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**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

DOCKET NOS. UE-060266
UG-060267

Complainant,

v.

PUGET SOUND ENERGY, INC.,
Respondent.

**DIRECT TESTIMONY
OF
DONALD W. SCHOENBECK
ON BEHALF OF
THE NORTHWEST INDUSTRIAL GAS USERS**

JULY 25, 2006

1 **DIRECT TESTIMONY OF DONALD W. SCHOENBECK**
2 **ON BEHALF OF THE NORTHWEST INDUSTRIAL GAS USERS**

3 **INTRODUCTION AND SUMMARY**

4 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS**

5 A. My name is Donald W. Schoenbeck. I am a member of Regulatory &
6 Cogeneration Services, Inc. ("RCS"), a utility rate and economic consulting firm. My
7 business address is: 900 Washington Street, Suite 780, Vancouver, WA 98660.

8 **Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.**

9 A. I've been involved in the electric and gas utility industries for over 30 years. For
10 the majority of this time, I have provided consulting services for large industrial
11 customers addressing regulatory and contractual matters. I have appeared before the
12 Washington Utilities and Transportation Commission ("WUTC" or "Commission") on
13 many occasions, including proceedings regarding the establishment of charges for
14 customers of Puget Sound Energy Inc. ("Puget" or the "Company"). A further
15 description of my educational background and work experience can be found in Exhibit
16 No. ____ DWS-2 in this proceeding.

17
18 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

19 A. I am testifying on behalf of the Northwest Industrial Gas Users ("NWIGU").
20 NWIGU is a nonprofit association comprised of thirty-two end-users of natural gas with
21 major facilities in the states of Washington, Oregon and Idaho. NWIGU members
22 include diverse industrial interests, including food processing, pulp and paper, wood
23 products, electric generation, aluminum, steel, chemicals, electronics and aerospace. The
24 association provides an information service to its members and participates in various
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1 regulatory matters that affect member interests. NWIGU member companies purchase
2 natural gas sales and transportation services from local distribution companies (“LDCs”),
3 including Puget.

4 **Q. PLEASE BRIEFLY SUMMARIZE THE TOPIC YOU WILL ADDRESS AND**
5 **YOUR RECOMMENDATION.**

6 A. I am responding to the proposal forwarded by Mr. Story and Mr. Karzmar to
7 establish a “depreciation tracker” that would allow Puget to increase its natural gas rates
8 between rate cases to reflect increases in the Company’s depreciation expenses between
9 rate cases. *See* Exhibits JHS-IT and KRK-IT. PSE is proposing a tracking mechanism to
10 surcharge natural gas customers in order to recover increased expenses stemming from
11 growth in depreciation due to natural gas transmission and distribution plant investment.

12
13 The depreciation tracker proposal should be rejected by the Commission because
14 it is single-issue ratemaking that isolates one of dozens of factors that impact a utility’s
15 earnings between rate cases. The proposal advanced by Puget does not balance
16 shareholders’ and ratepayers’ interests.

17
18 **Q. COMPANY WITNESSES CLAIM THAT THE DEPRECIATION TRACKER IS**
19 **DESIGNED TO ADDRESS EARNINGS ATTRITION THAT PUGET IS**
20 **EXPERIENCING BETWEEN RATE CASES. WHY DO YOU DISAGREE WITH**
21 **THIS PROPOSAL?**

22 A. There are many reasons why a utility might earn less than its authorized return in
23 years immediately following a rate case. Loads can be lower than forecasted, operating
24 expenses can be higher, and the cost of debt can be higher than forecasted. It is equally
25 true that numerous events can result in a utility earning more than was forecasted when
26 rates were set in a rate case. Expenses can be below forecasts, revenues can exceed those

1 used in establishing rates, and the cost of capital can decline. A change in depreciation
2 expenses is only one of numerous elements of Puget's business that changes over time.

3 **Q. MR. STORY STATES THAT THE HIGH LEVEL OF CAPITAL INVESTMENT**
4 **PUGET IS EXPERIENCING IN NATURAL GAS INFRASTRUCTURE**
5 **IMPROVEMENTS MAKES DEPRECIATION EXPENSE AN ITEM THAT**
6 **SHOULD BE SINGLED OUT FOR SPECIAL TREATMENT THROUGH A**
7 **TRACKING MECHANISM. WHY DO YOU DISAGREE?**

8 **A.** First, depreciation is not an expense that puts any cash strain on the Company.
9 Depreciation is purely an accounting expense. While changes in depreciation expenses
10 can impact the Company's earnings, it is vastly different than purchased gas costs, for
11 example, that could put a real cash strain on the Company. Second, Puget fails to note
12 that incremental depreciation expense associated with infrastructure improvements can
13 also lead to cost savings in other areas of the Company's operations. When older pipe is
14 replaced, operation and maintenance expenses should decline.

15 What Mr. Story and Mr. Karzmar have done in their testimony is focus on one
16 negative change to the Company's earnings that can occur between general rate cases.
17 They are ignoring, however, the many changes that work in Puget's favor between rate
18 cases, such as productivity improvements, additional revenue the Company realizes by
19 obtaining new customers, lower capital costs, and lower maintenance expense.

20 Allowing Puget to adjust its rates by isolating depreciation expense would be a bad
21 regulatory policy. While Puget is allowed to adjust rates to reflect changes in gas costs
22 through its Purchased Gas Adjustment, single-issue ratemaking is, and must continue to
23 be, a rare exception to the broader policy of only adjusting a utility's rates through a
24 general rate case.
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1 **Q. PUGET WITNESSES ASSERT THAT THE DEPRECIATION TRACKER IS**
2 **BEING FORWARDED AS AN ALTERNATIVE TO AN ATTRITION**
3 **ADJUSTMENT AND CITE PRECEDENT FROM THIS COMMISSION THAT**
4 **PREVIOUSLY ALLOWED ATTRITION ADJUSTMENTS. DO YOU AGREE**
5 **WITH THE COMPANY'S ASSERTION THAT PAST COMMISSION**
6 **PRECEDENT ALLOWING ATTRITION ADJUSTMENTS IS SOUND**
7 **PRECEDENT FOR ADOPTING THE DEPRECIATION TRACKER?**

8 A. No. The economic conditions that existed in the 1980s that lead to the adoption
9 of an attrition adjustment are starkly different from the economic conditions facing Puget
10 today. Puget cites to WUTC orders from 1983 to 1988 as precedent for an attrition
11 adjustment. In 1984, however, Puget's embedded cost of long-term debt was 10.09
12 percent. *See Puget Sound Power & Light Co.*, Cause No. U-83-54, Fourth Supplemental
13 Order, 62 PUR 4th 557 (Sept. 28, 1984). In that case, the WUTC authorized Puget to earn
14 a 16.25 percent return on equity. *Id.*

15 Today, Puget is not facing anything analogous to the economic conditions it faced
16 in the mid-1980s. During these times of low inflation and low cost of capital, the past
17 justifications for an attrition adjustment simply do not exist. The mere fact that Puget is
18 making significant capital investments in gas infrastructure is not justification for
19 allowing an attrition adjustment or a depreciation tracker.

20 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

21 A. Yes.

22 / / /

23 / / /

24 / / /

**QUALIFICATIONS AND BACKGROUND
OF
DONALD W. SCHOENBECK**

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Donald W. Schoenbeck, 900 Washington Street, Suite 1000, Vancouver, Washington 98660.

Q. PLEASE STATE YOUR OCCUPATION.

A. I am a consultant in the field of public utility regulation and I am a member of Regulatory & Cogeneration Services, Inc. (RCS).

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I have a Bachelor of Science Degree in Electrical Engineering from the University of Kansas and a Master of Science Degree in Engineering Management from the University of Missouri.

From June of 1972 until June of 1980, I was employed by Union Electric Company in the Transmission and Distribution, Rates, and Corporate Planning functions. In the Transmission and Distribution function, I had various areas of responsibility, including load management, budget proposals and special studies. While in the Rates function, I worked on rate design studies, filings and exhibits for several regulatory jurisdictions. In Corporate Planning, I was responsible for the development and maintenance of computer models used to simulate the Company's financial and economic operations.

In June of 1980, I joined the national consulting firm of Drazen-Brubaker & Associates, Inc. Since that time, I have participated in the analysis of various utilities for power cost forecasts, avoided cost pricing, contract negotiations for gas and electric services, siting and licensing proceedings, and rate case purposes including revenue requirement determination, class cost-of-service and rate design.

In April 1988, I formed RCS. RCS provides consulting services in the field of public utility regulation to many clients, including large industrial and institutional customers. We also assist in the negotiation of contracts for utility services for large users. In general, we are engaged in regulatory consulting, rate work, feasibility, economic and cost-of-service studies, design of rates for utility service and contract negotiations.

Q. IN WHICH JURISDICTIONS HAVE YOU TESTIFIED AS AN EXPERT WITNESS REGARDING UTILITY COST AND RATE MATTERS?

A. I have testified as an expert witness in rate proceedings before commissions in the states of Alaska, Arizona, California, Delaware, Idaho, Illinois, Montana, Nevada, North Carolina, Ohio, Oregon, Washington, Wisconsin and Wyoming. In addition, I have presented testimony before the Bonneville Power Administration, the National Energy Board of Canada, the Federal Energy Regulatory Commission, publicly-owned utility boards and in court proceedings in the states of Washington, Oregon and California.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on July 25, 2006 I caused to be served the foregoing DIRECT TESTIMONY OF DONALD W. SCHOENBECK ON BEHALF OF THE NORTHWEST INDUSTRIAL GAS USERS upon all parties of record on the following current Service List of these proceedings **via Federal Express** to their respective addresses, and via e-mail to those parties who provided e-mail addresses, as indicated below:

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11 DATED: July 25, 2006.
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