

Exhibit No. ____ (TES-2)
DOCKET UE-121373
DOCKETS UE-121697/UG-121705
DOCKETS UE-130137/UG-130138
Witness: Thomas E. Schooley

BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY, INC.

Respondent.

DOCKET UE-121373
DOCKETS UE-121697/UG-121705
DOCKETS UE-130137/UG-130138

EXHIBIT TO
TESTIMONY OF

THOMAS E. SCHOOLEY

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

*Letter from Governor Gregoire to Chairman Goltz dated January 4, 2013
and
Response Letter from Chairman Goltz dated January 15, 2013*

March 27, 2013

CHRISTINE O. GREGOIRE
Governor



STATE OF WASHINGTON
OFFICE OF THE GOVERNOR

P.O. Box 40002 • Olympia, Washington 98504-0002 • (360) 753-6780 • www.governor.wa.gov

January 4, 2012

Washington Utilities and Transportation Commission
1300 S. Evergreen Park Dr. SW
Olympia, WA 98504-7250

Dear Chairman Goltz and Commissioners Oshie and Jones:

I am writing to ask the Washington Utilities and Transportation Commission to undertake a number of administrative actions to improve the UTC energy ratemaking process.

It is important that Washington's regulatory climate encourages prudent and necessary investment in the infrastructure needed to ensure a reliable energy system, and maximizes the opportunity for energy efficiency and the use of clean and renewable energy. As you know, concerns have been expressed by our regulated utilities that existing rate-setting practices and timelines have made it difficult for the utilities to recover costs related to these investments. In response, I convened an informal discussion group, with experts from UTC, consumers, regulated utilities, energy advocates and others, to recommend improvements to the existing process.

The group came to agreement on a number of administrative actions that UTC could take under their existing authority. The group noted that UTC had already made progress on some of the concerns, such as the Commission's formal policy on renewable energy projects, and recommended additional actions to accelerate the work of the Commission.

A list of the group's recommendations is enclosed. I respond to the recommendations in three categories, as follows:

First, the group recommends that the Commission use its rulemaking or policy development authority to establish or clarify processes or standards relating to the setting of rates. These would include provisions for expedited rate proceedings, general ratemaking principles, the establishment of legislative-type policies related to ratemaking, rate case filing requirements, and the settlement process. (Recommendations 1-5)

I fully agree with these recommendations and ask the Commission to move forward with their implementation. Clear rules and policies will increase the efficiency, predictability and consistency of the regulatory system, and will help ensure a timely recovery on infrastructure investments.

Second, the group recommends that the Commission continue its work on implementing LEAN processes and include a broader set of stakeholders in relevant LEAN discussions. (Recommendation 8)

I appreciate the Commission's current efforts to implement LEAN principles in your work. Because many of the Commission's processes have such a large potential financial impact on utilities and on utility customers, representatives of those groups should be included in the LEAN discussions, in particular when you turn to the ratemaking process.



Washington Utilities and Transportation Commission
January 4, 2013
Page 2

Finally, the group recommends appropriate actions, by the Commission and other state agencies, to ensure that the Commission is better able to recruit and retain expert staff, such as accountants, economists, engineers, and administrative law judges, in order to better fulfill its ratemaking and policy development functions. The group also recommended additional funding for the Office of Public Counsel within the Office of the Attorney General, so that Public Counsel can better participate in rate cases, settlements, and Commission policy development. (Recommendations 7 and 9)

As noted by the group, UTC funding is derived from fees paid by the regulated companies, and sufficient funds exist in the dedicated account. I agree with the need to appropriate sufficient resources to make sure the system functions effectively and efficiently. To that end, I proposed a 2013-2015 state operating budget that includes an increase in funding for Public Counsel.

I also agree with the need to secure and retain qualified technical experts for the Commission. I share the group's concern with the number of Commission regulatory and policy staff that have accepted positions for higher compensation with private utilities, as well as at public power entities and even other state agencies.

Therefore, I am requesting that the Office of the State Human Resources Director undertake, in cooperation with the Commission, an evaluation of the appropriate classification for the relevant positions at the Commission. Further, I ask the Commission to take steps within existing resources to fill vacant positions and use existing authority to secure competitive salaries for staff positions as needed to successfully implement the recommended actions, and as essential to ensuring an effective energy ratemaking system.

I am sending a copy of this letter to Governor-Elect Inslee as well as to the currently assigned committee chairs and ranking members in the Senate and House of Representatives. I encourage them to engage with the Commission and periodically review progress in improving the ratemaking process.

I appreciate the Commission's progress to date on these issues, and urge your prompt attention to implementing the recommended actions to ensure that our energy systems are safe, reliable and affordable over the long term.

Sincerely,



Christine O. Gregoire
Governor

Enclosure

cc: Governor-Elect Jay Inslee
Senator Kevin Ranker
Senator Jerome Delvin
Representative John McCoy
Representative Larry Crouse
Office of the State Human Resources Director

SUMMARY OF RECOMMENDATIONS FROM THE RATEMAKING DISCUSSION GROUP

1. Establish by rule a mechanism by which investor-owned utilities may seek expedited treatment of a request for a rate increase that updates test period information on investment (including generation, transmission and distribution facilities), revenues, and expenses since the last formal rate proceeding. The purpose is to hold some elements of rates constant, such as recently determined rate of return and capital structure, and focus on changes in investment, revenues, and expenses in order to minimize regulatory lag. The rule should include the prerequisites for such a request, limitations on its use, and the process by which it will be considered.
2. Establish, and adopt by rule or initially by policy statement, “ratemaking principles” – to reduce repetitive litigation, and to increase predictability and consistency of rate decisions, with an initial focus on:
 - The methods for determining capital structure.
 - Separate accounting of energy conservation costs (e.g., “decoupling” or other methods to address the “throughput incentive”).
 - The use of attrition, pro forma and other adjustments to better match up investment and recovery.
3. Initiate an ongoing docket of, or other regular process to address, significant legislative-type policy decisions, in particular those of first impression, with a clear intent to adopt generic requirements, policy guidance, or formal rules as appropriate. Establish an administrative system to maintain a current system of adopted policies, to be consistently applied by all parties.
4. Establish new requirements for information that must be pre-filed for a rate case, in order to improve communications, enhance the opportunities for early settlement, reduce later discovery work, and shorten the regulatory proceedings.
5. Improve the current case settlement process by requiring and appointing a qualified settlement judge for all major cases, as determined by UTC. Authorize the settlement judge to effectively lead the settlement process, including the authority to establish requirements for the parties to the settlement process, to mediate agreement among the parties, and to resolve or dismiss issues from the settlement process.
6. Move state funding for the office of Public Counsel from the UTC to the Office of the Attorney General, to establish the appropriate lines of accountability. Ensure the PC has adequate resources to effectively participate in the UTC process, including settlements. Adjust funding to better match the current pace of rate cases. (These actions can be done through the state budget, using utility funding from the Public Service Revolving Fund.)
7. Ensure that UTC has an ongoing ability to recruit, train and retain qualified staff, with competitive compensation. This will include some needed changes to the personnel classifications of UTC positions.
8. Engage the key stakeholders in the ongoing UTC process improvement group (Lean), including the “UTC bar.”
9. The current fees paid by regulated electric companies to the state provide sufficient revenue for the UTC ratemaking process, including the increased system investments called for in this outline. The Group recommends the fund balances should be directed to ensuring that the system functions properly, and not redirected to other state programs.



STATE OF WASHINGTON

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

1300 S. Evergreen Park Dr. S.W., P.O. Box 47250 • Olympia, Washington 98504-7250
(360) 664-1160 • TTY (360) 586-8203

January 15, 2013

The Honorable Christine O. Gregoire
Governor of Washington
Legislative Building
Olympia, Washington 98504-0002

Dear Governor Gregoire:

Thank you for your January 4, 2013, letter requesting the Utilities and Transportation Commission to take certain administrative actions to improve our ratemaking processes and recommending that we work with the Office of the State Human Resources Director to address our ongoing recruitment and retention issues.

These recommendations were considered by an informal group of people, involved or knowledgeable in energy regulatory matters, convened at your request and coordinated under the leadership of your energy adviser, Keith Phillips. I was pleased to participate in the meetings of what came to be known as the "ratemaking discussion group."

Though the group was convened with a charge to consider both legislative and administrative actions, the group concluded that legislative action is not warranted at this time. However, it did recommend a number of administrative actions for consideration by the Commission, essentially to use our rulemaking and policy development authority to clarify or articulate standards relating to the setting of rates. I am pleased that the discussion group focused on these administrative issues and that you are endorsing them to the Legislature and to Governor-Elect Inslee.

Let me summarize what we have undertaken already relative to these proposals and what I personally hope we can accomplish in the next biennium.

1. *Expedited rate proceedings.* In the Commission's May 7, 2012, decision on the request for a rate increase for Puget Sound Energy (PSE) in Docket Nos. UE-111048 and UG-111049, the Commission staff proposed a process for an expedited rate proceeding akin to the type endorsed by the discussion group. The Commission endorsed this or other processes that could help break the cycle of almost annual rate cases. I understand that PSE and Commission Staff have had discussions on how best to accomplish this for that utility. I agree that such a process would benefit from some guidance from the Commission, and that guidance would best be developed through a public process involving all relevant stakeholders.

The Honorable Christine Gregoire
Governor of Washington
January 15, 2013
Page 2 of 3

- 2. Establishment of general ratemaking principles and policies and use of legislative-type proceedings to articulate policy.* As I have explained to the discussion group, though setting of rates is "legislative" in nature, state law requires that it be done in a formal adjudicative proceeding under the Administrative Procedure Act. That can result in a lack of regulatory certainty and limitations on the Commission's ability to consider factors outside a formal evidentiary record. Accordingly, we have in recent years used more generic, legislative-type processes to develop general principles that can be applied in specific rate proceeding. Examples in the energy area include policy statements on conservation incentives (UTC Dkt. No. UE-100522); acquisition of renewable resources (UTC Dkt. No. UE-100849); and determining whether projects are "eligible renewable resources" under Initiative 937 (UTC Dkt. No. UE-111016). We also have adopted policy statements on the sharing of revenues from sales of recyclables (UTC Dkt. No. TG-112162) and enforcement (UTC Dkt. No. A-120061). There is an ongoing proceeding on commission policies to evaluate the cost-effectiveness of gas conservation programs (UTC Dkt. No. UG-121207).

I fully expect that, consistent with the discussion group's recommendations, the Commission will continue this trend, articulating general standards for ratesetting and articulating general policies. Indeed, in our recent decision approving a multi-party settlement with Avista Utilities, we indicated that we would commence a generic proceeding to consider regulatory mechanisms to account for utility "earnings erosion" or "attrition" caused by the need for major capital investment or other factors. (UTC Dkt. Nos. UE-120436, UG-120437.)

- 3. Additional filing requirements for rate proceedings.* At one of the meetings of the discussion group, one participant with experience in Oregon recommended that we adopt a rule similar to that of the Oregon Public Utility Commission that requires utilities filing a general rate case to file responses to a "standard data request," in effect accelerating some of the discovery process. This could have the effect of saving valuable pre-hearing time, thereby enabling the Commission to process these cases more quickly or allow more time for parties to discuss settlement. I hope we can commence a rulemaking proceeding on this issue in the near future.
- 4. Improve and formalize settlement processes.* Current Commission policy, as embodied in rules, encourages settlement. In the past, on occasion, the Commission has appointed a qualified administrative law judge, not presiding in the case, to serve as a settlement judge. In the recent rate case with PacifiCorp, the Commission appointed such a settlement judge. He successfully facilitated an agreement by which all parties agreed the rates met the statutory "fair, just, reasonable, sufficient" standard and also set in motion a collaborative process to address a number of ratemaking process issues. (UTC Dkt. No. UE-111190.) Subject of course to staffing constraints, we will explore appointing as a

The Honorable Christine Gregoire
Governor of Washington
January 15, 2013
Page 3 of 3

matter of course a settlement judge in certain classes of cases and certainly will use such an appointment whenever we agree with the parties that it would be useful.

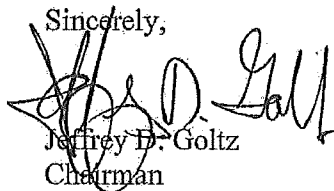
In sum, I am pleased to continue, and accelerate, the work on these process issues.

The discussion group also recommended, and you endorsed, continued work on LEAN principles and the inclusion of stakeholders in LEAN discussions relating to the ratemaking process. I agree. We have not focused our LEAN efforts to date on the ratemaking process, hoping to learn from some smaller projects involving various paperwork and licensing processes. However, we have been reviewing our rate case processes on a less formal basis. In that regard, we have a meeting annually with the attorneys who practice before us in all areas in part for the purpose of discussing process issues. For the next such "bench-bar" meeting, I will recommend formalizing stakeholder involvement in LEAN process discussions.

Finally, the discussion group recommended that the Commission's staff salaries be competitive with the market so that we can recruit and retain qualified employees. As the group learned, the Commission has lost a significant number of its best senior staff in recent years not just to investor-owned utilities but to publicly-owned utilities and to state agencies as well. The Commission's existing salary structure is simply inadequate to recruit and retain technically trained staff such as accountants, engineers, and economists who can find similar jobs, for greater pay, elsewhere in the private and public sectors. Therefore, I particularly appreciate your endorsement of this recommendation and requesting that the Office of the State Human Resources Director work with us in reviewing appropriate job classifications. That effort is already underway, as are efforts to review other possible steps we can take in this regard.

Again, thank you your interest in the work of the Commission and helping us with improved processes that can further our statutory charge to balance the interest of our utilities and the customers they serve.

Sincerely,



Jeffrey D. Goltz
Chairman

cc: Governor Elect Jay Inlsee
Senator Kevin Ranker
Senator Jerome Delvin
Representative John McCoy
Representative Larry Crouse
Office of the State Human Resources Director

