

**Exhibit No. \_\_\_ T (TES-4T)**  
**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**

**REBUTTAL TESTIMONY OF**

**THOMAS E. SCHOOLEY**

**STAFF OF  
WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION**

***In Support of Multiparty Settlement Re:  
Coal Transition Power Purchase Agreement and Other Pending Dockets***

**May 8, 2013**

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**LIST OF EXHIBITS**

Exhibit No. \_\_\_\_ (TES-3 Revised), Rates of return in Commission-basis Reports

1 I. INTRODUCTION

2  
3 Q. Please state your name and business address.

4 A. My name is Thomas E. Schooley. My business address is The Richard Hemstad  
5 Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA  
6 98504. My email address is tschoole@utc.wa.gov.

7  
8 Q. Are you the same Thomas E. Schooley that submitted testimony on March 27,  
9 2013?

10 A. Yes.

11  
12 II. SCOPE AND SUMMARY OF TESTIMONY

13  
14 Q. What is the purpose of your rebuttal testimony in this proceeding?

15 A. I reiterate Staff's support for the global settlement of five dockets<sup>1</sup> covering three  
16 major issues and rebut various claims of Public Counsel, and intervenors.<sup>2</sup>

17  
18 Q. Have any other parties joined the Global Settlement since Staff filed testimony  
19 on March 27, 2013?

20 A. Yes. NWIGU and The Energy Project have joined the Settling Parties.

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<sup>1</sup> Those five dockets are: Docket UE-121373, Coal Transition Power Purchase Agreement; Dockets UE-121697/UG-121705 (*consolidated*), Decoupling Plan; and Dockets UE-130137/UG-130138 (*consolidated*), Expedited Rate Filing (collective dockets, or Global Settlement).

<sup>2</sup> The intervenors filing testimony include the Industrial Customers of Northwest Utilities (ICNU), Northwest Industrial Gas Users (NWIGU), Nucor Steel, Kroger, and The Energy Project.

1 NWIGU accepts the Global Settlement as fair and reasonable with one  
2 condition. It requested that Schedules 85, 85T, 87 and 87T be removed from the  
3 decoupling mechanism and instead, be treated consistently with “rate plan  
4 customers.” The demand charges in these schedules will be exempt from the annual  
5 K-factor rate plan increases of 2.2 percent. The dollar impact is about \$300,000 over  
6 the term of the plan, and will be absorbed by PSE. This condition is acceptable to  
7 PSE and Staff.

8 The Energy Project joins the Global Settlement with the conditions: (1) The  
9 funding for HELP program is increased by \$1.5 million to a total of \$21.7 million;  
10 and (2) PSE’s shareholders will contribute an additional \$100,000 per year to low-  
11 income energy efficiency programs for a total of up to \$400,000 in additional non-  
12 recurring shareholder funding. These conditions are acceptable to PSE and Staff.

13  
14 **Q. Have you prepared any exhibits in support of your rebuttal testimony?**

15 **A.** Yes, I revised my Exhibit No. \_\_\_ (TES-3) to include the most recent information on  
16 PSE’s results of operations in 2012.

17  
18 **III. DISCUSSION**

19  
20 **A. Summary of Contested Issues**

21  
22 **Q. Please give a brief description of the issues presented by intervenors and Public**  
23 **Counsel in opposition to the Global Settlement.**

1 A. Public Counsel and the intervenors contest the Global Settlement with the following  
2 claims:

- 3 (a) They claim the rate of return is too high;
- 4 (b) They claim the use of end-of-period rate base is unfair;
- 5 (c) They claim decoupling and the K-factor is unacceptable in  
6 whole, or at least not without a decrease in the rate of return;
- 7 (d) They claim the rate plan is overly generous;
- 8 (e) They largely ignore the merits of the public benefits of the  
9 PSE/TransAlta Centralia Power Purchase Agreement.
- 10

11 **B. Rate of Return**

12

13 **Q. Please summarize your reply to concerns about the rate of return.**

14 A. The parties raise two distinct issues about the rate of return. One is the return in the  
15 expedited rate case (ERF); the other is adjusting the return for a decoupling program.  
16 Taking the ERF issue first; I must point out one basic premise of the ERF. The  
17 whole point of this filing receiving “expedited” processing is to keep certain  
18 ratemaking variables constant. Principal among those variables is the rate of return.  
19 The Commission determined that 7.8 percent was fair and sufficient in Dockets UE-  
20 111048/UG-111049 in Order 08 dated May 7, 2012. Subsequently, parties reached a  
21 settlement in the Avista general rate case.<sup>3</sup> The Commission accepted and adopted  
22 that settlement in December 2012, which authorized a 7.8 percent rate of return.  
23 Given that the Avista settlement is less than five months old, the rate of return of 7.8

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<sup>3</sup> *WUTC v. Avista*, Dockets UE-120436/UG-120437.

1 percent remains within the range of reasonableness. Although the record will now  
2 have some testimony on equity returns and capital structure, the Commission does  
3 not have before it sufficient or balanced presentations to enable it to arrive at a rate  
4 of return other than 7.8 percent. Moreover, the concept of an expedited rate filing  
5 does not contemplate that such a determination be made in this context. Finally PSE  
6 continues to earn significantly less than their authorized rate of return as I discuss  
7 below.

8  
9 **Q. What is your response to the issue of reducing returns in the context of a**  
10 **decoupling program?**

11 A. To that point, one must consider the fact that the rates in place today are not  
12 producing revenues sufficient to provide PSE its target rate of return of 7.8 percent.  
13 Nor have rates over the past several years been sufficient to keep up with the  
14 Company's increases in costs or investments. I presented Exhibit No. \_\_\_\_ (TES-3)  
15 as evidence of this trend and now update my exhibit to reflect the rate increase  
16 instituted in May 2012, and the earnings results for 2012.<sup>4</sup> Revised Exhibit No. \_\_\_\_  
17 (TES-3) shows PSE's electric earnings were about 70 basis points less and gas  
18 earnings were 30 basis points less than the rate of return granted in 2012. The other  
19 parties' push to reduce returns for any reason seem overstated since PSE's earnings  
20 are lower than its authorized rates of return and PSE has not achieved its authorized  
21 return for electric operations since 2006, and for gas operations since at least 2004.

22  

---

<sup>4</sup> Dockets UE-130652 and UG-130653.

1 **Q. The Commission’s policy statement advocates a reduction to a company’s rate**  
2 **of return in a decoupling setting. What do you make of that?**

3 A. The Decoupling Policy Statement sets forth principles for a decoupling plan, but the  
4 Commission clarifies its intent stating, “[The Policy Statement] was not intended to  
5 set forth immutable doctrine on [decoupling] or to negatively imply that we would be  
6 receptive to nothing else.”<sup>5</sup> The claim that decoupling reduces risk for regulated  
7 utilities has theoretical appeal, but is at best hypothetical and unsupported by  
8 empirical evidence. Here we have the opportunity to test that hypothesis. This full  
9 decoupling program will compare the financial revenues determined by multiplying  
10 the number of customers by the delivery revenues per customer versus the cash  
11 collected through volumetric rates intended to generate the same level of dollars.  
12 The magnitude of the refunds and surcharges will be direct evidence of the volatility  
13 dampened by the decoupling program. Given that this program addresses only  
14 delivery costs it cannot be extrapolated to the full impact on the utility’s rate of  
15 return. However, it will be a good measure of decoupling’s impact on the one-half to  
16 one-third of the revenues represented by the delivery of gas or electricity. It is  
17 important to understand these impacts on real world operations before establishing  
18 an “adjustment” to rates of return.

19  
20 **C. Expedited Rate Filing and End-of-Period Rate Base**

21  
22 **Q. Do the non-settling parties lodge complaints against the expedited rate filings?**

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<sup>5</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049, consolidated, Order 08 (May 7, 2012) (“Order 08”), page 167, fn 617.

1 A. Yes. Mr. Deen for ICNU raises issues concerning: (1) the rate of return; (2) a  
2 “hybrid” test year;<sup>6</sup> and (3) “the novel use of end of period (EOP) rate base”.<sup>7</sup>  
3 Mr. Dittmer for Public Counsel supports “the ERF in concept,” but chafes at the  
4 EOP rate base and rate of return, and proposes a “test-year-end revenue  
5 adjustment.”<sup>8 9</sup>

6  
7 **Q. How do you respond?**

8 A. I address the following points: (1) the test year; (2) EOP rate base; and (3) the year-  
9 end revenue adjustment. I addressed the rate of return in Section B above.

10 The so-called “hybrid” test year is a curious argument. The gas and electric  
11 ERFs are based on a test period for the 12 months ending June 30, 2012. There is  
12 nothing whatsoever unusual about that. The use of test years ending at dates other  
13 than the calendar year end is a common practice. Note that the current PacifiCorp  
14 general rate case is based on the same test year ending June 30, 2012.<sup>10</sup> This is a  
15 non-issue.

16  
17 **Q. Please discuss rate base at the end-of-period values.**

18 A. PSE used rate base values as of the end of the test period, June 30, 2012. The  
19 Commission squarely addressed the possibility of using EOP rate base in Order 08.<sup>11</sup>

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<sup>6</sup> Exhibit No. \_\_\_\_ (MCD-1T) at 10:23.

<sup>7</sup> Id., at 11:16.

<sup>8</sup> Exhibit No. \_\_\_\_ (JRD-1T) at 4:12-16.

<sup>9</sup> Mr. Higgins for Kroger and Nucor states “Kroger (and Nucor) neither supports nor opposes the revenue requirement provisions proposed by PSE in the ERF.” Exhibit No. \_\_\_\_ (KCH-1T) at 3:19-20 and Exhibit No. \_\_\_\_ (KCH-5T) at 3:18-19

<sup>10</sup> *WUTC v. PacifiCorp*, Docket UE-130043.

<sup>11</sup> Order 08, pages 180-181 ¶ 491. The Commission in addressing periods of time when “new plant is more costly than plant being replaced, or more costly than the average cost of plant included in rates” states, it is



1 This approach is hardly “novel.” End-of-period rate base was accepted by the  
2 Commission in a 2001-02 Olympic Pipeline<sup>12</sup> case and in a 1980-81 Washington  
3 Natural Gas case which references cases in 1972-73 and 1973-74.<sup>13</sup> In short, the  
4 issue of valuing rate base at the end of a period is neither new nor novel.

5  
6 **Q. Is the use of EOP rate base necessary and useful today?**

7 A. Yes. In Cause No. U-80-111 the Commission identified a number of circumstances  
8 where the use of EOP is prescribed. We have at least two of those circumstances  
9 here: regulatory lag and persistent under earnings. With respect to the issue of  
10 regulatory lag, the Commission stated;

11 “We must also recognize that regulatory lag (the interim period  
12 elapsing between the filing of a rate case and its ultimate disposition)  
13 has long been a concern of both the utilities and their regulators, and  
14 regulatory lag may tend to erode the earnings of a utility. If regulatory  
15 lag has a deleterious effect, it is difficult to compensate for its overall  
16 adverse effect. However, as regulators we have the responsibility to  
17 mitigate that effect to the extent possible.”<sup>14</sup>

18  
19 In the early 1980s inflation was a serious economic concern. Today we are faced  
20 with replacing old infrastructure with new. The cost impacts are quite similar with  
21 regulatory lag causing the same “deleterious effect” on earnings. Therefore,

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open to remedies which include “use of plant accounts (rate base) measured at the end, or subsequent to the end of the test-year rather than the test-year average.”

<sup>12</sup> *WUTC v. Olympic Pipe Line Company*, Docket TO-011472, Twentieth Sup. Order, at page 44 ¶ 160. Stating, “This (EOP) adjustment to the traditional rate base calculation is warranted and appropriate. It contributes to the Company’s ability to serve its customers and contributes to rates that are fair, just, reasonable, and sufficient.”

<sup>13</sup> *WUTC v. Washington Natural Gas*, Cause No. U-80-111, Third Supp. Order at pages 5-7. Here the Commission addresses the phenomenon that new plant and new customers are occurring, but new revenues produced by those additions are not parallel with the costs. The Commission notes that delivered new therms from the new customers were less than the therms delivered during previous years. A cause of this decline is cited as “serious and conscientious efforts of the public to conserve energy.” The Commission concludes that “year-end rate base will be adopted for ratemaking purposes in this proceeding.”

<sup>14</sup> *Id.*, at page 6.

1 measuring rate base at EOP values is a viable, simple way to mitigate regulatory lag  
2 in today's filings.

3 In addition, the Commission stated in Cause No. U-80-111 that the use of  
4 EOP rate base is "an appropriate regulatory tool" where there is a "failure of [the]  
5 utility to earn its authorized rate of return over a historical period."<sup>15</sup> That is  
6 precisely the situation faced by PSE today, as shown in Exhibit No. \_\_\_\_ (TES-3  
7 revised).

8  
9 **Q. Does EOP rate base violate the matching principle as argued by Mr. Dittmer<sup>16</sup>?**

10 A. No. While it is true that the Commission has stated that average rate base is a  
11 preferred option,<sup>17</sup> it also has regularly opined on the validity of end-of-period  
12 valuations. Moreover, in financial reporting the balance sheet is a report of assets  
13 and liabilities valued at the end of the fiscal year while the accompanying income  
14 statement represents transactions over the course of the year. These account  
15 balances are used in developing various financial metrics without regard to averaging  
16 the year-end balance sheet. The regulatory goal is to reach a representation of the  
17 ratios of the rate base, revenues and expenses to establish rates for a future period. If  
18 the end of period rate base fairly presents the going forward values that rates are  
19 intended to capture, then progress on reducing regulatory lag is achieved.

20

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<sup>15</sup> Id.

<sup>16</sup> Exhibit No. \_\_\_\_ (JRD-1T) at 3:9

<sup>17</sup> *WUTC v. Washington Natural Gas*, Cause No. U-80-111, Third Supp. Order, at page 6

1 **D. Claims That the ERF and Rate Plan are Overly Generous**

2

3 **Q. Intervenor witnesses estimate varying degrees of revenue increases, with Mr.**  
4 **Dittmer's as the highest. It is difficult to understand what each professes to**  
5 **calculate over what time period. Mr. Dittmer testifies that the cumulative**  
6 **revenue impact from the ERF and K-Factor increases will amount to about**  
7 **\$465 million through February 2017 and calls this a "very significant" impact.<sup>18</sup>**  
8 **What is your response?**

9 A. No responsive witness puts the revenue increase in perspective. The gross figure Mr.  
10 Dittmer presents is the cumulative increase over today's base revenues for both gas  
11 and electric and for both the ERF and the rate plan. He covers a total of 46 months,  
12 from May 2013 through February 2017. I can accept his figure at face value for  
13 illustrative purposes. However, Mr. Dittmer does not calculate the total revenues  
14 over that same period. From May 2013 through February 2017, PSE's total revenues  
15 from today's rates will exceed \$11.6 billion. Mr. Dittmer's \$465 million is all of  
16 four percent collectively for almost four years. This is a nominal increase of but one  
17 percent per year. This does not represent a significant impact, in my view.

18

19 **E. Decoupling<sup>19</sup>**

20

21 **Q. Please summarize the intervenor and Public Counsel opinions of the amended**  
22 **decoupling proposal.**

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<sup>18</sup> Exhibit No. \_\_\_\_ (JRD-1T) at 3:23-24.

<sup>19</sup> Dockets UE-121697/UG-121705 (*consolidated*), Exhibit No. \_\_\_\_ (DJR-1T) presents Staff's review of the decoupling mechanism in the context of the Commission's decoupling policy.

1 A. A common thread in opposition to the decoupling proposal is how the proposal  
2 departs from the policy statement. A main argument is the lack of an adjustment to  
3 the rate of return. Other complaints include: (1) the K-factor is not based on  
4 conservation achievement and allows revenues to grow with additional customers;  
5 (2) decoupling is not filed in a general rate case; (3) this decoupling plan will not  
6 remove barriers to acquire all cost-effective conservation; and (4) there is no  
7 consideration for off-system sales from power freed up due to increased  
8 conservation.<sup>20</sup>  
9

10 **Q. Does Staff offer a witness on decoupling in these matters?**

11 A. Yes. Staff witness Deborah Reynolds fully explains Staff's opinions in her March 4,  
12 2013, testimony addressing the amended decoupling proposal. Ms. Reynolds fully  
13 discusses how the amended decoupling proposal deviates from the decoupling policy  
14 statement and why such deviation is both reasonable and consistent with the  
15 Commission's most recent orders. The intervenors' arguments concerning rates-of-  
16 return are unhelpful and unproductive.  
17

18 **Q. How do you respond to the other issues above?**

19 A. First, the K-factor is not intended to be a measure of conservation success or impact.  
20 It is intended to give PSE minor revenue increases for a limited period of time and is  
21 applied only to the revenues that support the non-generation portion of the business.

22 Additionally, the application of the K-factor to the number of actual  
23 customers each month is fair and reasonable. This is not "found margin" due to

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<sup>20</sup> Most of these are listed in Exhibit No. \_\_\_\_ (MCD-1T), at 22-25.

1 customer growth. I define margin as the difference between the incremental revenue  
2 and the incremental cost from the addition of a new unit, here a customer. Mr. Deen  
3 acknowledges this by quoting a similar phrase in the Commission's Decoupling  
4 Policy Statement.<sup>21</sup> For "found margin" to exist either each new customer must be  
5 cheaper to serve than the average, or each new customer must consume more gas or  
6 electricity than the average. Neither situation is likely, nor does the data support  
7 this.<sup>22</sup>

8 Second, it is true that the decoupling proposal was not filed in a general rate  
9 case. The decoupling dockets, UE-121697/UG-121705, were filed as accounting  
10 petitions, not within a general rate case, and still maintain that procedural status.  
11 This fact does not detract from the merits of the proposals. Those merits are  
12 enumerated in the testimonies of PSE witnesses Katherine Barnard, Jon Piliaris,  
13 NWECA witness Ralph Cavanagh, and Staff witness Ms. Reynolds.

14 Third, it is unclear why Mr. Deen states that the decoupling proposal will not  
15 remove barriers to acquiring all cost-effective conservation. He seems to confuse  
16 himself by considering the rate plan's K-factor as a decoupling feature. It is clear  
17 that the decoupling proposal will remove PSE's incentive to sell more kWh and  
18 therms. That is the proposal's true intent.

19 Finally, the proposal for full decoupling does not directly consider capturing  
20 additional off-system sales to be returned to customers. Conservation savings is not  
21 separately measured in order to determine incremental off-system sales. Any so-

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<sup>21</sup> Exhibit No. \_\_\_ (MCD-1T), at 27:10-11, citing the Decoupling Policy Statement at page 17, n. 44.

<sup>22</sup> See Mr. Higgins Exhibit No. \_\_\_ (KCH-3), page 5. The 12-year trend (2000 to 2011) for residential customers declines from 11.752 MWh per customer to 11.510. The 10-year trend (2002 to 2011) for non-residential customers declines from 87.324 MWh per customer to 85.890. Natural gas declines are even greater.

1 called "savings" will be reflected in power cost only rate cases and the power cost  
2 adjustment filings. This sufficiently addresses the "off-system sales" concerns.<sup>23</sup>

3

4 **Q. Does Public Counsel offer any conditions upon which it might accept a**  
5 **decoupling plan?**

6 A. Yes. Mr. Dittmer for Public Counsel states that a full decoupling proposal would be  
7 reasonable with a reduced cost of capital, an earnings test, and certain reporting  
8 requirements.<sup>24</sup>

9

10 **Q. Please comment on Mr. Dittmer's position.**

11 A. I addressed the rate of return issue above. To reiterate, the theoretical potential that  
12 decoupling may stabilize revenue needs empirical evidence. Staff supports leaving  
13 the rate of return as is in order to gather that evidence.

14 The amended decoupling proposal does contain an earnings test along the  
15 lines that Mr. Dittmer proposes. He simply selects a lower baseline.

16 Staff can support reporting requirements in the Global Settlement and will  
17 work with PSE and settling parties to add such language.

18

19 **F. Merits of the TransAlta Power Purchase Agreement and Global Settlement**

20

21 **Q. Why do you think it important that the Commission approve the Global**  
22 **Settlement in its entirety?**

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<sup>23</sup> Dockets UE-121697/UG-121705, Exhibit No. \_\_\_\_ (DJR-1T) at 14-17.

<sup>24</sup> Exhibit No. \_\_\_\_ (JRD-1T) at 22:9-23:3.

1 A. The TransAlta Power Purchase Agreement and its proposed amendment are an  
2 integral part of the parties' Global Settlement. Staff believes it is in the public  
3 interest for that contract to go forward as part of the overall resolution of the many  
4 dockets at issue. The contract has many positive attributes that will benefit both  
5 ratepayers and Washington residents. Chief among them is the benefit that will inure  
6 to the Lewis County economy, in accordance with the TransAlta statute's legislative  
7 policy. Second, the power generated under the contract will be relatively  
8 inexpensive, as compared to alternatives, benefiting ratepayers. Moreover and  
9 significantly, the contract will further the Legislature's environmental goal of  
10 transitioning away from coal generation to cleaner fuel sources. Absent approval of  
11 the settlement, including the TransAlta PPA, PSE has stated in its pending Motion  
12 for Reconsideration that it will not go forward with the contract, under the conditions  
13 set forth in the Commission's Order 03 in Docket UE-121373.

14  
15 **G. Adequacy of the Procedural Schedule**

16  
17 **Q. Both Public Counsel and ICNU witnesses Dittmer and Deen, respectively,**  
18 **complain about the procedural schedule that governs these proceedings. Do**  
19 **you agree that their complaints are valid? Why not?**

20 A. No. The procedural schedule established by the Commission is adequate to the task  
21 at hand. As the Commission noted in its Order denying Public Counsel's motion to  
22 modify the procedural schedule: (1) decoupling has been around and discussed for  
23 many years, (2) the ERF is intended to be an expedited filing in the nature of a true-

1 up, and (3) the Commission has entered its TransAlta Order. Additional time to  
2 analyze PSE's proposals would serve only to cause unnecessary delay in the  
3 processing of PSE's filings.

4  
5 **IV. CONCLUSION**

6  
7 **Q. What is Staff's final recommendation?**

8 A. Staff is pleased that NWIGU and The Energy Project have joined the Settling  
9 Parties. This strengthens the position that the Global Settlement is a fair, just and  
10 reasonable solution to the various issues presented in the combined dockets. Staff  
11 supports the Global Settlement with the conditions added by NWIGU and the Energy  
12 Project. The positions of the opposition are fully refuted and no further amendments  
13 to the Global Settlement are necessary. We recommend the Commission accept the  
14 Global Settlement as revised and approve the tariffs and accounting deferrals  
15 necessary to accomplish the mechanisms outlined in the Global Settlement. Staff  
16 also recommends the Commission reopen the record in Docket UE-121373 to enter  
17 the amendment to the Coal Transition PPA and to clarify Order 03, consistent with  
18 the terms in paragraphs 16 and 17 of the Global Settlement.

19  
20 **Q. Does this conclude your testimony?**

21 A. Yes.  
22  
23