Exhibit No. ___ (DWS-17T)
Docket Nos. UG-040640 *et al.*
Witness: Donald W. Schoenbeck

BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. PUGET SOUND ENERGY, INC., Respondent.	**DOCKET NO. UG-040640** **DOCKET NO. UE-040641** *(consolidated)*
In the Matter of the Petition of PUGET SOUND ENERGY, INC. For an Order Regarding the Accounting Treatment for Certain Costs of the Company's Power Cost Only Rate Filing.	**DOCKET NO. UE-031471** *(consolidated)*
In the Matter of the Petition of PUGET SOUND ENERGY, INC. For an Accounting Order Authorizing Deferral and Recovery of the Investment and Costs Related to the White River Hydroelectric Project.	**DOCKET NO. UE-032043** *(consolidated)*

CROSS ANSWERING TESTIMONY OF
DONALD W. SCHOENBECK
ON BEHALF OF
THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

November 3, 2004

I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME.

A. My name is Donald W. Schoenbeck. I am a member of Regulatory & Cogeneration Services, Inc., a utility rate and economic consulting firm. I am the same Donald Schoenbeck who sponsored direct testimony in this proceeding on behalf of the Industrial Customers of Northwest Utilities ("ICNU").

Q. WHAT IS THE PURPOSE OF YOUR CROSS ANSWERING TESTIMONY?

A. The purpose of my cross answering testimony is to respond to arguments offered by the Staff and Public Counsel regarding: 1) electric rate spread; 2) hydro normalization; and 3) the appropriate gas price forecast.

II. ELECTRIC RATE SPREAD

Q. ARE THERE ANY ISSUES IN THE ELECTRIC RATE SPREAD TESTIMONY OF PUBLIC COUNSEL WITNESS JIM LAZAR THAT YOU WOULD LIKE TO ADDRESS?

A. Yes. Mr. Lazar suggests that retail wheeling customers who take service on Schedule 449 are within a reasonable parity ratio, based on a flawed hypothetical adjustment to administrative and general ("A&G") costs. The Commission should reject Mr. Lazar's approach and approve a rate spread that recognizes that the rates of retail wheeling customers are greater than their cost of service.

Q. CAN YOU PLEASE EXPLAIN MR. LAZAR'S RECOMMENDATION?

A. Mr. Lazar acknowledges that retail wheeling customers have a parity ratio of 120% under the Commission Basis Cost of Service Study.[1/] This ratio is outside

[1/] Exh. No. __ (CEP-9) at 2; Exh. No. __(JL-1T) at 20-21.

his "range of reasonableness" of a 90% to 110% parity ratio.[2/] However, Mr. Lazar proposes to alter the Commission Basis Cost of Service Study to include A&G costs that he believes should be directly allocated to retail wheeling customers. According to Mr. Lazar, directly allocating these A&G costs to retail wheeling customers would result in a retail wheeling parity ratio of 96%, which falls within Mr. Lazar's range of reasonableness.[3/] From this "revised" number, Mr. Lazar concludes that the proposed increase in revenue requirement should be spread over all customer classes on a uniform percentage basis, because they are all close to parity.[4/]

In Puget Sound Energy's ("PSE") cost of service study, the total revenue requirement for the retail wheeling class, before Mr. Lazar's adjustment, is approximately $7 million, which includes approximately $0.8 million of A&G costs that are allocated to retail wheeling customers.[5/] Mr. Lazar's A&G adjustment would nearly triple the amount of A&G costs allocated to Schedule 449 by adding an additional $3 million to the Schedule 449 class revenue requirement, resulting in a total of $3.8 million in A&G costs being allocated to the retail wheeling customers.[6/] As a result, the total revenue requirement for retail wheeling customers would increase by 39% to approximately $10 million.

Mr. Lazar supports his proposal by comparing it to the modifications to gas cost of service studies that were adopted when gas transportation services

[2/] Exh. No. __ (JL-1T) at 20-21.
[3/] Id. at 21.
[4/] Id. at 25.
[5/] Exh. No. __ (JL-5) at 1-2.
[6/] Id.

were introduced.[7] According to Mr. Lazar, these modifications allocated a portion of the A&G expenses on the basis of throughput, and a portion based on a subtotal of other operation and maintenance costs.[8] Finally, Mr. Lazar claims that his proposal to assign additional A&G expenses to Schedule 449 customers is justified because he believes significant management attention is given to large customers and this cost is not recovered through transmission and distribution rates.[9]

Q. HOW IS MR. LAZAR'S ANALYSIS FLAWED?

A. Mr. Lazar's A&G adjustment is unreasonable because it is inconsistent with how PSE operates its system. Mr. Lazar inappropriately and without any cost support seeks to assign a higher percentage of A&G expense to Schedule 449 customers simply for the purpose of shifting costs to those customers. Mr. Lazar provides no support for his unsubstantiated claim that PSE is allocating additional management attention to serve its retail wheeling customers. In fact, since Schedule 449 was implemented, PSE has derived a dramatically smaller revenue requirement from its larger customers, which suggests that PSE has likely reduced the management attention given to large customers. Finally, Mr. Lazar provides no empirical evidence comparing the A&G costs of retail wheeling customers with other customer classes.

In addition, regardless of whether retail wheeling is analogous to gas transportation, the results of Mr. Lazar's recommendation must be reasonable before the Commission should apply the same cost allocation principles. For

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[7] Exh. No. __ (JL-1T) at 22.
[8] Id.
[9] Id.

retail wheeling or Schedule 449 customers, Mr. Lazar's proposal would result in A&G costs comprising 37% of the class revenue requirement, when total A&G costs comprise only about 10% of PSE's non-production costs.[10/] A methodology that results in A&G costs comprising almost 40% of the class revenue requirement, when A&G costs are a much smaller portion of the overall revenue requirement, is unreasonable.

Q. DO YOU AGREE WITH STAFF WITNESS JOELLE STEWARD'S RATE SPREAD RECOMMENDATION?[11/]

A. No. As I noted in my direct testimony, PSE's new cost model implements a greater degree of direct assignment of costs instead of using general allocation factors.[12/] As a result, PSE's model provides a more accurate assignment of costs than previous models.

Q. DOES MS. STEWARD OPPOSE PSE'S NEW COST OF SERVICE MODEL?

A. Yes. Ms. Steward appears to take exception to the model on the basis that it shifts costs between customer classes.[13/] However, Ms. Steward recognizes that the greater accuracy of cost assignment that the PSE model provides "may justify reevaluation of some of the previously accepted methodologies."[14/]

Q. DO YOU AGREE WITH MS. STEWARD'S PROPOSAL REGARDING COST ALLOCATION?

A. No. The Commission should adopt the cost of service allocation proposed by the Company, subject to the two modifications proposed in my direct testimony. ICNU's proposed revenue to cost ratios are set out in the table on page 36 of my

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10/ Exh. No. __ (JHS-E3C) at 1.
11/ Exh. No. __ (JRS-1T) at 17-20.
12/ Exh. No. __ (DWS- 1HCT) at 32.
13/ Exh. No. __ (JRS-1T) at 17.
14/ Id. at 12.

direct testimony.[15/] This proposal is an improvement over previous methodologies because it more accurately assigns costs on a cost causation basis.

Q. WHAT DO YOU RECOMMEND WITH RESPECT TO RATE SPREAD?

A. The Commission should implement PSE's proposed rate spread, subject to removal of the proposed floor value, because it implements the results of the cost of service study without causing undue harm to other customers.[16/]

III. HYDROELECTRIC GENERATION

Q. DO YOU SUPPORT STAFF'S RECOMMENDATION TO USE 50 WATER YEARS FOR MODELING HYDRO GENERATION?

A. No.

Q. PLEASE DESCRIBE STAFF WITNESS YOHANNES MARIAM'S RECOMMENDATION.

A. Dr. Mariam recommends departing from the Commission's historic use of 40 years of streamflow data for modeling hydro generation.[17/] I note that Dr. Mariam appears to agree with me that the issue of the use of water years in modeling hydro generation should be studied further. Dr. Mariam states, "Staff encourages the Company to engage regional and national researchers to develop an approach for hydro normalization."[18/] Dr. Mariam also agrees with my conclusion that the Commission has historically utilized a 40-year streamflow analysis for normalizing hydro generation.[19/]

Despite recognizing the Commission's precedent regarding the use of 40 years of hydro data, Dr. Mariam recommends that the Commission abandon its

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15/ Exh. No. __ (DWS-1HCT) at 36.
16/ *See* id. at 36-38.
17/ Exh. No. __ (YKGM-1T) at 5, 23-25.
18/ Id. at 27.
19/ Id. at 23-24.

historic approach to hydro normalization and do so before developing a consistent policy on hydro normalization for all three Washington investor-owned electric utilities. Dr. Mariam's recommendation is based on his belief that "there is no definitive rule for deriving normal hydro or water years."[20/]

Q. WHY SHOULD STAFF'S 50-YEAR STREAMFLOW PROPOSAL BE REJECTED?

A. The Commission has a long-standing precedent rejecting proposals to use 50 and 60 years of hydro data.[21/] In addition, the Commission has found that the use of 40 years of hydro data is appropriate for PSE because it is less prone to errors. For example, in 1993, the Commission rejected the Company's proposal to use a 50-year average and stated that Puget Sound Power & Light was "put on notice that [a 40-year rolling average] will remain the Commission's position on this issue unless and until a clear and convincing argument supports a superior alternative."[22/] Dr. Mariam does not provide a clear and convincing argument to abandon the use of 40 years of hydro data, nor is his alternative superior.

As I explained in my direct testimony, the use of the latest 40 years of hydro data is tested and proven, and should be used to develop base rates until the Commission determines that a different standard should be applied. Encouraging utilities to deviate from the existing 40-year standard on an ad hoc basis will result in proposals to use the number of streamflow years that produces the greatest rate increase, which is exactly what PSE has done in this proceeding.

20/ Id. at 23.

21/ *E.g.* WUTC v. Avista, WUTC Docket Nos. UE-991606 and UG-991607, Third Suppl. Order at 43 (Sept. 29, 2000); WUTC v. Puget Sound Power & Light Co., WUTC Docket Nos. UE-920499 and UE-921262, Eleventh Suppl. Order (Sept. 21, 1993); WUTC v. the Washington Water Power Co., WUTC Cause No. U-85-36, Third Suppl. Order at 17-18 (April 4, 1986).

22/ WUTC v. Puget Sound Power & Light Co., WUTC Docket Nos. UE-920499 and UE-921262, Eleventh Suppl. Order (Sept. 21, 1993).

IV. NATURAL GAS PRICES

Q. DO YOU HAVE ANY CONCERNS REGARDING STAFF'S NATURAL GAS PRICE PROPOSAL?

A. Yes. Staff's proposed natural gas price forecast should be rejected because it takes into account only the short-term future, and fails to propose a long-term, durable methodology for estimating natural gas prices for PSE.

Dr. Mariam's gas price forecast attempts to forecast a "better" gas price to use in setting the Company's base power costs under the Company's power cost adjustment ("PCA") mechanism. The analyses performed by both Staff and PSE are based on an assumption that recent gas prices are the best predictors of future gas prices. However, neither the Company's nor Dr. Mariam's analyses are accurate for the long-term, because recent prices are a less-reliable predictor the further out in time the analysis is performed. In contrast, I propose using normalized gas costs to set the power cost baseline.

Q. WHAT IS THE IMPACT OF PSE'S PCA ON STAFF'S PROPOSED NATURAL GAS PRICE FORECAST?

A. As I explained in my direct testimony, the value selected for natural gas in this proceeding will not have a significant impact on the Company because the PCA virtually eliminates sharing once the $40 million PCA cap is reached, which will likely be well before July 1, 2006.[23/] As a result, prior to July 1, 2006, the PCA will allow PSE to recover deviations between the forecast gas price assumed in base power costs and the actual gas price. Dr. Mariam acknowledges that the PCA will limit PSE's losses due to price fluctuations.[24/]

23/ Exh. No. __ (DWS-1HCT) at 16-17.
24/ Exh. No. __ (YKGM-1T) at 32.

The PCA provides for a new sharing mechanism applicable to the difference between the baseline gas prices and actual gas prices after July 1, 2006. At that point, the PCA should measure the difference between gas prices based on normalized conditions and actual gas prices, not the difference between forecast gas prices and actual gas prices. Staff's proposal is a short-term remedy, because the Staff forecast of gas prices does not extend beyond June 30, 2006.[25/] Staff's proposal requires the Commission to conduct a new proceeding to develop a new gas price forecast or new normalized gas prices prior to June 30, 2006.

In contrast, my proposal is a more durable, long-term solution regarding gas prices. I propose that the Commission adopt a long-term, normalized gas price forecast that is based on a more rigorous and sophisticated analysis than simply forecasting forward prices.[26/] ICNU's proposal, unlike Staff's, would not expire in June 2006, would not require a new proceeding to determine gas prices, and would allow the PCA to recover actual differences based on the agreed upon methodology in the PCA.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

25/ Id. at 33.

26/ Exh. No. __ (DWS-1HCT) at 15.