EXH. KRR-1T
DOCKETS UE-190529/UG-190530
UE-190274/UG-190275
2019 PSE GENERAL RATE CASE
WITNESS: KARL R. RÁBAGO

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY,** **Respondent.**	**Docket UE-190529** **Docket UG-190530 (*Consolidated*)**
In the Matter of the Petition of **PUGET SOUND ENERGY** **For an Order Authorizing Deferral Accounting and Ratemaking Treatment for Short-life IT/Technology Investment**	**Docket UE-190274** **Docket UG-190275 (*Consolidated*)**

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF

KARL R. RÁBAGO

ON BEHALF OF PUGET SOUND ENERGY

REVISED
JANUARY 29, 2020

JANUARY 15, 2020

PUGET SOUND ENERGY

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I. INTRODUCTION

Q. Please state your name, business address and employer.

A. My name is Karl R. Rábago. My business address is 2025 E. 24th Avenue, Denver, Colorado. I am Principal and sole employee of Rábago Energy LLC, a Colorado limited liability company.

Q. Please summarize your experience and expertise in the field of electric utility regulation and the renewable energy field.

A. I have worked for nearly 30 years in the energy industry and related fields. I have been actively involved in a wide range of energy utility issues across the United States as an expert witness. Through Rábago Energy, I provide advisory services and expert witness services to a wide variety of clients in regulatory proceedings. Recently, and in my former capacity as Executive Director of the Pace Energy and Climate Center, I participated as a party in New York rate cases and in Reforming the Energy Vision proceedings. I continue to work with Pace as a senior policy advisor and provide policy and regulatory support to ongoing projects in New York, Arkansas, Connecticut, and other locations.

My previous employment experience includes Commissioners with the Public Utility Commission of Texas, Deputy Assistant Secretary with the U.S.

Department of Energy, Vice President with Austin Energy, and Director with AES Corporation, among others.

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

A. Yes, I have. Please see the First Exhibit to the Prefiled Direct Rebuttal Testimony of Karl R. ~~Rabago~~Rábago, Exh. KRR-2 for an exhibit describing my education, relevant employment experience, and other professional qualifications.

Q. Do you have any special expertise on the topic of electric utility transformation and sector modernization?

A. Yes. As a Commissioner with the Public Utility Commission of Texas from 1992 through 1995, and later as an advocate, I played a key role in launching the wind industry in the Texas. While serving as a commissioner, I also co-chaired the Texas Sustainable Energy Development Coalition, a multi-sector task force that crafted a strategic plan issued in 1995 that would enable Texas to obtain its energy service needs from sustainable energy resources. I co-chaired the NARUC energy conservation committee and served as regulatory representative in the creation of the Utility PhotoVoltaic Group and the PV-COMPACT.

Additionally, as Deputy Assistant Secretary for the U.S. Department of Energy, I was responsible for the nation's research, development, and deployment programs relating to renewable energy, hydrogen, demand-side management, high-temperature superconductivity, energy storage, and other technologies. In that role I worked with Congress, federal agencies, states, the national laboratory complex,

universities, and the private sector in advancing and deploying technologies and technology enabling programs. Additional detail can be found in Exh. KRR-2.

Q. Have you ever testified before the Washington Utilities and Transportation Commission ("Commission" or "WUTC")?

A. No. In the past six years, I have submitted testimony, comments, or presentations in proceedings in 30 jurisdictions. A listing can be found in Exh. KRR-2.

Q. On whose behalf are you appearing in this proceeding?

A. I am appearing on behalf of Puget Sound Energy ("Company" or "PSE").

Q. Have you ever submitted testimony on behalf of an electric or gas utility before this?

A. As vice president for distributed energy services with Austin Energy, a municipal electric utility serving Austin, Texas, I frequently testified on behalf of the utility before the Austin City Council in support of budgets, tariff modifications, and program activities. In 1998, I prepared testimony in support of a green pricing tariff proposal by Houston Light & Power Company while a vice president with Planergy that was never filed. On several occasions during my career, I have also provided supporting comments on various utility proposals before regulatory and legislative bodies. Other than those occasions, I have never before submitted expert testimony on behalf of an electric or gas utility.

Q. Why then are you submitting testimony on behalf of PSE in this case?

A. My career in the utility industry has involved thirty years of advocacy for increased adoption and support by utilities of clean energy resources like energy efficiency, large-scale renewable energy, and distributed energy resources including distributed generation. In my experience, most utilities have, in the past, been opponents of those changes. Now, in the face of the increasingly severe threats from climate change and the increasingly compelling technological and economic case for utility industry transformation and widespread clean, distributed, and efficient energy use, I am excited to see leader states like Washington moving toward establishing a new paradigm for performance by regulated energy service providers. I believe that the Company is committed to making those changes and meeting its regulatory and statutory obligations even while it is also, and quite reasonably committed to maintaining a healthy financial condition during the transition and transformation.

Q. What is the purpose of your rebuttal testimony?

A. In this testimony I offer rebuttal to the response testimony submitted by Mr. Chris McGuire on behalf of the Staff of the WUTC ("Commission Staff"), Mr. Mark Garrett on behalf of the Washington State Office of the Attorney General Public Counsel Unit ("Public Counsel"), Mr. Michael Gorman on behalf of the Alliance of Western Energy Consumers ("AWEC") and Ms. Wendy Gerlitz on behalf of the NW Energy Coalition ("NWEC"). In particular, I will rebut the reliance by those witnesses on backward-looking and inappropriately narrow interpretations of regulatory policy in evaluating PSE's proposal for an attrition adjustment in

this proceeding. I provide a brief description of revenue-adjustment mechanisms and other flexible regulatory mechanisms considered and adopted by commission's seeking to advance and accelerate utility sector transformation in their respective states. I support the Company's proposal for an attrition adjustment in order to counter the effects of regulatory lag and attrition that flow from traditional rate making. My judgment is that the attrition adjustment for both gas and electricity sides of the business is necessary and proper in order to mitigate and prevent unnecessary adverse financial and investment consequences as the Company continues making significant investments in addressing current reliability-related issues and in modernization of its electric and gas systems, and in preparation for development and execution of Clean Energy Implementation Plans ("CEIP") on the aggressive timeline contemplated by Washington's Clean Energy Transformation Act[1] ("CETA").

II. THE OPPOSING WITNESSES FAIL TO PROVIDE COMPELLING POLICY ARGUMENTS FOR DENYING PSE'S ATTRITION PROPOSAL

A. Introduction

Q. What is your understanding of the Company's proposal for an attrition adjustment in this case?

A. As succinctly summarized by Company witness Daniel A. Doyle, the Company "is requesting an attrition adjustment in this proceeding to address the backward-

[1] SB 5116, Laws of 2019, ch. 288.

looking, historical nature of traditional ratemaking, which contributes significantly to regulatory lag and attrition."[2] The attrition adjustment, as updated in the Company's rebuttal testimony, increases the Company's revenue request by approximately $40 million.[3]

Q. Does your rebuttal testimony address the mechanics and financial analysis underlying the quantification of the proposed attrition adjustment?

A. No. The mechanics and financial analysis to support the level of the attrition adjustment is established in the direct and rebuttal testimony of Company witnesses Ronald J. Amen, Daniel A. Doyle, and Susan E. Free. My testimony focuses on rebutting opposition to the regulatory policy justification for the attrition adjustment proposal.

Q. Please provide a high-level summary of the position of Mr. Chris McGuire on behalf of Commission Staff, Mr. Mark Garrett on behalf of Public Counsel, Mr. Michael Gorman on behalf of AWEC, and Ms. Wendy Gerlitz on behalf of NWEC.

A. Each of those witnesses opposes the Company's proposal for an attrition adjustment. Taken as a whole, the argument in opposition to the attrition adjustment from these witnesses is that the proposed adjustment is not financially justified, is not consistent with backward-looking regulation, and is not proposed

[2] Doyle, Exh. DAD-1Tr at 13.
[3] .Free, Exh. SEF-17T at Table 1.

as a means for mitigating the precise kinds of problems for which attrition adjustments have been used in the past.

Q. As a whole, what is your response to the arguments of witnesses in opposition to the Company's attrition adjustment proposal?

A. As previously stated, I do not address the analysis and data offered by the Company and addressed by the witnesses relating to the financial justification for the proposed attrition adjustment and its level. As to the regulatory policy issues raised by the Company's adjustment proposals, I find that the opposing witnesses do not provide compelling policy arguments for denying the Company's proposals. That is, the attrition mechanism is needed precisely because it is partially curative of the problems of backward-looking regulation—problems that could inhibit the spending necessary to move apace in implementing utility sector transformation and preparing for achieving the objectives of CETA in Washington. This policy justification for the Commission's approval of an attrition adjustment is this case is novel and, in some ways, represents a new use of the attrition mechanism, but that is precisely the point. The attrition adjustment is a measured and effective mechanism for mitigating some of the adverse impacts that regulatory lag and backward-looking regulation have on securing the needed level of spending from the Company in the period between rate cases.

Q. In your view, what is the regulatory policy justification for the Company's attrition adjustments?

A. The Company, and indeed the entire State of Washington, ~~is~~are facing an unprecedented need for fundamental transformation in the way electricity and gas service providers like PSE do business. Utilities like PSE must continue, without discontinuity, to provide affordable, safe, and reliable services to customers. They must also make an unprecedentedly rapid transition to a business model and structure that enables them to ensure that services are available and provided in a clean, climate-responsible, and sustainable manner under the obligations of CETA, and do so while successfully meeting the challenges of utility sector transformation currently underway. That means serving as a platform for expanded customer engagement in electric and gas utility services, including services on the demand side and those provided by competitive service providers. I believe the Company is committed to optimizing its performance against all three of these objectives in an integrated fashion and at a pace that will ensure legal and regulatory compliance with laws and regulations and maximum benefits at minimum costs for customers and the citizens of Washington

Q. What role does the attrition adjustment have in supporting the Company's efforts to meet its three primary business and policy objectives?

A. The attrition adjustment is necessary to ensure that the unprecedented level and evolving character of expenditures required of the Company can be made on a timely basis and without compromise to the Company's basic financial integrity. Again, the testimony of Company witnesses Doyle and Kensok establish the

spending outlook and potential impacts on earnings if adjustments are not approved by the Commission.

B. Commission Staff's Ripeness Concerns Are Without Merit

Q. What position does witness McGuire take regarding the attrition adjustment proposal on behalf of Commission Staff?

A. Witness McGuire summarizes his position in opposition to the attrition adjustment by stating that in his opinion, "PSE's circumstances do not meet the Commission's threshold criteria for considering attrition allowances,"[4] and that even if the Commission were to consider the proposed allowance, the Staff takes issue with the financial analysis justification and calculation of the proposal.[5] Finally, Mr. McGuire takes the position that the Commission's consideration of an attrition adjustment proposal based on mathematical extrapolation of costs is not ripe until the Commission has completed its reconsideration of the status of its Order 05 in Avista's 2015 General Rate Case and its implementation of the amendments to RCW 80.04.250.[6] Mr. McGuire asserts that the Company "presumes" Commission policy and "requires" parties to respond before the ~~Company~~Commission has had an opportunity to provide guidance on the issues.[7] Mr. McGuire expands at length on his arguments in a section of his testimony captioned "Attrition Policy."[8]

[4] McGuire, Exh. CRM-1T at 8:14-15.
[5] *Id.* at 8:15-19.
[6] *Id.* at 8:19-9:5.
[7] *Id.* at 9:6-9.
[8] *Id.* at 14-30.

Q. How does Mr. McGuire argue that the Company proposal is inconsistent with Commission policy on attrition adjustments?

A. Mr. McGuire asserts that the Company proposal fails to demonstrate chronic under-earning or that the factors creating underearning are beyond the Company's control.[9] Importantly, he recognizes that the extent and timing of investments and spending are predominantly within the control of a utility, but that in practical effect, a decision not to invest could rise to the level of imprudence at some point.[10]

Q. How do you respond to that argument?

A. Company witnesses Daniel A. Doyle and Joshua A. Kensok provide a detailed justification and substantial evidence establishing the Company's earnings attrition expected in the rate year and beyond due to the effects of regulatory lag on recovery of increasing amounts of spending. I concur with Mr. McGuire's practical conclusion that any "beyond control" test for the approval of an attrition mechanism must be applied pragmatically. Some investments and spending, like IT spending relating to platform and DER integration functionality will not directly generate revenues to offset earnings impacts, have shorter lives that under conditions of regulatory lag would effectively deny the utility recovery of spending, and are so essential that they cannot fairly be considered discretionary. In other words, I agree with Staff that overly rigid and simplistic application of the Commission's prior consideration of an attrition adjustment could produce

[9] *Id.* at 14:9-12.
[10] *Id.* at 26:1-9.

unjust and unreasonable results. In light of the unprecedented changes that the utility industry must fully and successfully navigate over the coming years, the watchword for the application of regulatory flexibility should be *flexibility.*[11]

Q. Is Mr. McGuire's ripeness argument a valid basis for rejecting the Company's attrition adjustment proposal?

A. No. Mr. McGuire's testimony begs the question in its assumption that the "current policy context" cannot support an attrition mechanism based on forward-looking projections of rate base. The Commission will have an adequate foundation and record in this case to support approval of the Company's proposed attrition adjustment. This rate case application includes all of the real-world data necessary to enable the Commission to make a utility-specific determination of the appropriateness of an attrition adjustment. Staff's position on this issue would create unnecessary delay in needed investments and spending, would disincentivize necessary spending, and would exacerbate the burdens created by regulatory lag.[12] For that reason, I concur with Staff's conclusion, even though posed by Mr. McGuire as a straw man, that the Commission could find justification for approving PSE's proposed attrition adjustment in this

[11] Though Mr. McGuire recognizes that regulatory lag relating to short-lived assets does create a burden that merits regulatory flexibility, he asserts that Staff-proposed measures are sufficient to mitigate the burdens and potential problems. *Id.* at 27. Whether the Staff mitigation measures are adequate is addressed by Company witnesses Susan E. Free, Exh. SEF-17T, and Joshua A. Kensok, Exh. JAK-1T.

[12] Followed to its logical conclusion, a recommendation to wait until Commission has *generically* sorted out all the new issues associated with flexible regulation and utility sector transformation, and laying even the foundations for CETA implementation, would mean that no real decisions on spending and investment could come until after a subsequent rate case in which specific spending decisions, including those proposed in this proceeding, would be evaluated.

proceeding.[13] As Mr. McGuire states, "a properly performed attrition study could supply convincing evidence that the modified historical test year approach produces revenues insufficient to cover costs in any given rate year."[14] I would go further and assert that when faced with such evidence, approval of an attrition adjustment as proposed by PSE is a just and reasonable course of action for the Commission that Staff should support as being appropriate to the current policy context and in the public interest.

C. Public Counsel's Focus on Backward-Looking Regulation Ignores the Transformation in the Energy Industry Occurring in Washington and Around the Country

Q. What issues does witness Garrett raise on behalf of the Attorney General in his testimony relating to the Company's proposed attrition adjustment?

A. Mr. Garrett correctly identifies the Company's proposed attrition adjustment as a modification to the traditional, backward-looking historical test year approach to setting cost components. He cites the concern stated by the Commission in its order in Avista's 2015 rate case that projections of future spending may become a "self-fulfilling prophecy" and an incentive for the utility to match spending to projections.[15] On this basis, Mr. Garrett asserts "significant cause for concern."[16]

[13] McGuire, Exh. CRM-1T at 29:1-8.
[14] *Id.*
[15] Garrett, Exh. MEG-1T at 6, citing *WUTC v. Avista Corp.*, Dockets UE-150204 & UG-150205, Final Order 5 ¶ 119 at 44 (Jan. 6, 2016).
[16] *Id.* at 6:14 (citation omitted).

Q. Do you agree with his concerns?

A. No. First, the context for the Company's attrition adjustment proposal must be taken into account. This is precisely the time when the Commission should be exercising its flexible regulation authority to establish strong incentives and clear signals to motivate the Company to make much needed investments. In other words, in the face of the forces driving transformation and an effective response to the threat of climate change, there are strong policy reasons for the Commission to maximize the potential for the Company's spending proposals to occur as planned and as a matter of intention. Moreover, the evidence provided by the Company in this case provides clear and detailed information about the kinds of spending and resulting outcomes proposed by the Company. That evidence is contained in the testimony of Company witnesses Joshua J. Jacobs, Margaret F. Hopkins, Joshua A. Kensok, and Catherine A. Koch.

Q. Do you believe that traditional backward-looking regulatory approaches to utility spending advocated by Mr. Garrett have a place in the regulatory toolbox?

A. Yes, but less so right now and under the urgent need for transformation that we currently face and that will continue over the next decades. I agree with the Company's characterization of the adverse financial impacts of traditional regulatory oversight and approval of utility spending under current and future conditions. As CETA recognizes, it will take decades to make the transformation to 100 percent clean energy and backward-looking regulatory approaches are not well suited to accomplish the task.

I understand and even respect the ways that traditional regulation imposes controls on utility spending under relatively stable industry conditions and during times when utilities might be inclined toward *unnecessary* overspending and capital investments in an effort to bolster earnings. Backward looking regulation and resulting regulatory lag are powerful financial oversight tools that help curb the worst instincts of a traditional monopoly under traditional circumstances by making excessive spending unappealing to financial investors and lenders.

Q. What happens under traditional regulation when spending between rate cases exceeds levels approved in the last rate case?

A. Increases in spending above the levels approved in the last rate case weakens earnings levels, even with pro forma adjustments between rate cases. Consistently high spending levels and increases in expenses, such as depreciation expenses associated with short-lived capital investments like information technology infrastructure, can create under-earnings scenarios that raise concerns among investors and rating agencies. Year-over-year trends in under-earnings can result in ratings changes and challenges to affordable access to capital and debt. This is what makes regulatory lag and attrition under high-spending scenarios effective as tools to tap the brakes on utility spending. But it is precisely because this backward-looking approach is so effective in dampening spending by that the traditional approach must be modified in order to not stifle critically necessary spending to support transformation.

Q. Are there additional problems with backward-looking regulatory approaches and consequences during a period of sector transformation that Mr. Garrett fails to recognize?

A. Yes. The core challenge is that the utility sector must take on transformation while keeping the business operating and delivering traditional utility services. In order to meet climate policy goals, incumbent utilities must create and operate platform structures that can maximize investments and utilization of all manner of DER, even if the utility is not the provider or operator of such resources. The utility must maintain reliability and resiliency in a much more interactive and transactional distribution environment; it must therefore increase its visibility into a utility system far more dynamic and challenging than anything experienced today. Some of what must be done can be adapted from other jurisdictions and industry sectors, but to a very real extent, every utility's pathway to transformation will be *sui generis*—distinct and customized for the unique regulatory environment and challenges the particular utility faces—as will be every customer's path to engagement with the transformed utility business.

Backward-looking regulation requires an effectively closed set of books on every spending program in order to assess it in its entirety and decide the appropriate level and form of revenue recovery. Even under the ideal condition that every expenditure is deemed prudent on *post hoc* review, the unrecovered spending between rate cases not only erodes earnings, but also weakens the financial incentive for undertaking additional necessary spending until revenue recovery is readjusted through a rate case or other regulatory mechanism. For a series of

necessary investments, such as those involved in building a distribution system platform infrastructure and systems, the backward-looking approach slows the entire agenda of transformation and adds regulatory process costs that may be unnecessary and counterproductive.

Moreover, the entire focus of *post hoc* regulatory reconciliations is on the past and what happened during the test year or true-up period. In a technologically dynamic environment, that bespeaks an inappropriate focus on what has been done rather than on what needs to be done.

Q. Can you offer a simple analogy to make these points?

A. Utilities are entering a period of what must be rapid transformation in utility business models and approaches and a dramatic increase in reliance on more distributed and sustainable energy resources. Unmitigated reliance on backward-looking regulatory models and impacts at such a time is like driving into the future with one foot on the gas, another on the brakes, and both eyes firmly fixated on the rearview mirror. Under such an approach, the road to a clean energy future would be unnecessarily littered with crashes and breakdowns.

Q. Do you take issue with other aspects of Mr. Garrett's testimony?

A. Yes. Mr. Garrett takes an unreasonably narrow view of the purpose and utility of an attrition adjustment—as an adjustment to the revenue requirement that ensures that the Company has a "reasonable opportunity to earn its authorized return." In light of the very real problems resulting from regulatory lag at a time when the utility must be making significant and increasing investments, some of which, like

IT investments, that have short useful lives, traditional backward-looking regulation does impede a utility's opportunity to earn its authorized return. But I was disappointed that Mr. Garrett repeats his aversion to even much-needed Company spending and investment through a failure to recognize that an attrition adjustment mechanism is also a necessary and proper mechanism to support and incentivize the Company's willingness to make those necessary investments.

Q. Mr. Garrett asserts that the concept of an attrition adjustment is contrary to the customary ratemaking formula. Is that a valid criticism of the mechanism?[17]

A. It is a valid characterization, but it is not a valid criticism. The Company's witnesses have tried to be very clear that the proposed attrition adjustment is both necessary and proper to *correct for* inherent problems created by traditional rate making approaches and to mitigate those problems in a measured and reasonable way.

[17] Garrett, Exh. MEG-1T at 7:6-12.

Q. Mr. Garrett also characterizes the attrition adjustment mechanism as an anachronistic throwback to an era when high inflation rates and large power plant investments were the primary driver of utility earnings erosion, and on this basis takes issue with testimony by Company witness Ronald Amen regarding the causes of earnings attrition.[18] Do you agree with this characterization?

A. No. While Mr. Garrett quotes Mr. Amen's testimony accurately, he fixates on the historical experience that attrition can be caused by high inflation and ignores the key point in Mr. Amen's testimony—that *today* the industry has "entered into a 'new normal' in which utilities are making increased capital investments in non-revenue generating distribution plant in an environment of low load growth,"[19] and that this, today, is a driver of earnings attrition. Mr. Garrett spends several pages of testimony arguing that current and near-term market conditions are not characterized by high inflation and resulting increases in the cost of capital—a point that is not at issue and that was not submitted by the Company as a justification for the proposed attrition adjustment. As set forth in this testimony, I support Mr. Amen's characterization of today's key drivers of earnings attrition, with additional emphasis on the need to establish a foundation for rapid and effective implementation of CETA.

[18] *Id.* at 7:13-8:20.

[19] *Id.* at 7:24-8:4 (citing Prefiled Direct Testimony of Ronald J. Amen, Exh. RJA-1T at 16:16-25).

Q. Does Mr. Garrett's testimony evaluate utility sector transformation or Washington's CETA legislation as factors that drive the need for increased spending and that, in conjunction with low load growth, could result in earnings attrition?

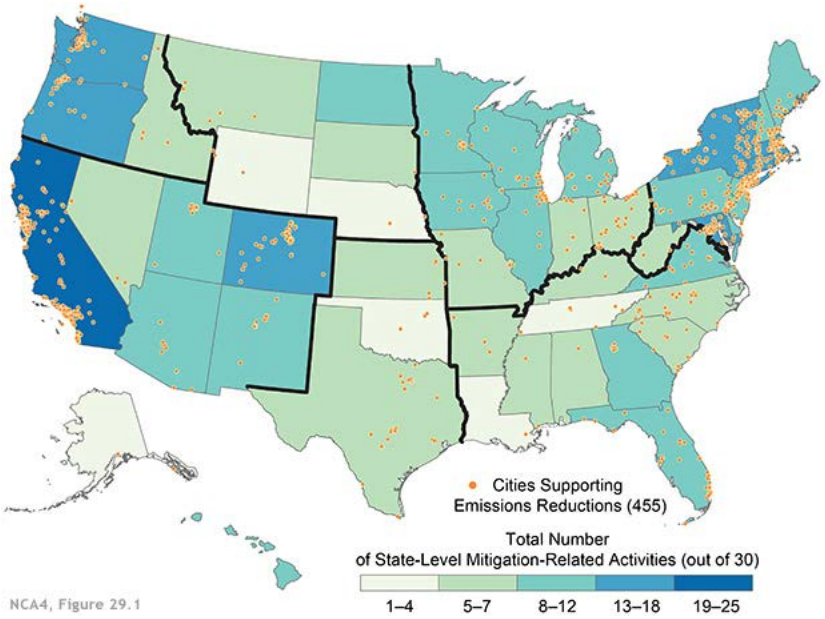
A. Disappointingly, Mr. Garrett does not, and in my opinion, that failure constitutes a fundamental deficiency of his opposition to the Company's proposed attrition adjustment. As a result, his criticism of the proposed attrition adjustment is out of step with the current market and policy context.

Q. **Mr. Garrett also cites his familiarity with regulation in the states of Oklahoma, Texas, and Nevada relating to adjustments based on costs incurred after the test year end to argue that the attrition adjustment proposal should not be approved by the Commission. Do you find merit in Mr. Garrett's argument in this regard?**

A. No. First, Mr. Garrett's discussion is generally a recitation of the traditional backward-looking regulatory approach and a description of mechanisms such as post-test year known and measurable change adjustments. His testimony does not address how those jurisdictions have addressed the kind of regulatory policy and market conditions faced by PSE today. Moreover, the states of Oklahoma, Texas, and Nevada are not on a par with Washington in aggressive leadership to address climate change. Figure 1, below, summarizes city and state activities to mitigate climate change as reported in the "Fourth National Climate Assessment" and shows the significant gap between what Washington is doing and what the states cited by Mr. Garrett are doing on this critical issue. Mr. Garrett's citations to

regulatory and legislative practice in Oklahoma, Texas, and Nevada are therefore inapposite and do not support a rejection of the Company's proposed attrition adjustment.

Figure 1: National Climate Assessment Map of State and City Carbon Reduction Activities[20]



Q. How does your engagement experiences in sector transformation proceedings in other jurisdictions inform your support for the Company's proposed attrition and rate case date adjustment proposals rather than the standard historical test year approach?

A. Several leading states, both large and small, have embarked upon utility sector transformation agendas. The objectives of these proceedings include: animation of markets for DERs, economic development, increased efficiency in the use of

[20] Source: U.S. Global Change Research Program, *Fourth National Climate Assessment, Vol. II: Impacts, Risks, and Adaptation in the United States,* Fig. 1.19(a) (Mitigation-Related Activities at State and Local Levels) (2018). Available at: https://nca2018.globalchange.gov/downloads/NCA4_2018_FullReport.pdf.

energy services, improvements in energy equity, long-term control on utility capital spending, improved performance in light of societal and regulatory objectives, improved resilience and reliability, and reduced contribution and vulnerability to the impacts of accelerating climate change.

Q. Is earnings erosion widely recognized as a problem in other states pursuing utility sector transformation?

A. Yes, and for the same reasons that I have already described. Other states have recognized that problems stemming from regulatory lag such as earnings attrition act as a disincentive to a utility spending of the pace, level, and character necessary to support transformation. In many jurisdictions, as in PSE's service territory, retail sales growth has slowed or even begun to decline, further increasing the likelihood of earnings falling significantly below allowed levels. In addition, many of the kinds of spending needed to accelerate sector transformation—like dramatic increases in spending on efficiency programs, customer portals, automated interconnection application processes, and DER hosting capacity improvements, among others—will further reduce traditional volumetric consumption and revenue earned from sales. While growth in all of these services is often a desired end-stage, regulators have recognized that utilities and their financial stakeholders will expect to see earnings stability, if not growth and risk reduction, in order to enthusiastically—or even willingly—embrace a transformation agenda.

Q. What kinds of regulatory flexibility mechanisms have you encountered to address earnings erosion in the face of sector transformation

A. This is an exciting time in regulatory innovation. Regulatory commissions and stakeholders have devoted a great deal of time and effort to developing a host of regulatory mechanisms to address the earning erosion issue. In New York, the Public Service Commission ("NY PSC") and staff dedicated significant effort to understanding and addressing the financial implications and objectives of its Reforming the Energy Vision ("NY REV") initiative. In what is commonly known as the "Track Two Order" of May 19, 2016, the NY PSC set out a number of regulatory mechanisms to address earnings and incentives issues, including guidelines for platform services revenues, earnings adjustment mechanisms, and market-based earnings for regulated utilities. Critical to the NY PSC's structure for earnings adjustments was a shift toward an outcome orientation that would reflect performance objectives and encourage utility innovation and an enterprise-wide approach to achieving results. In subsequent proceedings, the Commission expanded its approach to the gas side of regulation, approving incentives for and increased spending on gas efficiency and "non-pipeline solutions" initiatives by gas utilities. Like the NY PSC's model for utility earnings under NY REV, the Company's proposal for an attrition adjustment will act as an incentive for the Company and its financial supporters to do the spending necessary to support transformation in its service territory

Q. What other kinds of flexible regulatory mechanisms have been approved or evaluated by state commissions advancing transformation agendas?

A. Mechanisms that have been discussed and, in some cases have been adopted, include decoupling, performance incentive mechanisms and PBR more broadly, major capital project approval processes between rate cases, rate riders and revenue adjustment mechanisms, pro forma adjustments, multi-year rate plans, and others. I have been involved in discussions about all of these mechanisms in proceedings in the states where I have been engaged. While diverse in nature, these mechanisms share a common characteristic with the Company's attrition adjustment proposal of correcting or offsetting the adverse impacts of traditional regulation while also providing clarity to regulatory intention and policy—facilitating the utility's financial partnership in securing challenging policy objectives.

Q. Mr. Garrett characterizes the Commission's standard for granting an attrition adjustment as requiring a showing by the utility that the need to invest "is so necessary and immediate as to be beyond its control."[21] He finds that PSE's costs are not beyond its control and that therefore the proposal should be rejected. Do you agree with Mr. Garrett's description and application of the standard in this case?

A. No. First, as the ~~testimony~~testimonies of Company witnesses David E. Mills, Margaret F. Hopkins, Joshua J. Jacobs and Catherine A. Koch demonstrate, the spending that would occur and that supports the attrition adjustment is both necessary and immediate. In addition, though Mr. Garrett takes an unreasonably narrow view of what costs are beyond the control of PSE's management, appearing to modify the standard to mean that the Company must be "unable to control" ongoing levels of spending.[22] As previously described, Staff witness McGuire recognized that too narrow a definition of "beyond the control of management" would practically eliminate the attrition adjustment option. Such an application of the standard would conflict with the discretion that the state of Washington clearly granted to the Commission to approve the attrition adjustment as a mechanism for encouraging that investment and spending and to prevent the earnings erosion that would result from regulatory lag and other consequences of backward-looking regulation.

[21] Garrett, Exh. MEG-1T at 12:3-6, citing *WUTC v. Avista Corp.*, Dockets UE-160228 and UG-160229, Order 07, Order on Reconsideration ¶ 29 (Feb. 27, 2017) (quoting Dockets UE-150204 and UG-150205, Order 05 ¶ 110).

[22] *Id.* at 12:7-16.

Q. Does Mr. Garrett recognize the problems associated with regulatory lag in general?

A. No. It appears that Mr. Garrett sees regulatory lag as more of a feature than a bug in backward looking regulation. As I previously testified, I understand taking this approach under different market and regulatory conditions, but it is inappropriate under the real-world conditions faced by the Company, the Commission, and the state of Washington today and for the ~~decade~~decades to come. I note that Staff also recognizes that problems and burdens that flow from the operation of regulatory lag are real and merit the application of regulatory flexibility, especially with the kind of spending the Company must do today and in the years ahead.

Q. Are you saying that the Company's attrition adjustment proposal is or should be the definitive final word in flexible regulatory mechanisms for PSE

A. No. The Company's proposal is reasonable as a tool to mitigate the adverse impacts of regulatory lag and attrition between this rate case and the next. All options should remain on the table as the Commission continues its process of evaluating and implementation aspects of CETA, including its authorization of regulatory flexibility, as well as recent changes to RCW 80.04.250, relating to property valuation, and utility sector transformation in general. My testimony is that the Company proposal for the attrition adjustment is a reasonable step to ensure time and progress are not lost to unnecessary regulatory lag and reductions in essential spending on transformation initiatives.

D. AWEC Ignores the Detailed Spending For Modernization Investments and the Changing Regulatory Landscape in Opposing PSE's Attrition Adjustment

Q. What deficiencies do you identify in the testimony of witness Gorman on behalf of AWEC?

A. Mr. Gorman asserts that the attrition mechanism sets aside "virtually all" customer protection, ignores post-test year regulatory adjustment mechanisms, and does not capture technology or productivity-driven reductions in operating costs. I take issue with Mr. Gorman's assertions. First, the Company has provided extensive detail in this case, subject to discovery by Staff and intervenor parties, relating to its plans for spending. As additional spending obligations arise, such as those flowing from development and implementation of its CEIP, parties and the Commission will have the opportunity to review and comment upon that spending as well. It is true that "receipts" are not available when spending is forecasted into the future, but the Company's proposal is not a request for unlimited spending authority for unspecified purposes. As set forth previously in this testimony, the regulatory policy justification for ensuring that the Company makes the investments and does the spending necessary to execute successfully on transformation and CETA obligations justifies the attrition adjustment factor as a means for offsetting the burdens and disincentives created by backward-looking regulation and resulting regulatory lag. Mr. Kensok addresses the Company's cost savings in JAK-1T.

Q. What kind of spending is the Company proposing in this case?

A. The table attached at Exhibit KRR-3 summarizes the extensive modernization investments that the Company proposes and addresses in detail in this case. Not only do these details address Mr. Gorman's concerns about consumer protections, but they also establish the detailed foundation for the forward-looking projections of spending the Company must undertake.

E. NWEC's Proposal For Performance and Incentive-Based Regulation Would Cause Unnecessary Delay and Further Aggravate Regulatory Lag

Q. What deficiencies do you identify in the response testimony of Ms. Gerlitz of NWEC?

A. Ms. Gerlitz points out that an attrition adjustment mechanism can be considered and applied in the context of performance and incentive-based regulation ("PBR") as part of a "more holistic set of regulatory reforms."[23] While I agree that an attrition adjustment can be used in such a fashion along with other reforms, I disagree with any assertion that implementation of the Company's requested attrition adjustment should be delayed in order to consider and implement it as part of a broader agenda of PBR review and design. Such a delay would only add another kind of regulatory lag to the Company's realization of its allowed earnings. And while an attrition relief mechanism can and should be considered in the context of a multi-year rate plan ("MYRP"), there is no compelling reason to

[23] Gerlitz, Exh. WMG-1T at 3:22-23.

delay implementation of the attrition adjustment at this time to address a real and near-term problem of regulatory lag prior to designing the next MYRP.

Q. Ms. Gerlitz points out that attrition relief mechanisms can be of three different general types and can also be enhanced with formula features like X factor and Z factor adjustments.[24] Do you see merit in the Commission delaying implementation of the Company's requested attrition adjustment factor in order to evaluate ~~and~~ such issues and enhancements?

A. Not at this time. The kinds of adjustments and enhancements to an attrition relief mechanism are reasonable considerations when the mechanism is implemented in conjunction with a MYRP, but that is not what the Company or any other party is requesting in the case. The record supports the Company's attrition adjustment, but not the much larger set of issues that must be addressed in the context of an MYRP and comprehensive PBR initiative.

Q. Ms. Gerlitz provides additional testimony relating to PBR and associated mechanisms, such as performance-incentive mechanisms ("PIMs") as well and points out that the Commission has enhanced and clarified authority to address and implement a wide range of flexible regulatory mechanisms.[25] Do you disagree with the conclusions reached in that testimony?

A. Yes. Ms. Gerlitz points to the regulatory, judicial, and legislative changes of the past few years as evidence that the context for review of the Company's proposed

[24] *Id.* at 21, 18 through 22, 15.
[25] *Id.* at 6, 20 through 9, 11.

attrition adjustment has changed since the Commission approved an attrition adjustment for Avista in dockets UE-150024, UE-160228, and UG-160229. I take no issue with that assertion. As my previous testimony points out, the changes in context strengthen the case for the Company's proposal. I differ with Ms. Gerlitz on the conclusion that this change of context compels consideration of the attrition adjustment only in a more complicated and time-consuming comprehensive and holistic approach to PBR implementation.

Q. On what basis do you express concern that a comprehensive PBR initiative will be more complicated and time-consuming?

A. My experience detailed earlier in this testimony, in the NY REV proceeding the Hawaii Phase 1 PBR proceeding, the Maryland Utility of the Future docket, the Rhode Island Power Sector Transformation proceeding, and other regulatory transformation and PBR dockets has taught me that PBR is complicated and time-consuming. There are many moving pieces and competing preferences among stakeholders, and often Commissions ultimately decide to move incrementally rather than comprehensively. The Company's attrition adjustment to support the spending it needs to do is a good first step that can be integrated easily into any subsequent PBR agenda, so there is no good reason to delay with that measure. While the ultimate rewards may make a comprehensive PBR effort worthwhile, waiting for such a process means that the earnings erosion for the Company will go unmitigated and may even frustrate PBR evaluation and implementation—provided the Commission concludes a comprehensive agenda is the best way to go. In other words, the benefits of full-scale PBR development and

implementation *might* be high, but the opportunity costs of not addressing earnings erosion in this proceeding are *definitely* high for the Company in the near term.

Q. Ms. Gerlitz ultimately states that she does not support the Company's attrition adjustment proposal because it does not include a "clear and compelling link" to CETA and public interest goals and is not, by itself, like to promote either societal benefits such as decarbonization or customer value.[26] Do you agree that these are reasons to reject the proposed attrition adjustment?

A. While these are positive aspirational goals, Ms. Gerlitz' proposes an entirely new test for attrition adjustment approvals and, again, would necessitate further delay in providing the earnings relief the Company has demonstrated that it needs. The goals she articulates are the kinds of outcomes that can and should be a part of a comprehensive evaluation of PBR, if the Commission decides to take that course. But they are not ready for application as evaluation criteria for the Company's proposal in this case. The Company proposal was not crafted as its response to such broad objectives. Rather, the spending proposals supported by the attrition adjustment are foundational and necessary to subsequently taking up the kind of agenda Ms. Gerlitz proposes, if that is where the Commission wants to go.

[26] *Id.* at 9:20-10:2.

Q. Ms. Gerlitz also asserts that the Company should have evaluated other flexible regulatory mechanisms and a broader PBR agenda that included collaborative engagement with stakeholders as a precondition for approval of its application for an attrition adjustment.[27] Do you agree that these should be conditions precedent for approval of an attrition adjustment?

A. No. Again, the practical effect of Ms. Gerlitz' standard is further regulatory lag in recovery of earnings and resulting disincentives for needed spending.

III. CONCLUSION

Q. What do you conclude based on your review of the testimony of witnesses McGuire, Garrett, Gorman, and Gerlitz opposing the Company's proposed attrition adjustment?

A. The witnesses have failed to make a compelling case in opposition to the Company's attrition adjustment proposal. The witnesses failed to account for the pressing and vital demands of moving quickly and with determination to ensure that the Company can develop and implement a CEIP in conformance with CETA's requirements. The witnesses ignore the substantial discretion granted to the Commission to adopt and approve flexible regulatory mechanisms. The witnesses that propose additional regulatory processes as a precondition for the consideration of an attrition adjustment as proposed by the Company are effectively seeking a multi-year delay on essential investments in Washington's current and future well-being. There is no good case for that delay.

[27] *Id.* at 10:3-12:15.

Q. Does this conclude your prefiled rebuttal testimony?

A. Yes, it does.