**EXHIBIT NO. \_\_\_(KSJ-1T)
DOCKET NO. UE-121373
DOCKET NO. UE-121697/UG-121705
DOCKET NO. UE-130137/130138
WITNESS:  KENNETH S. JOHNSON**

**BEFORE THE**

**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| In the Matter of the Petition of PUGET SOUND ENERGY, INC.For Approval of a Power Purchase Agreement for Acquisition of Coal Transition Power, as Defined in RCW 80.80.010, and the Recovery of Related Acquisition Costs | DOCKET NO. 121373 |
| In the Matter of the Petition of PUGET SOUND ENERGY, INC. and NW ENERGY COALITION For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms | DOCKET NOS. UE-121697 and UG-121705 (Consolidated) |
| WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant,v.PUGET SOUND ENERGY, INC.,  Respondent. | DOCKET NOS. UE-130137 and UG-130138 (Consolidated) |

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
KENNETH S. JOHNSON
ON BEHALF OF PUGET SOUND ENERGY, INC.**

*In Support of the Multiparty Settlement*

*Re: Coal Transition PPA and other Pending Dockets*

**MAY 8, 2013**

**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY
(NONCONFIDENTIAL) OF** **KENNETH S. JOHNSON**

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**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF KENNETH S. JOHNSON**

# I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Kenneth S. Johnson. I am employed as Director, Rates and Regulatory Affairs for Puget Sound Energy, Inc. ("PSE"). My business address is 10885 NE Fourth Street, Bellevue, WA 98009-9734.

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

A. Yes, I have. It is Exhibit No. \_\_\_(KSJ-2).

Q. What is the purpose of your rebuttal testimony?

A. This prefiled rebuttal testimony responds to those parties who challenge key components of the Multiparty Settlement Re: Coal Transition PPA and Other Pending Dockets (the “Multiparty Settlement”), originally negotiated and entered into by PSE, Staff of the Washington Utilities and Transportation Commission (“Commission Staff”), and the NW Energy Coalition. I provide a high-level review of the benefits of the settlement—for customers, PSE, and the region—and explain how approval of the Multiparty Settlement is in the public interest.

Q. Please explain how approval of the Multiparty Settlement is in the public interest.

A. The Multiparty Settlement embraces a new era of ratemaking that is consistent with the direction provided by the Commission in recent cases and with the recommendations of the ratemaking discussion group convened by former Governor Gregoire and endorsed by Governor Inslee. Both the Commission and the Governor’s ratemaking discussion group have focused on methods of reducing regulatory lag through expediting rate processes in which test period information on investment, revenues, and expenses is updated while certain elements of rates—such as rate of return and capital structure—are held constant.

PSE and its customers will benefit from this progressive shift in the ratemaking paradigm provided in the Multiparty Settlement. Customers will benefit from the rate predictability provided by the K-factor component of decoupling, which limits PSE’s annual rate increases for non-power costs to a preset amount. The annual increase established in the Multiparty Settlement is substantially below PSE’s average increases over the past several years. This will require PSE to manage its delivery-related expense to a budget that is below the consumer price index (“CPI”) as discussed in more detail in the Prefiled Rebuttal Testimony of Ms. Katherine J. Barnard, Exhibit No. \_\_\_(KJB-11T), and the Prefiled Testimony of Mr. Thomas E. Schooley, Exhibit No. \_\_\_(TES-1T). Thus, PSE is required to operate with exceptional efficiency in an effort to achieve a return on equity close to what the Commission set in its last general rate case in Docket Nos. UE-111048 and UG-111049 (the “2011 General Rate Case”).

At the same time, PSE will benefit from reductions in regulatory lag that has delayed PSE’s recovery of prudently incurred costs made for the benefit of customers, and which has hindered PSE’s ability to earn its authorized returns for more than a decade. All stakeholders benefit from a more certain and transparent process and by reducing the number of time-consuming, expensive, and contentious general rate cases.

The Multiparty Settlement comports with and enhances Washington’s State Energy Policy. Once it is approved, PSE will finalize a long-term power purchase agreement for coal transition power that provides customers low-cost power and facilitates the closure of Washington’s sole remaining coal plant, consistent with the policy set forth in the Coal Transition Energy Bill. As part of the transition from coal-power generation in Washington State, TransAlta Centralia Generation LLC (“TransAlta”) has committed to contribute $55 million to fund economic and community development in Lewis and South Thurston County. This includes $20 million for education, retraining, economic development, and community enhancement; $10 million for energy efficiency and weatherization; and $25 million for energy technologies with the potential to create considerable energy, economic development, and air quality, haze, or other environmental benefits. In the absence of a long-term power purchase agreement between TransAlta and PSE, it is highly unlikely any of these transition benefits will accrue to Washington State or Lewis County.

The Multiparty Settlement contains an agreement for the implementation of electric and natural gas decoupling that is landmark. For more than two decades, regulators, utilities and stakeholders have strived to design and implement decoupling in Washington in a manner that promote innovation and deployment of energy efficiency technologies while protecting utilities from undue financial harm. The decoupling mechanisms that are a part of the Multiparty Settlement accomplish these long desired objectives by eliminating PSE’s incentive to increase energy usage per customer and reducing the negative financial impact on the company of its conservation programs. Furthermore, the Multiparty Settlement builds on PSE’s long-standing commitment to energy efficiency by setting targets for conservation that go beyond its I-937 requirements.

Over the past few years the Commission has moved progressively and creatively to shape the ratemaking landscape in Washington in a manner that benefits consumers as well as regulated industries. This can be seen in the 2011 General Rate Case Final Order, the recent approval of the Avista rate case settlement, and the Policy Statement on Recycling Revenue Sharing Plans for the waste industry.[[1]](#footnote-1) The Commission can build on this forward-looking leadership by approving the Multiparty Settlement, which is endorsed by PSE, Commission Staff, NW Energy Coalition, The Energy Project, and the Northwest Industrial Gas Users.

# II. RESPONSE TO ISSUES RAISED REGARDING THE MULTIPARTY SETTLEMENT AND ITS COMPONENTS

## A. The Multiparty Settlement

Q. ICNU questions the appropriateness of including the Coal Transition Power Purchase Agreement in the Multiparty Settlement. Why did the Settling Parties choose to include the Coal Transition Power Purchase Agreement in the Multiparty Settlement?

A. The Coal Transition Power Purchase Agreement (the “Coal Transition PPA”) was one of three major issues that PSE and its stakeholders considered in the second half of 2012. The other two major issues were the expedited rate filing (“ERF”) and the decoupling mechanism. Discussions to resolve these three issues began on separate tracks but converged to allow the settling parties to enter into a Multiparty Settlement to resolve all three of these outstanding major issues that are of importance to PSE and its stakeholders.

The Coal Transition PPA is a product of the broad state public policy found in Engrossed Second Substitute Senate Bill 5769, commonly referred to as the Coal Transition Bill. A broad coalition of stakeholders supported the Coal Transition Bill, which reflects a historic agreement to responsibly end coal-fired electric generation in Washington and invest in an economic transition for Lewis County.

The Centralia Coal Transition PPA is a key component of carrying out the plan to responsibly transition beyond coal generation in Washington while ensuring the stability of the electric grid and providing customers low-priced power. However, as discussed in PSE’s Petition For Reconsideration in Docket UE-121373, the Final Order entered by the Commission left areas of uncertainty for PSE regarding prudence and cost recovery if events beyond PSE’s control occurred. It also provided an equity adder that was substantially below what was contemplated under the statute. The conditional approval granted by the Commission left uncertainty regarding cost recovery and potential future prudence determinations such that PSE would be required to reject the Coal Transition PPA. Commission Staff and PSE came together to resolve the uncertainties in the Final Order so that PSE could potentially move forward with the Coal Transition PPA. The Multiparty Settlement facilitates that transition to coal-free generation in Washington State.

At the same time that PSE had been working with stakeholders on the Coal Transition PPA docket, it also had been working with many of the same stakeholders on the ERF and decoupling proposals. These discussions had been in process since shortly after May 2012, when the Commission issued its Final Order in PSE’s 2011 General Rate Case. When Commission Staff and PSE came together to discuss settlement of PSE’s Petition For Reconsideration on Centralia, it naturally followed that the scope of the settlement discussion would extend to these other pending and important objectives, and how they could be addressed in a global resolution of outstanding issues. It made sense to reach a resolution on all of these outstanding issues to further facilitate the implementation of Washington’s progressive State’s Energy Policy, benefiting customers and providing a more efficient and predictable ratemaking process.

Q. How do you respond to allegations by ICNU that the global settlement is a calculated attempt to subvert the regulatory process. (Deen, p. 10-11)?

A. PSE disagrees with ICNU’s accusation. The Prefiled Rebuttal Testimony of Mr. Jon A. Piliaris, Exhibit No. \_\_\_(JAP-24T), and the Prefiled Rebuttal Testimony of Ms. Katherine J. Barnard, Exhibit No. \_\_\_(KJB-11T), both refute the specific allegation by ICNU witness Mr. Deen that certain “offsetting factors” are being obscured in this proceeding.

However, from a broader perspective, the ICNU testimony demonstrates the lingering resistance to change from the traditional ratemaking process from parties, such as ICNU, who have previously agreed that change should be pursued. The Commission has made significant strides towards progressive changes in the ratemaking process in recent years, and although some parties have participated in processes and cases addressing these issues and at times have supported the recommendations for progressive change in the ratemaking process, they continues to resist changes that differ from the familiar processes of old. ICNU is not alone in this regard. The testimony of other intervenors, such as Kroger and Nucor, ask the Commission to reject the Decoupling K-factor because the rate increases are not known and measurable adjustments presented in the context of a rate proceeding.

The bottom line is that the Multiparty Settlement is consistent with the direction charted by the Commission in recent rate cases and policy statements and with the Governor’s ratemaking discussion group. It provides for decoupling mechanisms that remove throughput incentives and encourage accelerated conservation. It provides for an expedited rate mechanisms that allows PSE to better recover costs related to investments made for customers’ benefit, while also expanding low-income bill assistance and shareholder funded energy efficency assistance. The Multiparty Settlement also allows PSE to move forward with the Coal Transition PPA, which is a key component of the state policy to responsibly transition beyond coal generation in Washington.

Q. How is the Multiparty Settlement consistent with the direction charted by the Commission and the Governor’s ratemaking discussion group?

A. Both the Commission and the Governor’s ratemaking discussion group have addressed the need to address regulatory lag that is preventing utilities such as PSE from having a reasonable chance of recovering costs related to energy investments and from earning their authorized rate of return. For example, in PSE’s last general rate case, the Commission viewed favorably a proposal by Commission Staff allowing PSE to file an expedited rate filing that would update the test period revenues and costs, contain only restating adjustments, and hold constant the rate of return. Similarly, a few months later, the Governor’s ratemaking discussion group, which included members of customer groups, utility representatives, and other stakeholders, made a series of recommendations addressing concerns that existing rate-setting practices and timelines have made it difficult for the utilities to recover costs related to investments needed to ensure a reliable energy system and maximize the opportunity for energy efficiency and the use of clean and renewable energy. The ratemaking discussion group recommended that the Commission consider expedited treatment of requests for rate increase that updates test period information on investment, revenues, and expenses since the last formal rate proceeding, while holding some elements of rates constant, such as recently determined rate of return and capital structure.

The ERF and Decoupling K-factor contained in the Multiparty Settlement follow the guidance of the Commission and the Governor’s ratemaking discussion group. Through the ERF, PSE’s investment, revenues, and costs are updated from the 2011 general rate case, while rate of return is held constant. The Decoupling K-factor allows PSE annual increases in allowed revenues per customer that are below PSE’s historical growth in costs. It avoids the need for contentious general rate cases over the next few years while incentivizing PSE to continue to operate efficiently in order to have an opportunity to earn its allowed rate of return.

Q. Should the Commission wait for a rulemaking or policy statement on expedited rate filings rather than implementing the Multiparty Settlement?

A. No. The Commission made clear in PSE’s most recent general rate case the need to maintain reasonable and appropriate flexibility in its regulatory process to address the dynamic nature of the financial and economic tides that affect utilities and their customers. As discussed above, the Commission commented favorably on the outline of a Commission Staff proposal for an expedited rate filing, and noted that if PSE and Staff work together on such a filing, the Commission would give it fair consideration. The Multiparty Settlement before the Commission constitutes such a filing and the Commission should give it fair consideration on its merits, rather than wait for some other yet-undefined process to be initiated. The experience gained through the implementation of the negotiated aspects of the Multiparty Settlement—specifically the ERF and decoupling with a K-factor—will allow the Commission and stakeholders to undertake a more informed process when they do engage in rulemaking or policy workshops.

Q. Please respond to ICNU’s testimony that the global settlement does not contain adequate consumer protections and shifts risk from shareholders to ratepayers. Exhibit No. \_\_\_(MPG-1T), p. 20.

A. The settlement contains numerous consumer protections, including a soft cap on rate increases, a sharing of any earnings above PSE’s authorized rate of return, and limits on PSE’s ability to seek rate increases for delivery system investments beyond those set forth in the Multiparty Settlement. None of these protections exist at the present time. Currently, PSE may seek rate relief as frequently as needed, and there is no limit on the revenue requirement it may seek in these general rate cases.

Public Counsel also fails to recognize that customers and PSE both benefit from decoupling mechanisms. For example, when energy usage is higher due to colder than normal weather or other factors, PSE’s shareholders will no longer benefit from the margins associated with the higher use per customer. Those margins will be deferred and will flow back to customers.

Finally, PSE disagrees with ICNU's characterization that the property tax tracker unfairly shifts risks from shareholders to rate payers. The property tax tracker allows actual property tax expense to be fairly tracked and recovered from customers—as the Commission ordered in PSE’s last general rate case. As discussed in Mr. Marcelia's Prefiled Rebuttal Testimony, Exhibit No. \_\_\_(MRM-1T), no party has opposed the property tax tracker.

Q. Public Counsel proposes to revise to the Multiparty Settlement by replacing the K-factor rate plan with two additional ERFs and by reducing PSE’s allowed rate of return, among other things. Does PSE agree with this proposal?

A. No. The Multiparty Settlement is a carefully negotiated agreement. Revisions to the Multiparty Settlement as suggested by Public Counsel will not provide the balanced package that is pending before the Commission, a carefully crafted agreement to which many parties agreed and will cause this delicately knit settlement to break apart. Public Counsel has previously recognized the importance of approving a settlement agreement as a comprehensive package.[[2]](#footnote-2) In a PacifiCorp general rate case, Public Counsel stated, "[T]his settlement was a package that was put together during an occasionally painful process, and as with all things, there is give and take…" In urging the Commission to approve one particular provision, Public Counsel pointed out that such provision may be integral to a party's' willingness to accept a settlement.[[3]](#footnote-3) The Commission also views settlements as a whole package, recognizing the significant accomplishment it can be to reach a collaborative compromise among various parties regarding complex issues.[[4]](#footnote-4) One unfortunate consequence of the failure of the Multiparty Settlement would be PSE’s rejection of the Coal Transition PPA at issue in Docket UE-121373.

As discussed in more detail in the rebuttal testimonies of Ms. Barnard and Mr. Schooley, the decoupling K-factor and rate plan provide more benefits to customers than the repeated ERFs suggested by Public Counsel, because PSE’s revenue requirement for non-power costs are known and preset, and PSE must live within those preset constraints. In contrast, the ERF allows PSE to recover its revenue requirement based on costs spent the previous years as set forth in its Commission Basis Report. The ERF alone does not provide a limit on annual revenue requirement nor does it create an incentive to achieve the operational efficiencies required by the K-factor, that is, achieving our public service obligations within a known growth rate (the K-factor).

More fundamentally, there are likely many different iterations of settlements that could have been drafted, but there is only one settlement proposal before the Commission in this case. PSE, Commission Staff, the NW Energy Coalition, The Energy Project and the Northwest Industrial Gas Users ("NWIGU") request that the Commission approve this settlement.

Q. Were The Energy Project and NWIGU parties to the original settlement?

A. No. These parties have joined the settlement subject to certain conditions. The Energy Project joined the settlement subject to certain conditions. The Energy Project joined the settlement under the conditions that PSE and Commission Staff support additional funding for low-income bill assistance. Additionally, PSE has agreed to provide additional shareholder funding for low-income energy efficiency programs NWIGU joined subject to Schedules 85/85T and 87/87T being treated as rate plan customers rather than through the decoupling mechanism and subject to other terms set forth in the Settlement Joinder.

Q. How can a cumulative $351 million rate increase from decoupling and ERF benefit customers?

A. Customers will continue to benefit from a safe and reliable electric and natural gas system. The rate increase proposed in the settlement will provide PSE with the resources needed to efficiently operate, maintain and improve its critical delivery system. The rate increases proposed in the Multiparty Settlement provide customers with predictable rates and maintain the limits on equity return to the company established in the 2011 General Rate Case. Without the agreement, the cumulative rate increase over the comparable time frame is unknown.

It is important to consider the rate increases in the context of the number of customers PSE serves, the miles of pipes and wires PSE services, and PSE’s total revenue requirement. For example, in 2011 PSE delivered more than 302 million cubic feet of natural gas to over 750,000 customers daily through a pipeline network consisting of 12,000 miles of mains and 13,000 miles of gas service lines. PSE delivered on average approximately 62,000 megawatt-hours of electricity per day to over 1.1 million customers through approximately 20,500 miles of distribution lines and approximately 2,600 miles of transmission lines. [[5]](#footnote-5) The simple math is that the cumulative rate increase comes to less than $190 per customer ($365mm / 1.85 million customers) over the next four years. That’s less than $50 a year per customer.

Moreover, as previously discussed, the K-factor and rate plan proposed in this Multiparty Settlement require PSE to operate efficiently, within a fixed, predetermined revenue requirement that contains a significant stretch component, in the face of historical expense trends that exceed the K-factor increases proposed in this settlement. Customers benefit from a ratemaking paradigm that encourages more efficiency in operations.

## B. Decoupling

Q. How do you respond to the testimony of Mr. Deen that PSE’s decoupling proposal “effectively insulate[s] PSE from losses as result of conservation and improperly shift the risk of loss from conservation measures to ratepayers.” (Deen, p. 28)

A. I find it refreshing that Mr. Deen acknowledges that utilities such as PSE have borne the full risk of losses from conservation up until this time. I am unaware of any upward adjustment to PSE’s return on equity (“ROE”) to reflect the greater risk shareholders faced when conservation was mandated—for example when the Energy Independence Act was passed—and, as a result, I see no reason why decoupling should be accompanied by a decrease in ROE. The testimonies of Mr. Cavanagh and Mr. Doyle confirm that the majority of commissions around the country do not reduce utilities' equity returns or the equity component of utilities' capital structures when decoupling is implemented. Also, Mr. Deen fails to consider the legislative mandate in RCW 80.28.260 that the Commission must consider policies to protect a company from a reduction of short-term earnings that may be a direct result of utility programs to increase the efficiency of energy use. Based on this statute, utilities should not bear the full risk of loss from conservation measures.

**Q. How do you respond to Mr. Gorman’s testimony that “revenue decoupling is an inappropriate and unwarranted departure from traditional ratemaking principles” that should be rejected by the Commission? Exhibit No. \_\_\_(MPG-1T), page 21 lines 17-18.**

A. Mr. Gorman disregards completely the direction set forth by the Commission in its Decoupling Policy Statement. Further, he fails to recognize the emphasis on energy conservation established in Washington’s State Energy Policy. Significantly, Mr. Gorman agrees that revenue decoupling removes the strong incentives associated with sales growth that are created by the traditional ratemaking process, making shareholders indifferent to the impact of fluctuations in energy sales in its service territory,[[6]](#footnote-6) but apparently he sees this as a negative. It suggests Mr. Gorman endorses the antiquated historic regulatory model of rewarding utilities for encouraging their customers to use more energy. The State’s energy policy long ago moved beyond that philosophy and the Commission has addressed this progressive shift in policy in recent rate orders and policy proceedings. The very purpose of decoupling is to remove the financial incentive for utilities to sell more energy and make shareholders indifferent to the change in customer usage from such programs. Only by implementing a decoupling regime, like the one proposed in the Multiparty Settlement, can the throughput incentive be eliminated such that a utility can pursue efforts to exceed its conversation targets without suffering the well-documented economic disincentive to do so.

Q. Do you agree with Mr. Deen's proposal to consider the cost of capital in PSE’s pending PCORC proceeding?

A. No. The PCORC is an expedited six-month proceeding, which considers only power costs and effects only electric rates. Evidence on cost of capital would bog down the PCORC process making it a mini-general rate case and would create an unnecessary bifurcated cost of capital between the electric book and the gas book.

Moreover, the Multiparty Settlement does not include a provision for reviewing cost of capital until PSE files its next rate case, which PSE must do no later than April 2016. The settling parties’ waiver of the 90-day filing provisions embedded in the PCORC rules contemplated a delay in reviewing PSE’s total revenue requirement in the context of a traditional rate case filing, including cost of capital, until that time. To do otherwise contravenes the intent of the settlement. This approach is also consistent with the ERF proposal in PSE’s 2011 general rate case and recommendations from the Governor’s ratemaking discussion group.

# II. CONCLUSION

Q. Does this conclude your Prefiled Rebuttal Testimony?

A. Yes.

1. *See In the Matter of the Commn.'s Investigation of Recycling Revenue Sharing Plans,* Docket TG-112162, Interpretive and Policy Statement on RCW 81.77.185 (May 30, 2012). [↑](#footnote-ref-1)
2. *See WUTC v. PacifiCorp d/b/a Pacific Power & Light,* 204 P.U.R.4th 155, 171, Docket No. UE-991832, Third Supp. Order (Aug. 9, 2000). [↑](#footnote-ref-2)
3. *Id.* ("I also in that context want to emphasize that the prudence process is one of three…integral to our willingness to accept this settlement."). [↑](#footnote-ref-3)
4. *See WUTC v. PSE,* Docket Nos*.* UE-011570 and UG-011571 (consolidated), Twelfth Supp. Order at ¶¶ 18-20, 40 (June 20, 2002). [↑](#footnote-ref-4)
5. *See* McLain, Exh No. \_\_\_(SML-1CT), from the 2011 General Rate Case. [↑](#footnote-ref-5)
6. Exh. No. \_\_\_(MPG-1T) p.22, line 20 through p. 23, line 2; p. 24, lines 15-16. [↑](#footnote-ref-6)