BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.,
and NORTHWEST 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)

POST-HEARING BRIEF OF NUCOR STEEL SEATTLE, INC.

May 30, 2013

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I. INTRODUCTION

This Post-Hearing Brief is submitted on behalf of Nucor Steel Seattle, Inc. ("Nucor"). Nucor owns and operates a steel mill in Seattle and takes gas transportation service from Puget Sound Energy, Inc. ("PSE" or "the Company") under Schedule 87T. On February 1, 2013, PSE filed an expedited rate filing ("ERF") in Dockets UE-130137 and UG-130138. In a related proceeding, PSE and NW Energy Coalition ("NWEC") (collectively, "Joint Parties") filed an Amended Decoupling Petition in Dockets UE-121697 and UG-121705 on March 1, 2013. The Commission's Regulatory Staff ("Commission Staff" or "Staff") filed testimony in support of the revised proposal on March 4, 2013. PSE, NWEC, and Staff proposed a "rate plan" via a stipulation filed in these four dockets and in Docket UE-121373, on March 22, 2013. The Energy Project and the Northwest Industrial Gas Users ("NWIGU") subsequently agreed to support the stipulation upon certain specified conditions.

As part of the stipulation, the proposed rate plan includes a metric for increasing rates or allowed revenues. Nucor opposes this proposed metric, the "K-factor," as it would introduce an automatic, predetermined, cost escalator into rates. Nucor also opposes the entirety of the Joint Parties' proposed revenue decoupling package. Failing complete rejection, however, Nucor recommends that the Commission modify the proposal. In PSE's ERF, PSE proposes to increase electricity rates by $32.2 million, and to reduce natural gas rates by $1.2 million. Although, Nucor does not oppose the core revenue requirement proposal put forth in PSE's ERF, if the Commission approves the Joint Parties' full revenue decoupling proposal, then Nucor recommends a reduction of PSE's proposed ROE. In the event the Commission approves the proposed decoupling mechanism, Nucor also urges the Commission to fully recognize found margin and to exclude gas transportation customers from the proposed decoupling mechanism.

II. ARGUMENT

A. The Commission Should Reject PSE's Proposed K-Factor Component of the Rate Plan

The rate plan is a series of predetermined annual rate increases implemented through a metric that PSE calls the "K-factor". The proposed rate plan would extend at least through March 2016 and possibly through March 2017. As part of its proposal, and subject to certain caveats, PSE would not file its next general rate case before April 1, 2015, and would file it no later than April 1, 2016, unless otherwise agreed to by the parties to PSE's last general rate case.[1] The decoupling proposal envisions full revenue decoupling applied to fixed delivery costs for almost all electric and gas customer classes.[2] The revenue decoupling would be implemented through an "allowed revenue per customer" metric. The decoupling proposal is tied to the proposed rate plan in that each year's allowed revenue per customer would be increased via the K-factor. Thus, the overall proposal should be viewed as a combination "predetermined rate increase/decoupling" package extending over a multi-year period.

The Commission should reject the overall proposal as it does not constitute good ratemaking and is not in the public interest. For purposes of this discussion, it is useful to separate the K-factor component of the rate plan from the rest of the decoupling proposal. Even though these components are tied together in the Joint Parties' proposal, decoupling does not require adoption of predetermined annual rate increases nor does a rate plan consisting of predetermined annual rate increases require decoupling. Indeed, the proposed K-factor scheme

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[1] Prefiled Supplemental Direct Testimony of Jon A. Piliaris, on behalf of Puget Sound Energy, Dockets UE-121697 & UG-121705 (March 1, 2013) at 4.

[2] The proposed exceptions are gas lighting; gas water heater rental; gas schedules 85, 85T, 87 and 87T; electric lighting; and electric retail wheeling. The rates for these classes, however, would be subject to the proposed K-factor increases. Gas customers served under special contracts are also excluded from the decoupling proposal.

and the proposed decoupling mechanism are conceptually distinct, independent features that should be evaluated on their own respective merit.

The K-factor proposal is an attempt to introduce an automatic, predetermined cost escalator into rates. The proposed K-factor for gas service is 1.022 and would apply to all revenue requirements except gas supply costs and property taxes. Essentially, the K-factor hardwires a 2.2 percent annual cost increase into the applicable cost components, which would then automatically flow into customer rates. Extended over the potential term of the proposed rate plan (which could extend beyond the start of 2017), the revenue requirement for the affected gas cost components would increase 11.5 percent.[3] The proposed K-factor rate increases are not known and measurable adjustments presented in the context of a rate proceeding. Rather they are arbitrary and unsubstantiated rate increases that should be rejected by the Commission. PSE justifies the proposed level of these factors by referencing a calculation prepared by Ms. Barnard that results in a gas K-factor of 1.038 measured over the period 2006-2011.[4] Ms. Barnard's calculation was prepared using rate base and depreciation expense increases over that time period combined with a projection of O&M inflation that includes a small productivity adjustment. However, a trend line of past cost increases (blended with an inflation forecast) does not constitute a reasonable basis for locking in broadly applicable rate increases in the future, particularly over a multi-year period.[5] Moreover, Ms. Barnard's K-factor results are very sensitive to the time period selected. Selecting a time period that starts just one year later (2007-

[3] Prefiled Response Testimony of Kevin C. Higgins, on behalf of The Kroger Co., Dockets UE-130137, et al. (April 26, 2013) at 8.

[4] Prefiled Direct Testimony of Katherine J. Barnard, on behalf of Puget Sound Energy, Dockets UE-121697 & UG-121705 (consolidated) (March 1, 2013) at 7.

[5] Prefiled Response Testimony of Kevin C. Higgins, on behalf of The Kroger Co., Dockets UE-130137, et al. (April 26, 2013) at 8-9.

2011) reduces her calculation of the gas K-factor from 1.038 to 1.0299.[6] More generally, the Commission should be concerned about regulatory pricing formulations such as the K-factor proposal that reinforce inflation. This occurs when projections of inflation are built into formulas that are used to set administratively-determined prices, such as utility rates. Such pricing mechanisms help to make inflation a self-fulfilling prophecy. The Commission should use extreme caution before approving prices that guarantee inflation before it occurs.

A related, but distinct, concern involves the building of a K-factor "cost cushion" into PSE's base period costs. The cost increases represented by escalation factors may or may not come to fruition. In any case, PSE should be expected to strive to improve the efficiency of its operations on a continuous basis, and thereby lessen the net impact of inflation on its costs. It is not reasonable to gross up the Company's base period costs by an arbitrary escalation factor and pass these costs on to customers. There is nothing inherent in revenue decoupling that calls for this type of underlying cost escalation. The K-factor portion of the Company's filing can be readily excised and discarded, regardless of whether the revenue decoupling mechanism is approved.

B. The Commission Should Reject the Proposed Decoupling Mechanism

As discussed in the prefiled response testimony of Kevin C. Higgins, submitted on behalf of Kroger, there are numerous reasons for rejecting the Joint Parties' decoupling proposal.[7] First, the proposal by the Joint Parties fails to reduce the cost of PSE's equity that flows through to customers in exchange for the assumption of greater ratepayer risk. The proposal also does not provide for full recognition of found margin to offset the lost margin that would be charged

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[6] Prefiled Response Testimony of Kevin C. Higgins, on behalf of Nucor Steel Seattle, Dockets UE-130137, et al. (April 26, 2013) at 8-9.

[7] Prefiled Response Testimony of Kevin C. Higgins, on behalf of The Kroger Co., Dockets UE-130137, et al. (April 26, 2013).

to customers, and thus, is deficient in fully providing this offset that is highly emphasized in the Commission's report and policy statement issued in Docket No. U-100522.[8] Decoupling is sure to capture a much wider range of effects than just customer responses to utility-sponsored energy efficiency programs, even though the latter constitutes the underlying justification for its adoption. Decoupling also provides unwarranted insulation to the utility from the effects of price elasticity, representing an undue transfer of risk from utilities to customers. Moreover, to the extent that customers reduce usage in response to economic conditions or otherwise practice self-funded energy conservation, these behaviors will be captured in the decoupling adjustment and unduly increase rates to customers. Full revenue decoupling also suffers from the infirmities of single-issue ratemaking, which occurs when utility rates are adjusted in response to a change in a single cost or revenue item considered in isolation.

In short, the Joint Parties' decoupling proposal is a one-sided proposition that burdens customers with the negative characteristics of full revenue decoupling without providing the key benefits that the Commission stressed in its report and policy statement.

C. If the Commission Approves the Proposed Decoupling Mechanism, the Mechanism Should be Modified

As discussed above, Nucor recommends that the Commission reject the proposed decoupling mechanism. However, in the alternative, if the Commission decides to approve the proposed decoupling mechanism, Nucor recommends the following modifications.

1. The ROE Should be Reduced

If full revenue decoupling is imposed on customers, then it is essential that the benefit of lower equity costs be recognized in customer rates. Failure to adjust ROE would ignore one of the central tenets in the Commission's report and policy statement. The Joint Parties' proposal

[8] *Id.* at 10.

contains no such adjustment to the Company's ROE. Rather, the Joint Parties propose to allow PSE to continue to earn the 9.8% ROE ordered by the Commission in Docket Nos. UE-111048 and UG-111049, subject to an earnings test. The earning test would allow PSE to earn up to 25 basis points above its overall rate of return on rate base before rebating to customers 50 percent of the earnings in excess of this level.[9]

If full revenue decoupling is adopted, the Commission should reduce PSE's ROE by 25 basis points for the functions subject to the decoupling mechanism (i.e., electric and gas delivery). This adjustment lies well within the range of ROE adjustments adopted by other commissions and is reasonable in light of the mitigation of earnings volatility that the mechanism would provide for PSE.[10] This adjustment should be applied as part of the ERF proceeding. The adjustments result in a reduction in the ERF electric revenue requirement of approximately $5.1 million and in the ERF gas revenue requirement of approximately $3.1 million.[11]

2. Found Margin Should be Incorporated by the Decoupling Mechanism

The proposal by the Joint Parties also does not provide for full recognition of found margin to offset the lost margin that would be charged to customers. The concept of found margin is discussed at some length in the Commission's report and policy statement. The Commission's statement emphasizes that a properly constructed full decoupling mechanism would balance out both lost and found margin from *any* source.[12] The full revenue decoupling proposal advanced by the Joint Parties recognizes found margin only to the extent that it may

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[9] Prefiled Supplemental Direct Testimony of Jon A. Piliaris, on behalf of Puget Sound Energy, Dockets UE-121697 & UG-121705 (March 1, 2013) at 19.

[10] *Id.* at 20.

[11] Prefiled Response Testimony of Kevin C. Higgins, on behalf of The Kroger Co., Dockets UE-130137, et al. (April 26, 2013) at 12.

[12] *In re* Washington Utilities and Transportation Commission's Investigation into Energy Conservation Incentives, Docket No. U-100522, Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, to Encourage Utilities to Meet or Exceed Their Conservation Targets at ¶ 27 (November 4, 2010).

affect allowed revenue per customer. The proposal provides no recognition of found margin that would be associated with growth in the number of customers. Under the terms of the proposal, the full benefit of incremental fixed cost recovery associated with new customers accrues solely to PSE. If full revenue decoupling is approved by the Commission, the mechanism proposed by the Joint Parties should be modified to incorporate any found margin associated with growth in customer count as a credit against the decoupling balancing account.

3. The Revisions Negotiated By NWIGU Should Be Adopted

Full revenue decoupling should not apply to all gas rate schedules. In their initial stipulation, the Joint Parties proposed to exclude gas lighting, gas water heater rentals, and special contracts. In their revised stipulation filed May 8, 2013 with the Northwest Industrial Gas Users ("NWIGU"), Schedules 85, 85T, 87 and 87T of PSE's natural gas tariff are removed from the decoupling mechanism and instead are treated consistently with "rate plan customers." The removal of these Schedules from the decoupling mechanism is appropriate. First, maintaining a "fixed-cost recovery per customer" target – as occurs with the decoupling proposal – is not an appropriate rate design objective for these Schedules, which have heterogeneous populations and show a wide range of usage levels. Changes in the overall economy are far more likely to influence fixed-cost recovery per customer for these customers than energy conservation programs. Application of decoupling to these customers would result in undue changes in rates in response to factors that are unrelated to energy conservation.

Second, the group excluded by the revised stipulation includes large gas transportation customers. These customers do not take their gas supply service from PSE. In this sense, they are comparable to PSE's electric retail wheeling customers, who are properly excluded from the Joint Parties' revenue decoupling proposal.

Moreover, gas transportation customers are not even eligible to participate in PSE's energy efficiency programs. Subjecting these customers to revenue decoupling under the guise of "removing PSE's disincentive to support energy efficiency" would have been patently absurd. In short, the revision to the stipulation negotiated by NWIGU mitigates part of the harm to customers contained in the initial version of the stipulation.

4. The Gas Decoupling Mechanism Should be Modified

In addition to the substantive concerns expressed above, there are significant technical problems with the proposed implementation of the revenue decoupling mechanism. If a revenue decoupling mechanism is approved, it should be modified such that 100% of the contract firm revenues are excluded from the revenue decoupling adjustment (i.e., are treated as unvarying with variations in Dth per customer). PSE's non-residential gas rate schedules provide an option for contract firm demand, for which customers pay a demand charge. Customers subscribing to this option must contract on an annual basis. Rather than treat contract firm demand revenues as fixed revenues, PSE includes these revenues in determining the "volumetric delivery revenue," and will impute a reduction in these revenues whenever average throughput per customer declines – irrespective of the fact that customers have contracted for a fixed amount of firm service. This treatment would overstate the imputed revenue impact of a change in average throughput per customer.

III. CONCLUSION

For the reasons set forth above, Nucor respectfully requests that the Commission reject the proposed decoupling mechanism. In the alternative, Nucor requests that the Commission order the modifications discussed above.

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