Meeting Memo, (April 7, 2016). The Commission also issued orders (Order 01) in both of the above dockets discussing and the recommendations contained in the Open Meeting Memos.

²²² See *In the Matter of Puget Sound Energy's Pipe Replacement Program Plan*, Docket PG-131839, Open Meeting Memo, (Oct. 30, 2013); *In the Matter of Puget Sound Energy's Pipe Replacement Program Plan*,

Members of the Pipeline Safety division also attested to auditing the DIMPs and TIMPs for accuracy in both 2013 and 2016.²²³ The Commission's Regulatory Services Division's role is limited to verifying that the Company's subsequent Gas CRM tariff filing only includes costs of those previously-approved pipeline replacement plans.²²⁴

C. Staff favors traditional ratemaking over the proposed ECRM because the ECRM would lead to preapproval and unnecessary accelerated recovery.

1. The ECRM would functionally become preapproval for certain distribution-related investments.

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Mr. Schooley agrees with the Company's statement that the ECRM is functionally similar to the Gas CRM currently in place, but he focuses on those very important distinctions between the ECRM and the Gas CRM.²²⁵ First, the Commission has a natural gas safety section staffed with pipeline engineers to review the Gas CRM filings, but there is no equivalent group at the Commission to review the proposed ECRM investments.²²⁶ As noted above, the Commission's pipeline safety engineers play an integral role in the Pipeline Replacement Program. Absent that expertise for electric operations, the ECRM would functionally become a preapproval.²²⁷ Functional preapproval results because, in practice, PSE's electrical system engineers would be asking Staff accountants and economists to review and respond to distribution-related engineering plans.

Docket PG-160294, Open Meeting Memo, (April 7, 2016). The Commission also issued orders (Order 01) in both of the above dockets discussing and the recommendations contained in the Open Meeting Memos.

²²³ *In the Matter of Puget Sound Energy's Pipe Replacement Program Plan*, Docket PG-131839, Open Meeting Memo, (Oct. 30, 2013); *In the Matter of Puget Sound Energy's Pipe Replacement Program Plan*, Docket PG-160294, Open Meeting Memo, (April 7, 2016).

²²⁴ Docket UG-141212; Docket UG-151159; and Docket UG-160791 (approving or updating Schedule 149 Gas CRM costs as consent or no action items in an open meeting)

²²⁵ *Compare* Koch, Exh. CAK 1-CT at 1:20 ("the mechanism, which will closely follow the structure endorsed in the Commission Policy on Accelerated Replacement of Pipeline Facilities with Elevated Risk") and Schooley, Exh. TES-1T at 26:10-17 (explaining substantive difference between the proposed ECRM and approved Gas CRM).

²²⁶ Schooley, Exh. TES-1T at 27:11-13.

²²⁷ Schooley, Exh. TES-1T at 27:13-15.

2. The ECRM is unnecessary because PSE has not identified a public safety concern or some other pressing justification for alternative ratemaking.

95 Second, Mr. Schooley opposes the ECRM because it is unnecessary.²²⁸ As Mr. Schooley points out, the proposed ECRM is a reliability plan and not a response to public safety concerns.²²⁹ The Company also largely presents the ECRM as a reliability plan.²³⁰ PSE's stated objective in the ECRM would be to replace high molecular weight underground cable and improve the worst performing circuits to reduce the number and duration of power outages.²³¹ PSE witness Ms. Koch does include a paragraph at the end of her direct testimony generally tying public safety to reliable power supply.²³² Ms. Koch briefly points out that important infrastructure such as cellular networks, fuel pumps, banking systems, home and business climate control, lighting and security systems, and private wells all rely on electricity.²³³ PSE does not, however, present evidence that such critical infrastructure will face widespread failure without the proposed ECRM. Indeed, most of the evidence in the record suggests just the opposite.

96 PSE's testimony and exhibits show that the ECRM-targeted improvements relate to lightly-populated residential circuits²³⁴ and underground cable the Company is already in the process of replacing.²³⁵ Ms. Koch's testimony describes the worst performing circuits as heavily treed, long, and having lower numbers of customers.²³⁶

²²⁸ Schooley, Exh. TES-1T at 27:10.

²²⁹ Schooley, Exh. TES-1T at 26:15-17.

²³⁰ See, e.g., Gilbertson, Exh. BKG-1T at 34; Koch, Exh. CAK-1CT at 1-2.

²³¹ Koch, Exh. CAK-1CT at 2:18-3:3.

²³² Koch, Exh. CAK-1CT at 19:13-21.

²³³ Koch, Exh. CAK-1CT at 19:13-21.

²³⁴ Koch, Exh. CAK-1CT at 4:12-14; Koch TR. 211:16-23.

²³⁵ Koch, Exh. CAK-1CT at 4:11-14; Koch TR. 220:4-10; Doyle TR: 173:9-11.

²³⁶ Koch, Exh. CAK-1CT at 4:12-14; Koch TR. 211:16-23

The Company's testimony about the HMV cable also does not describe a pressing public safety concern. Mr. Doyle and Ms. Koch each point out that PSE has been addressing the ECRM-related cables for several decades.²³⁷ The Company has replaced about 60 percent of the problematic cable in that time.²³⁸ The basic fact that the Company has chosen to address these issues over such a long period of time suggests, as Mr. Schooley says, that there is no material, identifiable safety risk in relation to PSE's provision of electric service.²³⁹ Staff simply does not understand how the last 40 percent of bad cable could be a safety issue that merits alternative ratemaking when the first 60 percent was not and did not. Therefore, PSE did not provide any public safety or other pressing justification to depart from traditional ratemaking processes.

3. The ECRM is unnecessary because the Company already controls capital allocation for distribution-related investment and can re-prioritize certain projects at any time.

Lastly, the evidentiary record is clear that PSE controls the process by which the Company allocates capital to different projects. Mr. Schooley naturally questions why the Company needs an accelerated recovery incentive to direct a process that PSE's management already controls.²⁴⁰ The Company's responses seem to be that such an incentive with additional capital would speed up repair work and moderately improve reliability in lesser-populated areas of PSE's service territory.²⁴¹ As Mr. Schooley explains, however, the Company already has an obligation to provide safe and reliable service to all

²³⁷ Koch, Exh. CAK-1CT at 4:11-14; Koch TR. 220:4-10; Doyle TR: 173:9-11.

²³⁸ Koch, Exh. CAK-1CT at 4:11-14; Koch TR. 220:4-10; Doyle TR: 173:9-11.

²³⁹ Schooley, Exh. TES-1T at 26:15-17.

²⁴⁰ Schooley, Exh. TES-1T at 27:17-28:6.

²⁴¹ See Koch, Exh. CAK-1CT at 4-7.

customers and the traditional ratemaking process already offers sufficient returns for PSE's prudent investments.²⁴²

99 The Company's witnesses explained that PSE allocates capital based on an internal financial optimization tool.²⁴³ Between upper management's allocation of available capital and the engineering team's evaluation of needed investment, the Company controls the entirety of the optimization process.²⁴⁴ The Company's financial priorities mean that PSE effectively chooses not to fix the specific problems of the ECRM-targeted underground circuits and worst performing circuits. What is clear, is that the obligation to provide reliable service applies to all customers, not just to the customers in financially-optimized, dense suburban areas. PSE thus retains authority to re-prioritize HVM replacement and the worst performing circuits with or without the ECRM.²⁴⁵ As Mr. Schooley explains, the Company's work plans are wholly within management's control and there is no reason to provide an incentive for such a process that PSE can control and can choose to meet the utility's public service goals at the Company's discretion.²⁴⁶ Of course, if PSE were to choose to violate its public service obligations, this raises a wholly different specter worthy of Commission attention.

D. Summary of Staff's Recommendation for Rejection of the ECRM

100 An ECRM that allows PSE to accelerate recovery does not serve the public interest and is unnecessary. The existing ratemaking process already provides an obligation to serve with the opportunity for sufficient returns.²⁴⁷ In the Gas CRM, the Commission deviated

²⁴² Schooley, TES-1T at 28:3-6.

²⁴³ *E.g.*, Koch TR. at 210-11, Koch, Exh. CAK-1CT at 4:12.

²⁴⁴ Koch TR. at 220-221.

²⁴⁵ Koch TR. at 223:19-25.

²⁴⁶ Schooley, Exh. TES-1T at 28:2-6.

²⁴⁷ Schooley, Exh. TES-1T at 28:2-6.

from traditional ratemaking because of public safety concerns and the availability of a legitimate review process to ensure the filings carried out clearly-stated and defined Commission policies. As Mr. Schooley makes clear, neither of those conditions exist for the ECRM. As Mr. Schooley also explains, the Company controls the capital allocation process and does not need an economic incentive to manage that process beyond what traditional ratemaking provides. Commission Staff recommends the Commission maintain the traditional ratemaking process and reject the Company's ECRM proposal.

V. CONCLUSION

101 Staff's theme in this case is reasonableness. Staff supports the multiparty settlement because it is a fair and reasonable outcome for the majority of issues in this case. Reasonableness is also the motivation behind Staff's recommendations for rate spread and rate design, decoupling, and the ECRM. On the bases of fairness and reasonableness explained above, Staff recommends the Commission:

1. Adopt the settlement agreement,
2. Accept Staff's cost of service and rate design proposals,
3. Enforce the relevant rules and special contract terms for the special contract class of natural gas customers,
4. Adopt Staff's proposed decoupling mechanism, and

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5. Reject the Company's ECRM proposal.

DATED this 18th day of October 2017.

Respectfully submitted,

ROBERT W. FERGUSON
Attorney General

A handwritten signature in black ink, appearing to read "Brett P. Shearer", is written over a horizontal line. The signature is stylized and cursive.

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