

MEMORANDUM

July 24, 2013

TO: Chairman Danner
Commissioner Goltz
Commissioner Jones
Steve King
Mark Vasconi
Greg Kopta (w/attachments)
Sally Brown (w/attachments)
Marilyn Meehan
Tom Schooley
Deborah Reynolds

FROM: Lisa Wyse, Records Center *LW*

SUBJECT: Industrial Customers of Northwest Utilities v. Washington Utilities
and Transportation Commission, a Washington state agency
(UE-121697 and UG-121705; UE-130137 and UG-130138)
Petition for Judicial Review of Agency Action
Thurston County Case No. 13-2-01576-2

A Petition for Judicial Review of Agency Action has been filed in Thurston County Superior Court on July 24, 2013, by Melinda J. Davison, representing Petitioner listed above. The petition was received by the Commission on July 24, 2013.

Please contact the Records Center if you would like copies of the attachments.

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Date:	
Time:	
Judge/Calendar:	

2013 JUL 24 PM 3:52
 SUPERIOR COURT
 WASHINGTON STATE
 CLERK OF COURT
 COURT REPORTER
 COURT REPORTER

9 IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON IN AND FOR THE
 10 COUNTY OF THURSTON

INDUSTRIAL COSTUMERS OF)	
NORTHWEST UTILITIES,)	
)	
Petitioner,	)	Case No. 13-2-01576-2
)	
v.)	
	)	SUMMONS ON PETITION FOR
WASHINGTON UTILITIES AND	)	JUDICIAL REVIEW OF AGENCY
TRANSPORTATION COMMISION, a	)	ACTION
Washington State Agency,)	
)	
Respondent.)	

11 TO THE RESPONDENT: A lawsuit has been started against you in the above
 12 entitled court by Industrial Customers of Northwest Utilities. Petitioner's claim is stated
 13 in the written petition, a copy of which is served upon you with this summons.

14 In order to defend against this lawsuit, you must respond to the petition by stating
 15 your response in writing, and serving a copy upon the person signing this summons
 16 within 20 days after the service of this summons, excluding the day of service, or a
 17 default judgment may be entered against you without notice. A default judgment is one
 18 where a petitioner is entitled to what it asks for because you have not responded. If you

SUMMONS ON PETITION FOR JUDICIAL
 REVIEW OF AGENCY ACTION - 1

DAVISON VAN CLEVE, P.C.
 333 S.W. Taylor, Suite 400
 Portland, OR 97204
 Telephone (503) 241-7242

1 serve a notice of appearance on the undersigned person, you are entitled to notice before
2 a default judgment may be entered.

3 You may demand that the petitioner file this lawsuit with the court. If you do so,
4 the demand must be in writing and must be served upon the person signing this summons.
5 Within 14 days after you serve demand, the petitioner must file this lawsuit with the
6 court, or the service on you of this summons and complaint will be void.

7 If you wish to seek the advice of an attorney in this matter, you should do so
8 promptly so that your written response, if any, may be served on time.

9 This summons is issued pursuant to the Superior Court Civil Rules of the State of
10 Washington.

11 DATED this 24th day of July, 2013.

By 

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Melinda J. Davison, WSB #31182
Davison Van Cleve, P.C.
333 SW Taylor, Ste.400
Portland, Oregon 97209
Of Attorneys for Petitioner
Industrial Customers of Northwest
Utilities

SUMMONS ON PETITION FOR JUDICIAL
REVIEW OF AGENCY ACTION - 2

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 OFFICE OF THE CLERK
 SUPERIOR COURT
 COUNTY OF THURSTON

6 IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON IN AND FOR THE
 7 COUNTY OF THURSTON

INDUSTRIAL CUSTOMERS OF)	
NORTHWEST UTILITIES,	)	No. 13-2-01576-2
)	
Petitioner,	)	PETITION FOR JUDICIAL REVIEW
	)	OF AGENCY ACTION
v.)	
)	
WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISION, a)	
Washington State Agency,)	
)	
Respondent.)	

8 **INTRODUCTION**

9 1. Pursuant to the Washington Administrative Procedure Act ("APA"),
 10 chapter 34.05 RCW, Petitioner, Industrial Customers of Northwest Utilities ("ICNU")
 11 hereby requests judicial review of Final Order 07 ("Order 07") issued by the Washington
 12 Utilities and Transportation Commission ("WUTC" or the "Commission") jointly in its

1 Docket Nos. UE-121697 and UG-121705 (Consolidated) and UE-130137 and UG-
2 130138 (Consolidated).^{1/}

3 Order 07, issued on June 25, 2013, sets rates for electrical service for Puget Sound
4 Energy, Inc. (“PSE” or the “Company”), a “Public Service Company” under RCW §
5 80.04.010, that is subject to the regulation of the WUTC. Order 07 illegally sets PSE’s
6 electrical rates at a level that is neither just nor reasonable because a critical component
7 used to calculate those rates is unsupported by record evidence. By establishing this
8 unlawful rate, the WUTC acted outside its statutory authority, engaged in unlawful
9 procedure and decision-making process, made errors of law, acted inconsistently with
10 Commission precedent, and issued a decision that is arbitrary and capricious.

11 RCW § 80.28.020 charges the WUTC with the setting of just and reasonable rates
12 for public utilities. It is well-established that, while the WUTC may determine the
13 methodology that it will use to set just and reasonable rates, once it has selected a method
14 of ratemaking, that methodology must be applied consistently, legally, and rationally, and
15 Washington courts follow the standards of judicial review contained within the APA
16 when reviewing WUTC decisions.

17 The ratemaking process is conceptually straight-forward. Because investor
18 owned electrical utilities, like PSE, operate as monopolies, regulatory commissions have

^{1/} Dockets designated as “UE” indicate a case that involves a regulated electric utility, while “UG” indicates a natural gas utility filing. PSE provides both electric and natural gas service, thus, it regularly requests parallel rate increases for both functions in the same filing. In this case, the WUTC consolidated each set of electric and gas filings; however, it did not consolidate the two joint dockets into one proceeding. Nonetheless, the four docket numbers share one joint record.

1 the dual responsibilities of setting fair prices for customers, while assuring that a utility
2 has the opportunity to earn sufficient returns to remain in business.

3 A utility's rates are just and reasonable if they are set to recover the cost of
4 operations (including fuel for generation, power purchases, maintenance, etc.) and
5 compensate investors for the use of their financial resources. During the course of a rate
6 proceeding, the WUTC determines a utility's cost of providing electrical service by
7 establishing the Company's expenses for operations and adding to this a fair return on
8 investment for the shareholder/owners of the company. If any component of its costs,
9 including an appropriate return on equity ("ROE") for its shareholders, is not supported
10 by the record, the rates are not just and reasonable.

11 A fair return on investment requires first establishing the total dollar amount of
12 the shareholders' investment in used and useful electric plant and facilities, which
13 amount is designated as the "rate base." In its second step, the Commission determines
14 the cost of the Company's debt (i.e., the weighted average interest rates of the
15 Company's outstanding debt), and the cost of the Company's equity shares (i.e., the
16 ROE, or the return on equity investment that the contemporary market will expect to earn
17 on the utility stock). The Company's cost of debt is averaged with its ROE, which
18 establishes a rate of return ("ROR") on investment. The Company's rate base is then
19 multiplied by this ROR. The resultant dollar amount represents the revenue necessary to
20 service the Company's debt and compensate shareholders at the current market rate, and
21 is added to the Company's cost of operations and maintenance to establish the utility's

1 yearly revenue requirement. This process is often referred to as the “ratemaking
2 formula.”^{2/} Thereafter, rates are set at a level that will give the utility the opportunity to
3 collect this revenue requirement from customers during the rate year, if it is prudently
4 managed.

5 The WUTC typically sets requests for rate increases for hearing as adjudicative
6 proceedings, pursuant to the APA. This provides parties an opportunity to carefully
7 examine each component of the ratemaking equation and develop a factual record
8 supporting the components of the utility’s revenue requirement, which is then determined
9 through a final agency order.

10 Order 07 is the product of two such adjudicative proceedings, which were
11 considered jointly, and which developed parallel, indeed, nearly identical records. The
12 two dockets disposed of by Order 07 proposed experimental new mechanisms for cost
13 recovery by PSE. The first of these, Docket No. UE-121697 (the “Decoupling” docket),
14 resulted in the establishment of a new, experimental “rate plan,” which will grant PSE
15 future yearly rate increases without the scrutiny of rate case proceedings until 2016 or
16 2017. Additionally, Docket No. UE-121697 instituted a mechanism known as
17 “decoupling” that is ostensibly designed to promote conservation by ensuring that PSE
18 will recover its revenue requirement from customers regardless of fluctuations in

^{2/} This formula may be described as $O+B(r)=R$, where O is the cost of operations and maintenance, B is the total used and useful rate base, r is the rate of return, and R is the company’s revenue requirement that must be recovered from ratepayers.

1 electricity usage.^{3/} Both the rate plan and decoupling substantially decrease PSE's
2 business risk by imposing set rate increases outside a general rate case ("GRC").

3 The starting point for these automatic rate increases will be the new, increased
4 electric rates requested by PSE in the second filing, docketed as UE-130137. PSE styled
5 this filing for a rate increase as an "Expedited Rate Filing," or "ERF." In UE-130137,
6 PSE proposed to increase its rates by filing updated, higher costs for certain components
7 of its operations, as described in footnote 2 above, (the O in the ratemaking equation) and
8 updating its ratebase ("B" in the equation) to a new, higher level, without updating its
9 ROR ("r" in the equation). Instead of providing evidence establishing an appropriate
10 ROE in current market conditions, PSE "expedited" the proceeding by calculating its
11 new, increased revenue requirement using the 9.8% ROE that it had been awarded in its
12 previous general rate case which concluded in 2011.

13 The new rate plan, the decoupling mechanism, and the Expedited Rate Filing
14 represent a drastic change from traditional regulation and significantly alter PSE's risk
15 profile. Order 07 refers to them as "innovative" mechanisms, while in his dissent,
16 Commissioner Jones describes them as "distinct and significant" changes to traditional
17 ratemaking. Noticeably, the Commission did not have any rules or procedures governing
18 this new Expedited Rate Filing mechanism.

^{3/} While ICNU questioned the need for these experimental forms of regulation and opposed certain aspects of the rate plan and decoupling mechanism as implemented, this Petition does not request judicial review of the decision to adopt them.

1 During the adjudicative proceeding, ICNU's expert witness found that updating
2 PSE's ROR to reflect the market's current, lower capital costs concurrently with the
3 Company's update of its increasing operating costs and ratebase would offset
4 approximately \$11 million of the \$32 million rate increase customers would bear under
5 the filing.^{4/} ICNU and other parties filed evidence of the type used by the WUTC and
6 other state and federal commissions to determine the current market cost of equity for
7 PSE, and to set an accurate ROE that reflects current market conditions. The record
8 evidence, and Mr. Gorman's testimony (ICNU's expert witness) demonstrated that PSE's
9 current cost-of-capital should be 9.3%. All cost-of-capital witnesses who submitted
10 evidence agreed that the 9.8% ROE used by PSE to calculate its rate increase was well
11 outside the range of reasonable returns. Notably, neither PSE nor Commission Staff
12 ("Staff") provided any evidence to demonstrate that a 9.8% ROE represents a reasonable
13 cost of equity for PSE in the current market.

14 The Commission stated that it would have preferred not to consider PSE's current
15 cost of equity in the context of an experimental new expedited filing, yet it accepted the
16 cost-of-capital evidence into the record and stated in Order 07 that consideration of PSE's
17 ROE was proper in the context of the proceedings. Indeed, during the Company's 2011
18 rate case, the Commission had explicitly anticipated the possibility of taking new cost-of-
19 capital information into account when evaluating evidence in a future rate filing. In

^{4/} This accords with a foundational principle of ratemaking, termed the "matching principle," which requires that contemporary increases and decreases within a company's revenue requirement be considered together in the setting of rates, so as to create an accurate snapshot of the relationship between revenues and costs and ensure a just and reasonable outcome.

1 2011, the Commission merely approved a hypothetical capital structure for PSE, and the
2 WUTC expressly held that if assumptions supporting that hypothetical capital structure
3 turned out to be untrue, actual capital structure evidence could lead to contrary
4 determinations in a future rate case.

5 Despite the evidence of record, a Commission majority granted PSE its full
6 requested rate increase, basing the Company's revenue requirement calculation on a 9.8%
7 ROE. Order 07 states that the majority believes that 9.8% is "at best" at the upper end of
8 the range of reasonable returns for PSE. Thus, Order 07 improperly sets increased rates
9 using an ROE calculated from data over two years old, observed in a markedly different
10 economic environment, and based on a record from a different proceeding. This violates
11 Washington law. Commissioner Jones dissented from this decision, noting that PSE had
12 been given ample opportunity to provide evidence regarding its cost of equity, but chose
13 not to do so, and that the majority ignored the only credible evidence on the record. The
14 harm to customers caused by this improper decision will only be exacerbated by the new
15 mechanisms that were adopted in the decoupling docket, because they will use this
16 inflated revenue requirement as the starting point for yearly, automatic rate hikes.

17 The majority rationalized that it did not find enough evidence to support a
18 *reduction* in PSE's authorized ROE. This ignores the fact that Washington law requires
19 the Company to bear the burden of demonstrating that its rates are just and reasonable.
20 By stating that ICNU and others did not provide sufficient evidence to support a 9.3%
21 ROE, the Commission illegally shifted the burden of proof to PSE's customers in

1 contravention of RCW § 80.04.130. The WUTC cannot lawfully acknowledge that cost
2 of equity is an issue in the case, but then relieve PSE of its burden to support the ROE
3 embedded in its requested rates, particularly after parties have submitted expert testimony
4 supporting a lower ROE for the Company.

5 The WUTC also acted arbitrarily and capriciously by setting rates based on an
6 ROE that it states is “at best” at the upper end of the range of reasonableness. This is an
7 explicit acknowledgment that, in all probability, the approved rates may be outside the
8 range of reasonableness. In addition, in PSE’s last GRC, the WUTC followed its usual
9 practice of setting PSE’s ROE at the center of the range of reasonable returns, which, at
10 that time was 9.8%. In the current case, Order 07 adopts the rate plan and decoupling
11 mechanism that each have the effect of reducing PSE’s business risk because they create
12 automatic rate increases and shift the risk of reduced sales to customers and away from
13 PSE. The Commission’s policy prior to Order 07 stated that if such a risk-shifting
14 mechanism were adopted, it would be proper to make an additional modest adjustment to
15 PSE’s ROE to: 1) reflect PSE’s reduced business risk and 2) assure that ratepayers, who
16 accept the additional risk, are compensated. Inexplicably, with no reliable evidence to
17 the contrary, Order 07 reverses this policy and refuses to make any adjustments
18 recommended by the capital cost experts that testified in the proceedings. The
19 recommendations of Mr. Gorman and the other capital cost experts were well-justified;
20 immediately following the issuance of Order 07, Moody’s upgraded PSE’s outlook from
21 “Stable” to “Positive,” which is usually a step taken before upgrading a corporate bond

1 rating. Moody's specifically pointed to Order 07's risk-shifting mechanisms as a rationale
2 for this change.

3 **NAME AND MAILING ADDRESS OF PETITIONER**

4 2. ICNU: ICNU is a non-profit trade association that represents the interests
5 of many large industrial customers of PSE, who suffer direct and substantial financial
6 harm due to the illegal rates for electricity established by Order 07. ICNU's mailing
7 address is:

8 818 SW 3rd Ave #266
9 Portland, OR 97024

10 Attached as Exhibit 1 is a list of ICNU members that are large industrial customers of
11 PSE.
12

13 **NAME AND MAILING ADDRESS OF PETITIONER'S ATTORNEY**

14 3. Melinda J. Davison, WSBA # 31182
15 Davison Van Cleve
16 333 SW Taylor, Ste. 400
17 Portland, Oregon 97204
18

19 **NAME AND MAILING ADDRESS OF THE AGENCY**
20 **WHOSE ACTION IS AT ISSUE**

21 4. WUTC. The Washington Utilities and Transportation Commission is an
22 agency of the State of Washington established under RCW Chapter 80.01 and charged by
23 the legislature with the authority to regulate in the public interest the rates, services,
24 facilities, and practices of businesses in the state supplying utility service to the public for
25 compensation. The WUTC's mailing address is:

1 1300 S. Evergreen Park Drive SW
2 P.O. Box 47250
3 Olympia, WA 98504

4 **AGENCY ACTION AT ISSUE**

5 5. On June 25, 2013, the WUTC entered Order 07 jointly in Docket Nos.
6 UE-121697 as its *Final Order Granting Petition* and UE-130137 as its *Final Order*
7 *Authorizing Rates*. Order 07 is attached as Exhibit 2.

8 **PERSONS WHO WERE PARTIES**
9 **IN THE ADJUDICATIVE PROCEEDINGS**

10 6. The following entities participated in the WUTC proceedings, Docket No.
11 UE-121697 and Docket No. UE-130137, that led to the issuance of Order 07:

12 ICNU
13 Washington Utilities and Transportation Commission
14 Washington Utilities and Transportation Commission Staff
15 PSE
16 Public Counsel Division of the Office of the Washington Attorney General
17 Northwest Industrial Gas Users
18 Nucor Steel Seattle, Inc.
19 Kroger Company
20 The Energy Project
21 Federal Executive Agencies
22 Northwest Energy Coalition

23 **JURISDICTION AND VENUE**

24 7. Jurisdiction. The Court has jurisdiction over this petition under the APA,
25 RCW § 34.05.510 *et seq.*

1 8. Venue. Venue is proper in Thurston County under RCW §
2 34.05.514(1)(a).

3 9. Exhaustion of Administrative Remedies. The Commission has designated
4 Order 07 as a Commission Final Order. By rule, a Commission Final Order disposes of
5 the merits of a proceeding. WAC § 480-07-825(10) states that service of a Commission
6 Final Order commences the time period for a petition for judicial review. While some
7 parties have filed for reconsideration of certain decisions contained within Order 07,
8 RCW § 35.05.470(5) states that filing a petition for reconsideration is not a prerequisite
9 to seeking judicial review. Therefore, ICNU has exhausted administrative remedies, as
10 required by RCW § 34.05.534 and RCW § 34.05.470.^{5/}

11 10. Standing. ICNU is an incorporated, non-profit association of large
12 industrial electric customers in the Pacific Northwest. Organizations “whose members
13 are injured may represent those members in proceedings for judicial review.” Loveless v.
14 Yantis, 82 Wn.2d 754, 758 (1973). ICNU’s members include many of PSE’s largest
15 electric customers and these members have been substantially harmed and prejudiced by
16 the illegal rate increase ordered by the Commission in Order 07. ICNU was a party and

^{5/} The APA states that the filing of a petition for reconsideration with the WUTC tolls the time in which a petition for judicial review must be filed; however, ICNU has not discovered any case that has interpreted whether a petition for reconsideration filed by one party tolls the time for a petition for judicial review for another party. The Washington Court of Appeals has determined in Wells v. Western Washington Growth Management Hearings Board, 100 Wn. App. 657, 678 (2000), that the thirty day period for review begins to run as to individual parties on the date they receive service of an order, rather than on the date any other party receives service. Likewise, it is well established in the 9th Circuit that finality is a party-based concept. See, e.g., Public Citizen, Inc. v. Mineta, 343 F.3d 1159, 1170 (9th Cir. 2003). Because timeliness is a jurisdictional issue and ICNU has chosen not to request reconsideration by the WUTC, it has filed this petition within the original 30-day time to ensure it is timely filed.

1 fully participated in all aspects of the Commission's administrative proceedings below,
2 including the submission of testimony, participation in hearings, and the filing of legal
3 briefs and motions. Because the Commission is required to regulate for-profit electric
4 utilities in the public interest, and to protect the rights of customers, the interests of
5 ICNU's members are among those the Commission is charged with protecting in its rate-
6 setting capacity. A judgment in favor of ICNU would eliminate or redress the prejudice
7 caused by the WUTC's action by providing relief from PSE's illegally high rates. ICNU
8 has standing to obtain judicial review as required by RCW § 34.05.530.

9 **FACTS DEMONSTRATING ENTITLEMENT TO RELIEF**

10 11. On October 25, 2012, PSE and the Northwest Energy Coalition filed a
11 joint application for an order authorizing a decoupling mechanism with the WUTC. On
12 February 1, 2013, PSE filed with the Commission a request to implement a rate increase
13 based on an expedited filing that did not include updates to PSE's power costs or to its
14 cost-of-capital and permissible ROR. ICNU and numerous other parties petitioned to
15 intervene in both proceedings, and their petitions were granted by the Administrative
16 Law Judge.

17 12. After informal workshops with parties, PSE and Staff began engaging in
18 secret, bilateral negotiations that produced two additional filings. The first was an
19 amended filing for a decoupling mechanism that included (for the first time) the rate plan,
20 which would automatically increase customer rates each year until 2016 or 2017. The
21 second was a "Global Settlement of Five Dockets," later called the "Multiparty

1 Settlement,” that proposed a quid-pro-quo: under the proposed settlement, the
2 Commission would approve both of PSE’s filings in return for PSE dropping one element
3 in a petition for reconsideration that was pending in an entirely unrelated manner.

4 13. The Commission suspended the Expedited Rate Filing and the Decoupling
5 filing, and set both for hearing as adjudicative proceedings on parallel procedural tracks.
6 On May 16, 2013, the WUTC conducted joint evidentiary proceedings in the Expedited
7 Rate Filing and in the Decoupling dockets. ICNU’s expert witness, Mr. Gorman,
8 performed a comprehensive analysis of PSE’s current market cost of equity, including
9 discounted cash flow (“DCF”), risk premium, and capital asset pricing (“CAPM”)
10 analyses, which are the methods relied upon by the WUTC to establish ROE figures. In
11 fact, in PSE’s last GRC, the WUTC specifically endorsed Mr. Gorman’s methods and
12 based PSE’s ROE on Mr. Gorman’s analyses of PSE’s cost of equity in the market at that
13 time. Mr. Gorman used the same comprehensive analyses in this case.

14 14. Mr. Gorman’s market research revealed that current capital market utility
15 bond yields are much lower now than when PSE was awarded a 9.8% ROE. Mr. Gorman
16 found that PSE’s current cost of equity supports a 9.3% ROE, and that the 9.8% ROE
17 used by PSE to calculate its rate increase was well outside the range of reasonable returns
18 for PSE in current market conditions. Notably, no party challenged the validity of Mr.
19 Gorman’s analyses. His finding that PSE’s current 9.8% ROE is outside the range of
20 reasonable returns is corroborated by Public Counsel witness Mr. Hill’s testimony. No

1 other evidence of the type historically relied upon by the WUTC was entered into the
2 record.

3 15. PSE submitted no studies on cost-of-capital or attrition evidence to
4 support its \$32.2 million rate increase, relying only on data collected prior to December
5 2011 used in the course of its 2011 GRC.^{6/} This lack of evidence contrasts sharply with
6 the response testimony of ICNU witness Mr. Gorman, whose cost-of-capital study
7 incorporated all financial models customarily relied upon by the Commission in
8 establishing rates. After ICNU and Public Counsel submitted evidence demonstrating
9 that the 9.8% ROE employed in PSE's rate calculations was not within the range of
10 reasonable returns, PSE had the opportunity to provide cross-answering testimony
11 supporting its request for rates based on a 9.8% ROE, or to rebut ICNU's expert
12 testimony, but declined to do so. PSE Vice President Daniel Doyle stated at hearing that
13 he had been too busy "preparing for board meetings" to oversee the development of
14 evidence to support PSE's rate request on this issue.

15 16. Following a hearing, on May 30, 2013, all parties briefed issues in both
16 the Expedited Rate Filing and the Decoupling dockets.

^{6/} A general rate case is defined as a filing for a rate increase that exceeds 3%. While the statutory burdens of proof are identical for any filings to increase rates, by rule, a utility must include cost-of-capital evidence in its initial filing if the filing is defined as a GRC. Because the Expedited Rate Filing, on its own, raised rates by less than 3%, Commission rules did not demand PSE to include such evidence in its *initial* filing. Nonetheless, Commission rules did not and could not excuse the Company from the statutory burden of demonstrating that its rates were just and reasonable. Further, the cumulative rate increase established in the two dockets resolved by Order 07 surpassed 3%.

1 17. On June 25, 2013, the Commission issued an order rejecting the Global
2 Settlement on the basis that it illegally and improperly proposed to resolve issues in
3 Docket Nos. UE-121697 and UE-130137 on the basis of the record in an unrelated
4 docket. Simultaneously, the Commission issued Order 07, which approved the request
5 for a rate increase as well as the request for a decoupling mechanism. In effect, almost
6 all aspects of the Global Settlement were adopted by the Commission in Order 07,
7 including the Company's as-filed rate increase, with no adjustments.

8 18. Paradoxically, while acknowledging that PSE's cost of equity was
9 appropriately considered in the case, the majority stated that it was inappropriate to
10 criticize PSE or to claim that the Company had not carried its burden of proof on cost-of-
11 capital. Commissioner Jones, on the other hand, filed his dissenting statement to Order
12 07 finding that PSE had failed to carry its burden of proof to demonstrate that the 9.8%
13 ROE embedded in the requested rate increase was just and reasonable in light of current
14 capital market conditions. Further belying PSE's claim that cost-of-capital was not at
15 issue, the Company testified during the hearing that it had refinanced two debt
16 instruments, which slightly lowered its cost of debt. Order 07 required PSE to recalculate
17 its rates to reflect this change to its ROR. Thus, it cannot be credibly asserted that the
18 Company's cost-of-capital and ROR was improper or outside the scope of the
19 proceeding.

20 19. The majority made no attempt to reconcile the Commission's express
21 finding in the 2011 GRC regarding the possibility of future changes being made to reflect

1 PSE's actual capital structure. Far from prohibiting adjustments to ROE, the WUTC held
2 in the 2011 GRC that the Company's hypothetical capital structure would be entirely
3 susceptible to change if assumptions were proven incorrect. Rather than considering the
4 testimonial evidence establishing differences between PSE's current, actual capital
5 structure and the hypothetical structure approved in 2011, the majority simply declined to
6 impose a cost-of-capital adjustment, despite the evidence, other than the minor
7 adjustment to debt cost consented to by the Company.

8 20. In his separate statement dissenting in part from Order 07, Commissioner
9 Jones emphasized that consideration of cost-of-capital was an appropriate issue in the rate
10 filing, and noted that the Company's failure to submit a cost-of-capital study should not
11 prevent the Commission from setting the Company's equity return at the point that the
12 record evidence demonstrated to be just and reasonable, as required by statute.

13 Commissioner Jones specifically referenced the reliable and compelling nature of the
14 analysis and arguments of ICNU witness Mr. Gorman and Public Counsel witness Mr.
15 Hill. Ultimately, Commissioner Jones wrote that PSE had not met its burden of proof.

16 21. The majority decision also improperly declines to adjust PSE's ROE in the
17 face of the decoupling and rate plan mechanisms. Order 07 acknowledges that these
18 mechanisms reduce PSE's business risk and should have the effect of reducing the
19 Company's capital costs, which could justify an ROE in the lower end of the range of
20 reasonableness, yet, the majority decision adopts an ROE that it admits is at best at the
21 high end of the range of reasonable returns. The ROE component of rates is designed to

1 compensate investors for the risk they bear as owners of the Company, thus, a less risky
2 Company requires a lower ROE, because lenders and shareholders will accept lower
3 returns on a lower risk investment. As Commissioner Jones noted in his dissent,
4 ratepayers should share the benefits of these lower capital costs. The mechanisms do not
5 eliminate risk; they shift the risk to customers.

6 22. Further, each party that presented cost-of-capital evidence testified that
7 decoupling lowers a utility's business risk, and should therefore lead to a moderate
8 reduction of ROE. The only witness that testified to the contrary was not a PSE witness,
9 and was not a cost-of-capital expert. By declining to set PSE's ROE at a level justified
10 by record evidence in the face of the adoption of experimental new regulatory
11 mechanisms, the WUTC failed to set rates based on substantial evidence.

12 23. The Commission's ratemaking authority is governed by RCW §
13 80.04.130. This statute provides that the burden of proof is upon the public service
14 company, or PSE, to show that a rate increase is just and reasonable, in the context of any
15 hearing involving any change of any schedule, the effect of which is to increase any rate.
16 Additionally, RCW § 34.05.476 states that a Commission decision must be based
17 exclusively on the record in an adjudicative proceeding. Under the Washington Supreme
18 Court's decision, POWER v. WUTC, 104 Wn.2d 798 (1985), a court must examine the
19 manner in which the Commission has employed the methods of regulation that it has
20 itself selected, and must decide whether each of the order's essential elements is
21 supported by substantial evidence.

1 **REASONS WHY RELIEF SHOULD BE GRANTED**

2 24. ICNU files this petition because Order 07 and the electric rates established
3 therein are outside of the WUTC's statutory authority, are the product of unlawful
4 procedure and decision making process, contain errors of law, are unsupported by
5 substantial evidence, are inconsistent with Commission precedent, and are arbitrary and
6 capricious.

7 25. Orders outside WUTC's statutory authority – RCW § 34.05.570(3)(b).

8 Order 07 is outside the WUTC's statutory authority because it:

- 9 (a) Fails to set rates that are just and reasonable as required by RCW §
10 80.28.010, and based exclusively on the agency record;
- 11 (b) Fails to require the Company to bear the burden of proof regarding
12 cost-of-capital as required by statute RCW § 80.04.130;
- 13 (c) Fails to consider undisputed and un rebutted evidence that PSE's cost-
14 of-capital from its 2011 GRC is now unjust and unreasonable; and
- 15 (d) Fails to properly apply the traditional cost of service ratesetting
16 formula that the Commission used in this proceeding to establish
17 rates.

18 26. WUTC engaged in unlawful procedure, decision-making process, and has
19 failed to follow a prescribed procedure - RCW § 34.05.570(3)(c). The WUTC engaged in
20 unlawful procedure in issuing the Order 07 because RCW § 80.04.130, as well as WUTC
21 administrative rules, require PSE to bear the burden of proof that its rates are just and
22 reasonable in any proceeding involving a rate increase; nonetheless, in this proceeding,
23 which involved a rate increase, the Commission illegally excused PSE of this statutory
24 duty and instead required ICNU, a responsive, intervening party, to bear the burden of

1 proving that PSE's proposed rates were unjust and unreasonable. In so doing, the
2 Commission contradicted and failed to follow the methods of regulation articulated by
3 the WUTC itself in Final Order 08 in the 2011 GRC, in which the Commission explicitly
4 provided for possible changes to PSE's capital structure based on evidence establishing
5 differences between the hypothetical capital structure approved in 2011 and the
6 Company's current capital structure.

7 27. Also in Order 07, the WUTC engaged in unlawful decision-making
8 process and failed to follow a prescribed procedure because the Commission did not
9 employ the methods of regulation which it has itself selected concerning the
10 establishment of attrition and Expedited Rate Filing remedies, as articulated in Final
11 Order 08 in the 2011 GRC: more specifically, (i) the ROE component of the rate increase
12 was approved without the support of substantial evidence; and (ii) the Commission, by
13 claiming in Order 07 that the Company did not have a burden to support the cost-of-
14 capital component of its requested rates, also contradicted and failed to follow the
15 methods of regulation articulated by the WUTC itself in Final Order 08 in the 2011 GRC.

16 28. Orders contain errors of law – RCW § 34.05.570(3)(d). Order 07 contains
17 the following errors of law:

18 (a) RCW § 80.28.010 requires PSE to bear the burden of proof that its
19 rates just and reasonable in any proceeding involving a rate
20 increase; nonetheless, in this proceeding, which involves a rate
21 increase, the Commission illegally excused PSE of this statutory
22 duty, instead requiring ICNU to bear the burden of proving, as a
23 responsive, intervening party, that PSE's proposed rates were
24 unjust and unreasonable;

- 1 (b) The WUTC erred in approving a rate increase that was calculated
2 using an ROE component that is not supported by record evidence;
3
4 (c) The WUTC erred by ignoring substantial, un rebutted, and
5 unchallenged evidence of the type historically used by the WUTC
6 to set PSE's cost-of-capital.

7 29. Orders not supported by substantial evidence – RCW § 34.05.570(3)(e).

8 Order 07's conclusions on the following issues were not supported by substantial
9 evidence:

- 10 (a) Order 07 sets rates at a level that includes a 9.8% ROE, despite the
11 fact that no record evidence supports the reasonableness of this
12 ROE level, and that all record evidence demonstrates that 9.8% is
13 not within the range of reasonable returns for PSE based on market
14 conditions at the time of the order;
15
16 (b) Order 07 states that the record does not contain sufficient evidence
17 of the proper ROE for PSE; and that 9.8% is "at best" at the upper
18 end of the range of reasonableness; the ROE used to calculate rates
19 in Order 07 is not supported by substantial evidence, and that the
20 Commission itself is not certain that this key rate component is just
21 and reasonable;
22
23 (c) Order 07 approves an attrition-based rate increase without
24 substantial evidence supporting the ROE component of the rate
25 increase;
26
27 (d) Order 07 fails to account for the shift of risk to ratepayers that
28 occurs due to the rate plan and the decoupling mechanism, which
lowers PSE's cost-of-capital.

29 30. Orders inconsistent with WUTC's precedent - RCW § 34.05.570(3)(h).

30 Order 07 is inconsistent with the long established WUTC precedent of using rigorous
31 industry-standard methodologies to set the Company's ROR. Further, Order 07 is
32 inconsistent with the Final Order in the 2011 GRC, which explicitly provided that

1 evidence contrary to the Company's hypothetical capital structure could be taken into
2 account and result in changes to reflect PSE's actual capital structure.

3 31. Orders arbitrary and capricious – RCW § 34.05.570(3)(i). Order 07 is
4 arbitrary and capricious because it:

- 5
6 (a) Establishes rates that reflect an ROR that is based on no evidence
7 of the type that the WUTC relies upon for rate setting;
- 8 (b) Willfully and unreasonably ignores record evidence;
- 9
10 (c) Adjusts PSE's cost-of-capital to reflect the Company's admission
11 that its cost of debt has dropped, but refuses to adjust PSE's cost-
12 of-capital to reflect unrebutted evidence that its cost of equity has
13 also dropped;
- 14
15 (d) Compensates the Company as though it continues to bear
16 significant risks that have now been shifted to customers, and
17 bases that compensation on market conditions that no longer
18 reflect the Company's true cost-of-capital; and
- 19
20 (e) Establishes an ROE not based upon the Company's current, actual
21 capital structure supported by evidence in the record, but upon a
22 hypothetical capital structure wholly unsupported by the record.

23 **REQUEST FOR RELIEF**

24 32. ICNU requests that the Court grant the following relief:

25 A. Entry of judgment under RCW § 34.05.570 and RCW § 34.05.574(1)
26 vacating Order 07 as outside the WUTC's statutory authority, a violation of procedure
27 and decision making process, an error of law, not supported by substantial evidence,
28 inconsistent with WUTC precedent, and arbitrary and capricious, and further directing

1 that the WUTC revise Order 07 to set PSE's rates at a level that incorporates an ROR
2 based on the record evidence; or

3 B. In the alternative, entry of an order vacating Order 07 and remanding to
4 the WUTC under RCW § 34.05.574 with instructions to enter an order consistent with the
5 Court's determinations; and

6 C. Grant such other relief as the Court determines is just and appropriate.

7 DATED this 24th day of July, 2013.

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9
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14
15
16
17

Davison Van Cleve



Melinda J. Davison, WSBA #31182
Davison Van Cleve, P.C.
333 SW Taylor, Ste. 400
Portland, Oregon 97204
Of Attorneys for Petitioner
Industrial Customers of Northwest
Utilities

Exhibit 1

MEMBERS OF INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

*Air Liquide
*Air Products
AkzoNobel
*Amcor Rigid Plastics
Axiall, LLC
*Boeing
Boise Cascade, Inc.
Boise Paper
Certain Teed Gypsum & Ceiling Manufacturing (BPB)
ConAgra Foods
Dyno Nobel, Inc.
Emerald Performance Materials, LLC
Evraz, Inc.
Freres Lumber Co.
*Georgia-Pacific
Inland Empire Paper Co.
*Intel
*International Paper
JR Simplot
Linde, Inc.
Longview Fibre
*Microsoft Corporation
Norpac Foods
Northwest Hardwoods
PCC Structurals, Inc.
Ponderay Newsprint
REC Solar Grade Silicon LLC
Schnitzer Steel
*Shell Oil Products US
Simpson Paper & Timber
SP Fiber Technologies
*Tesoro Refining and Marketing Co.
Timber Products
Wah Chang
West Linn Paper Company
*Weyerhaeuser

**Members served by Puget Sound Energy*

Exhibit 2

[Service Date June 25, 2013]

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petition of	)	DOCKETS UE-121697
	)	and UG-121705 (consolidated)
PUGET SOUND ENERGY, INC.,)	
and NORTHWEST ENERGY)	
COALITION	)	ORDER 07
)	
For an Order Authorizing PSE To)	
Implement Electric and Natural Gas	)	FINAL ORDER GRANTING
Decoupling Mechanisms and To Record	)	PETITION
Accounting Entries Associated With the)	
Mechanisms)	
.....)	
)	
WASHINGTON UTILITIES AND	)	DOCKETS UE-130137
TRANSPORTATION COMMISSION,	)	and UG-130138 (consolidated)
)	
Complainant,	)	ORDER 07
v.)	
)	
PUGET SOUND ENERGY, INC.,	)	FINAL ORDER AUTHORIZING
	)	RATES
Respondent.)	
.....)	

Synopsis: The Commission in this Order implements several innovative ratemaking mechanisms that, together, fulfill the Commission’s policy goal of breaking the recent pattern of almost continuous rate cases for Puget Sound Energy, Inc. (PSE). As the Commission observed in PSE’s 2011/2012 general rate case (GRC): “This pattern of one general rate case filing following quickly after the resolution of another is overtaxing the resources of all participants and is wearying to the ratepayers who are confronted with increase after increase. This situation does not well serve the public interest and we encourage the development of thoughtful solutions.”

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The solutions we approve here include an update to PSE's rates established in the 2011/2012 GRC in an Expedited Rate Filing (ERF) that is limited in scope and results in a relatively modest increase (1.6 percent) in electric rates and a slight decrease (0.1 percent) in natural gas rates.

The Commission also approves a joint petition by PSE and the Northwest Energy Coalition, an organization that promotes environmental protection, seeking authority to implement full decoupling of electric and natural gas rates. The decoupling mechanisms we approve mean that PSE's recovery of the fixed costs it incurs for infrastructure and operations necessary to deliver power and natural gas will no longer depend on the amounts of electricity and natural gas the company sells. This removes the so-called throughput incentive, thus promoting PSE's more aggressive pursuit of cost-effective conservation to which it commits as part of the decoupling mechanisms. With the throughput incentive eliminated, the company will be indifferent to sales lost as a result of the success of its conservation efforts. The full decoupling approved here is the first utility -supported mechanism that is both generally consistent with, and truly targeted to achieve, this key objective embodied in the Commission's 2010 Decoupling Policy Statement.

The third initiative the Commission approves in this Order is a rate plan that will allow modest annual increases in PSE's rates while requiring that the Company not file a general rate increase before March 2016 at the earliest. This holds the promise of customers paying rates that are lower than might be the case under traditional approaches to ratemaking. The rate plan is designed to give an incentive to PSE to become more efficient and to implement cost-cutting measures that will promote its ability to earn its authorized overall rate of return. The rate plan includes important protections for customers, including an earnings test that requires PSE to share with customers on an equal basis any earnings that exceed its authorized return during the term of the plan. Annual rate increases also are capped at 3.0 percent.

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The Commission's Order includes requirements for regular reporting by PSE of detailed information concerning the operation of the three mechanisms and the results that are being achieved. The Commission will monitor closely the degree of success that these mechanisms achieve relative to the promise they hold. Whether the mechanisms will prove to be enduring remains to be seen. The ERF is a one-time adjustment. The rate plan expires by its own terms when PSE files its next general rate case as early as 2016. Decoupling will be allowed to continue only if it lives up to the Commission's expectations.

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SUMMARY

- 1 **PROCEEDINGS:** On February 1, 2013, Puget Sound Energy, Inc. (PSE), filed with the Washington Utilities and Transportation Commission (Commission) an Expedited Rate Filing (ERF) in Dockets UE-130137 and UG-130138, seeking to implement a \$31.9 million (1.6 percent) electric delivery revenue increase and a \$1.2 million (0.1 percent) gas delivery revenue reduction.¹ The purpose of the filing is to update PSE's rates established in May 2012 in Dockets UE-111048 and UG-111049, PSE's most recent general rate case.²
- 2 The 2011/2012 GRC rates are based on a test year ended December 31, 2010. The rates proposed in the ERF are based on a test year ended June 30, 2012, as reflected in a modified Commission basis report (CBR) PSE prepared specifically for the purpose of the update.³ The CBR includes only restating adjustments to certain delivery services costs, and excludes power costs and property taxes.⁴
- 3 The rate changes are premised upon PSE's currently authorized 9.8 percent return on equity, representing 48 percent equity in PSE's capital structure and a 7.8 percent overall return, as approved by the Commission in the 2011/2012 GRC. The CBR

¹ These amounts were subsequently revised to \$31,138,511 for electric and \$1,717,826 for natural gas to adjust for lower long-term debt costs.

² *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049 (*consolidated*), Order 08 (May 7, 2012) (2011/2012 PSE GRC Order).

³ The Commission requires "commission basis reports" to be filed annually by electric and gas utilities. WAC 480-100-257 (electric companies); WAC 480-90-257 (gas companies). The purpose of such reports is to provide information the utility's financial operations using the adjustments required by the Commission in the utility's most recent general rate case. The reports are not audited.

⁴ Ms. Barnard's testimony for PSE in the ERF filing proposes a property tax adjustment mechanism through which variations in property taxes would be reflected in rates as required in the 2011/2012 PSE GRC Order. Exhibit No. KJB-1T at 26:15-35:2; *see also* Exhibit Nos. KJB-9 and KJB-10; 2011/2012 PSE GRC Order ¶ 143.

PSE filed a PCORC in Docket UE-130617 on April 25, 2013, that will update the Company's power costs. The PCORC, as filed, proposes a \$616,833 (or an average of 0.03percent) decrease in power costs.

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uses end-of-test-year rate bases valued at \$2.622 billion (electric delivery only) and \$1.592 billion (gas delivery only).

- 4 According to PSE, the ERF was filed in response to the Commission's statement in its 2011/2012 PSE GRC Order that the Commission would give "fair consideration" to proposals "that might break the current pattern of almost continuous rate cases."⁵ The Commission opined in its 2011/2012 PSE GRC Order that:

This pattern of one general rate case filing following quickly after the resolution of another is overtaxing the resources of all participants and is wearying to the ratepayers who are confronted with increase after increase. This situation does not well serve the public interest and we encourage the development of thoughtful solutions.⁶

- 5 The Commission also stated in its 2011/2012 PSE GRC Order that it would be "open to proposals for a full decoupling mechanism, even to one that may vary somewhat from what was described in the Commission's Policy Statement on Decoupling" issued in 2010.⁷ On October 25, 2012, PSE and the Northwest Energy Coalition (NWECC) filed a joint petition in Dockets UE-121697 and UG-121705 seeking approval of revenue decoupling mechanisms for the company's electric and natural gas operations. PSE and NWECC initially proposed that the decoupling mechanisms would remain in effect for a five-year period.

- 6 The Commission held two open meeting workshops concerning the decoupling proposal during the fall of 2012. Based in part on these discussions, PSE and NWECC filed an Amended Petition for Decoupling Mechanisms (Amended Decoupling

⁵ See, e.g., Exhibit No. KJB-1T at 3:8-4:2 (quoting 2011/2012 PSE GRC Order ¶ 507 (May 7, 2012)).

⁶ *Id.*

⁷ The Northwest Energy Coalition (NWECC) proposed a full decoupling mechanism in Dockets UE-111048 and UG-111049. The Commission rejected the proposal in the face of opposition from PSE. *Id.* ¶¶ 453-456.

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Petition) on March 4, 2013. The Commission's regulatory staff (Commission Staff or Staff)⁸ filed testimony supporting the Amended Decoupling Petition the same day.

7 The Amended Decoupling Petition calls for the implementation of electric and natural gas revenue decoupling mechanisms, with a baseline revenue per customer to be derived from the results of the ERF proceeding. The mechanisms depend on deferral accounting that provides for PSE to "true up" on an annual basis any over-recovery or under-recovery of actual revenue per customer measured against allowed revenue per customer.

8 The Amended Decoupling Petition also proposes a rate plan that would provide for fixed annual increases in allowed revenue per customer for the duration of the rate-plan period. The rate-plan-period is proposed to continue through at least March 2016 and possibly through March 2017.⁹

9 The rate plan would work in conjunction with the decoupling mechanisms. The Amended Decoupling Petition proposes initial \$21.2 million electric and \$10.8 million gas rate increases effective May 1, 2013. These are in addition to the rate changes specified in the ERF.¹⁰ Subsequently, under the rate plan, the Company's

⁸ In formal proceedings, such as these, the Commission's regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. See RCW 34.05.455.

⁹ "The mechanism will remain in place, at a minimum, until the effective date of new rates set in PSE's next general rate case. PSE will file a general rate case no sooner than April 1, 2015, and no later than April 1, 2016, unless otherwise agreed to by the parties to PSE's last general rate case." Amended Decoupling Petition ¶ 20.

¹⁰ The combined effect of the ERF increases and the Decoupling increases is such that ICNU and Public Counsel argue these proceedings fit the definition of a general rate case in WAC 480-07-505(1)(b). According to Public Counsel, this means the filings, considered together, must be accompanied by the detailed supporting evidence listed in WAC 480-07-510. We disagree. Even though the combined effect of our approval of these separate filings results in gross revenue increases to some customer classes of slightly more than 3 percent, the filings are in structure, purpose and effect as distinct from a general rate case filing as they possibly could be. The very purpose of these filings is to avoid the need for yet another general rate case proceeding. To the extent the combined effect of the two filings meets the technical definition of a general rate case in WAC 480-07-505(1)(b), we waive the rule.

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allowed delivery revenue per customer would increase each January 1 during the rate plan period by 3.0 percent for electric and 2.2 percent for gas. This revised and increased revenue requirement, along with updated decoupling-related adjustments, would then be reflected in new rates effective May 1.¹¹ The decoupling mechanism and rate plan are proposed to remain in place until the effective date of new rates in PSE's next general rate case, which may not be filed before April 1, 2015, but no later than April 1, 2016.

- 10 The Commission conducted joint evidentiary proceedings in the ERF and Decoupling dockets on May 16, 2013, and held a public comment hearing the same evening, both in Olympia, Washington. The parties filed post-hearing briefs on May 30, 2013.
- 11 **PARTY REPRESENTATIVES:** Sheree Strom Carson and Jason Kuzma, Perkins Coie, Bellevue, Washington, represent PSE. Simon ffitch, Assistant Attorney General, Seattle, Washington, represents the Public Counsel Section of the Washington Office of Attorney General (Public Counsel). Sally Brown, Senior Assistant Attorney General, and Greg Trautman, Assistant Attorney General Olympia, Washington, represent the Commission Staff.
- 12 Melinda Davison and Joshua Weber, Davison Van Cleve, Portland, Oregon, represent the Industrial Customers of Northwest Utilities (ICNU). Chad M. Stokes and Tommy A. Brooks, Cable Huston Benedict Haagensen & Lloyd LLP, Portland, Oregon, represent Northwest Industrial Gas Users (NWIGU). Kurt J. Boehm and Jody M. Kyler, Boehm, Kurtz & Lowry, Cincinnati, Ohio, represent the Kroger Co., on behalf of its Fred Meyer Stores and Quality Food Centers divisions (Kroger). Norman Furuta, Associate Counsel, Department of the Navy, San Francisco, California, represents the Federal Executive Agencies (FEA). Ronald L. Roseman, Attorney,

¹¹ The decoupling tariff tracker adjustment calculated to clear each group's deferred balances on an annual basis is limited 3.0 percent of the average base rates for the group at the time the decoupling tariff tracker goes into effect. If the calculated rate adjustments will result in a credit on customers' bills, there is no limit on such changes to rates. If the deferred balances are not cleared as a result of the three percent limits placed on increases to the decoupling tariff tracker, the remaining balances will be included in the deferred balances and will be recoverable in the subsequent rate period, not to exceed three percent in any rate period. This describes the operation of a so-called soft cap on rate increases due to decoupling.

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Seattle, Washington, represents the Energy Project. Damon E. Xenopoulos, Brickfield, Burchette, Ritts & Stone, PC, Washington, D.C., represents Nucor Steel Seattle, Inc. (Nucor). Amanda W. Goodin, Earthjustice, Seattle, Washington, represents the Northwest Energy Coalition (NWEC).

MEMORANDUM

I. Procedural History

- 13 PSE and NWEC filed a petition on October 25, 2012, in Dockets UE-121697 and UG-121705 (*consolidated*), seeking approval of an electric and a natural gas decoupling mechanism and authority to record accounting entries associated with the mechanisms. After the petition and supporting testimony were filed, the Commission held two technical conferences to allow interested stakeholders to further discuss the proposed decoupling mechanisms. PSE agreed to cooperate with interested stakeholders by responding to their inquiries seeking additional information about the decoupling proposal.
- 14 PSE and NWEC filed on March 4, 2013, an Amended Decoupling Petition and testimony in support of a modified decoupling proposal. The amended petition also includes a rate plan providing for fixed annual increases in PSE's electric and natural gas delivery costs during its three to four year term.¹² Commission Staff filed testimony in support of the revised proposal the same day.
- 15 Puget Sound Energy, Inc., filed revised tariff sheets in Dockets UE-130137 and UG-130138 (*consolidated*) on February 4, 2013, seeking to update to May 2013 its rates established in general rate proceedings in May 2012.¹³ This Expedited Rate Filing is limited in scope and rate impact. In the context of the amended decoupling and rate plan filed by PSE and NWEC, the ERF's only purpose is to establish baseline rates on

¹² PSE is required under the rate plan to file a general rate case no sooner than March 2015, which would establish rates effective in 2016, and no later than March 2016, which would establish rates effective in 2017.

¹³ 2011/2012 PSE GRC Order.

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which the proposed decoupling mechanisms and a rate plan will operate during the several year term of the rate plan.

- 16 The Commission placed the ERF in Dockets UE-130137 and UG-130138, and the PSE/NWEC Amended Decoupling Petition in Dockets UE-121697 and UG-121705 on the agenda for its regular open meeting on March 14, 2013. Following discussion, the Commission suspended the ERF tariffs and set all four of these dockets for hearing. The Commission subsequently designated an Administrative Law Judge (ALJ) as a presiding officer and directed him to set an expedited schedule for discovery, additional prefiled testimony, and hearing. The Commission's direction for expedited proceedings recognized both the nature of the filings, the significant informal process that preceded the date these dockets were set for hearing,¹⁴ and the significant policy discussions of alternative forms of regulation that preceded these filings in various fora.¹⁵
- 17 The Commission convened a joint prehearing conference on March 22, 2013, in the ERF and Decoupling dockets.¹⁶ On the morning of the prehearing conference, PSE, NWEC and Staff filed their "Multiparty Settlement Re: Coal Transition Power Purchase Agreement and Other Pending Dockets." These four dockets are the "Other

¹⁴ These filings were discussed at several Commission open meetings, were opened for informal discovery in which PSE agreed to cooperate, the subject of various stakeholder workshops, and reflect extensive discussions between PSE and the Commission's regulatory staff, as the Commission encouraged in its Final Order in PSE's 2011/2012 GRC. 2011/2012 PSE GRC Order ¶¶ 506-07.

¹⁵ See, e.g., *Id.*, *passim*; *In re WUTC Investigation into Energy Conservation Incentives*, Docket U-100522, Report and Policy Statement on Regulatory Mechanisms, including Decoupling, To Encourage Utilities To Meet or Exceed Their Conservation Targets (Nov. 4, 2010) ("Decoupling Policy Statement").

¹⁶ The prehearing conference also was noticed for Docket UE-121373, a proceeding not related to the matters considered in this Order. The Commission, simultaneously with its prehearing conference orders in the Decoupling and ERF dockets, entered in Docket UE-121373 Order 06-Continuing the Deadline Date for Parties to File Answers to Puget Sound Energy's Petition for Reconsideration and Motion to Reopen the Record and Revised Notice of Intention to Act. Order 06 set May 30, 2013, as the date for responses to PSE's pending petition and motion, the same date established in the Decoupling and ERF dockets for parties to file post-hearing briefs.

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Pending Dockets” to which the settlement agreement caption refers.¹⁷ The presiding ALJ discussed at the prehearing conference that the Multiparty Settlement would be treated under the Commission’s procedural rules as the common position of these three parties.¹⁸ WAC 480-07-730 provides further that “[n]onsettling parties may offer evidence and argument in opposition.” Parties opposed to the proposed resolution of any issues in the settlement agreement retain all the rights available to them in any contested matter before the Commission and will have an opportunity to file evidence responsive to its terms, and in support of alternative outcomes on the merits.¹⁹

18 The Commission entered prehearing conference orders in the ERF and Decoupling proceedings on March 22, 2013, establishing a joint hearing process and procedural schedule for the two matters, which are interrelated to the extent previously discussed.²⁰ Evidentiary hearings on May 16, 2013, provided the parties an opportunity to move their prefiled evidence into the record and to conduct cross-examination. The Commission also posed questions to various witnesses to aid in the development of a record adequate to support reasoned decisions. During the evening on May 16, 2013, the Commission held a public comment hearing to give members of the public an opportunity to state on the record their views concerning the issues. The parties filed briefs on May 30, 2013.

¹⁷ The “Coal Transition Power Purchase Agreement” portion of the settlement caption refers to the issues raised by PSE’s Petition for Reconsideration and Motion to Reopen the Record filed after the Commission’s entry of its Final Order in Docket UE-121373. *See In the Matter of the Petition of Puget Sound Energy, Inc., for Approval of a Power Purchase Agreement for Acquisition of Coal Transition Power, as Defined in RCW 80.80.010, and the Recovery of Related Acquisition Costs*, Docket UE-121373, Order 03 – Final Order Granting Petition Subject to Conditions (January 9, 2013).

¹⁸ WAC 480-07-730(3), which distinguishes a “Multiparty Settlement” from both a “Full Settlement” (WAC 480-07-730(1)) and a “Partial Settlement” (WAC 480-07-730(2)), provides that: “[a]n agreement of some, but not all, parties on one or more issues may be offered as their position in the proceeding along with the evidence that they believe supports it.

¹⁹ WAC 480-07-740(2)(c).

²⁰ *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-130137 and UG-130138 (consolidated), Order 02 (Mar. 22, 2013); *In the Matter of the Petition of Puget Sound Energy, Inc. and NW Energy Coalition For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms.*, Dockets UE-121697 and UG-121705 (consolidated), Order 02 (Mar. 22, 2013).

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II. Discussion and Decisions

A. Introduction

- 19 The Commission's May 7, 2012, Final Order in PSE's most recently completed general rate case (GRC) proceeding includes nearly 30 pages of policy discussions on a variety of topics including decoupling, attrition and the concept of an expedited rate case.²¹ Such mechanisms are among the tools available to the Commission when carrying out its statutory duties that are fundamentally defined by its obligation to ensure that utility rates are fair, just, reasonable and sufficient on a continuing basis.
- 20 In this Order, we approve on the merits the increased rates proposed in the ERF, PSE and NWECA's Amended Decoupling Petition, and the proposed rate plan.²² Our approvals are subject to reporting and related conditions designed to keep the Commission informed concerning whether the implementation of these measures proves out in practice to strike an appropriate balance between the needs of PSE's residential, commercial, industrial and other classes of customers to have safe and reliable electric and natural gas services at reasonable rates, and the financial ability of the utility to provide such services on an ongoing basis.
- 21 We view our approval of the ERF, the decoupling mechanisms, and the rate plan in a single proceeding as a series of steps made in the interest of exploring new forms of rate making. An important policy objective underlying our decision is to relieve all stakeholders and the Commission from the burdens of almost continuous general rate case proceedings that have characterized our utility regulation during recent periods.
- 22 Taking this step is not without risks. The methods we approve here will relieve PSE to a very significant degree from its concerns about regulatory lag and under-earnings

²¹ 2012 PSE GRC Order, ¶¶434-511 (May 7, 2012).

²² The Commission, by separate orders entered today, rejects the Multiparty Settlement for reasons apart from the merits of the regulatory mechanisms proposed in these dockets. *In the Matter of the Petition of Puget Sound Energy, Inc., for Approval of a Power Purchase Agreement for Acquisition of Coal Transition Power, as Defined in RCW 80.80.010, and the Recovery of Related Acquisition Costs*, Docket UE-121373, Order 07 (June 25, 2013).

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that may be attributed to attrition.²³ Decoupling and the rate plan will continue for a period of several years before a comprehensive evaluation by a third party, and then the Commission, will be undertaken. In addition, the Company's financial condition for regulatory purposes will not again be comprehensively reviewed in a general rate case until at least 2015 and perhaps as late as 2016. This multi-year rate plan will provide the Company with ample opportunity to implement efficiencies that will afford the Company with the earnings opportunities it seeks. And these cost savings, which we will monitor carefully, will then be incorporated into rates for the benefit of ratepayers. While this combination of decisions takes us down a new regulatory path, we believe it is clearly within the public interest to proceed in this direction, giving close attention to results as we proceed.

23 It is for these reasons, among others, that this Order should not be taken as establishing hard and fast principles for general or future application. We confirmed at hearing PSE's commitments to transparent and regular reporting of its operating results, and to engage with the Commission in an ongoing dialogue concerning how these new approaches to establish rates are working out in practice.²⁴ In this Order, we impose certain conditions that clarify our expectations in this regard. We do not enter lightly into the adoption of these new approaches, and will carefully monitor the results over the next several years.²⁵ We expect the Company to be forthcoming and transparent in providing such information on a timely basis and expect Staff and all the intervening parties to participate fully in the reporting and oversight processes we set forth later in our conditions.

24 The mechanisms we approve here are not entirely novel. The Commission has at various times in the past conducted expedited rate proceedings, approved decoupling

²³ While the term "attrition" is used in a variety of contexts (*see* 1 Leonard Saul Goodman, *The Process of Ratemaking* 290-91, 636-38 (1998)), and has a variety of definitions, we use term broadly to mean any situation in which a rate-regulated business fails to achieve its allowed earnings. *See*, 2011/2012 PSE GRC Order ¶ 484 footnotes 658 and 659.

²⁴ TR. 178:16-182:10.

²⁵ The Commission also is presently engaged in rulemaking proceedings in Docket A-130355 with the goal of establishing procedural rules that will simplify and expedite the ratemaking process across the industries we regulate.

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mechanisms, and approved rate plans. Undertaking all three approaches to ratemaking in a single proceeding, however, is a significant departure from traditional ratemaking practice in Washington. Our approvals here, starting with the updated rates established via the ERF, will reduce substantially regulatory lag and smooth volatility in the Company's revenues and earnings. Full decoupling of both the electric and natural gas delivery costs by moving from volumetric rates to revenue per customer rates will relieve PSE from the risks associated with variations in sales levels by removing the so-called throughput incentive. The rate plan provides for fixed annual increases in the delivery costs based on factors set at a level somewhat below recent historical increases in PSE's operational expenses according to the Company's analysis. This removes yet additional risk associated with regulatory lag while preserving PSE's incentive to operate efficiently.

25 The removal of these risks means an improved opportunity for PSE to recover its authorized rate of return. Moreover, with no adjustments to PSE's capital structure or rate of return on equity, the Company will have the advantage, for the term of the rate plan, of a level of return that is at the high end of what we presently perceive to be within the range of reasonableness.²⁶

26 While PSE will enjoy the benefits of reduced risks in the recovery of its prudently incurred costs, these benefits are not unbounded. The fixed annual escalation factors for electric and natural gas rates are set at levels below what PSE's analyses show the Company needs to recover its increasing delivery costs from year to year. If historical trends on which PSE's analyses depend continue, the Company will need to become more efficient and implement cost saving measures if it is to actually earn its authorized return. If PSE takes the steps necessary to succeed beyond expectations, the approved mechanisms provide for an earnings test each year they are in effect. PSE proposes that if the Company earns more than 25 basis points (*i.e.*, 0.25 percent) above its overall authorized return of 7.8 percent (*i.e.*, 8.05 percent), it will return

²⁶ While those who do not participate directly in the regulatory process, seldom, if ever, hear of it, this is a form of regulatory lag that works to the benefit of the Company. Mr. Cavanagh testifies concerning the importance of regular, if somewhat less frequent, general rate cases when mechanisms such as the decoupling approved here are implemented. *See* TR. 174:9-175:18. This protects against the concern that a "locked-in" rate of return for too long a period may become a windfall for the Company.

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one-half of the excess revenue collected in rates to ratepayers. We modify this in our Order by requiring that the 50/50 sharing with ratepayers begin at the point PSE exceeds its authorized return by any amount.

- 27 The proposed decoupling mechanism also includes a 3.0 percent “soft cap” on rates. Rates cannot be increased by more than that amount in any given year during the rate plan. If the calculated rate adjustments will result in a reduction in customers’ bills, there is no limit on such changes to rates. However, the cap is “soft” because, to the extent that deferred balances are not cleared as a result of the limits placed on increases to the decoupling tariff tracker, the amount of the balances not surcharged will carry over as a deferred balance and will be recoverable in the subsequent rate period subject to the same limits on potential rate increases.
- 28 Our fundamental responsibility is to determine an appropriate balance between the needs of the public to have safe and reliable electric and natural gas services at reasonable rates, and the financial ability of the utility to provide such services on an ongoing basis. As set forth in our governing statutes, we are required to determine results that establish “fair, just, reasonable and sufficient” rates for prospective application.²⁷ This means rates that are fair to customers and to the Company’s owners; just in the sense of being based solely on the record developed in this proceeding; reasonable in light of the range of possible outcomes supported by the evidence; and sufficient to meet the needs of the Company to cover its expenses and attract necessary capital on reasonable terms.²⁸ We are persuaded by the evidence in these proceedings that by approving the ERF, implementing the decoupling mechanisms, and allowing the rate plan escalation factors to go into effect, the rates will be fair, just, reasonable, and sufficient for the term of the rate plan. It is in the context of these principles that we turn to the task of resolving the contested issues in these proceedings.

²⁷ RCW 80.28.010(1) and 80.28.020.

²⁸ See *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); See also *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm’n of W. Va.*, 262 U.S. 679 (1923).

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B. The ERF, Decoupling and Rate Plan Depart from Traditional Ratemaking

29 ICNU argues that the Commission should reject the ERF, Decoupling and the rate plan proposals and —~~per~~mit PSE to come back with a general rate case filing to develop a full and complete record.”²⁹ Nucor Steel argues that the Commission —~~should~~ reject the overall proposal as it does not constitute good ratemaking and is not in the public interest.”³⁰ Kroger believes the rate plan and the full decoupling proposals —~~are~~ poorly constructed ratemaking devices and are not in the public interest.”³¹ Kroger recommends that the Commission reject both.

30 Public Counsel’s first preference, too, is to have the Commission proceed in a more traditional fashion. Public Counsel argues that:

In many respects the best approach to unraveling the critical issues in these dockets would be for the Commission to initiate an attrition Notice of Inquiry/collaborative, and for PSE to then file a general rate case. This would enable PSE, the Commission and all parties to analyze attrition in a policy framework, set cost of capital, and review any related longer term rate plan proposals on a full record.³²

31 Public Counsel also proposes an alternative to the package presented by the Company that would allow PSE to obtain expedited rate relief to update its revenues based on a review of changes in actual costs, along the lines proposed by Commission Staff in PSE’s 2011 GRC. In addition, the Public Counsel’s plan would include full decoupling to allow for a balanced approach to revenue stabilization. Rates under the plan would incorporate a cost of capital adjustment to reflect PSE’s reduced level of risk as a result of decoupling.³³

²⁹ ICNU Brief ¶13.

³⁰ Nucor Steel Brief at 5.

³¹ Kroger Brief at 3.

³² Public Counsel Brief ¶ 69.

³³ Public Counsel Brief ¶¶ 4, 70-73.

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32 All of these arguments boil down to the proposition that the Commission should not establish rates for PSE by adopting in a single proceeding three approaches to ratemaking that depart from traditional practices. What these arguments miss is that, with the possible exception of Public Counsel’s alternative, a failure to grant comprehensive relief in these dockets most likely will frustrate the Commission’s goal to entertain, consider fairly and adopt ratemaking alternatives that can “break the current pattern of almost continuous rate cases” recognized in PSE’s most recent general rate case. As the Commission observed in its Final Order in that proceeding:

This pattern of one general rate case filing following quickly after the resolution of another is overtaxing the resources of all participants and is wearying to the ratepayers who are confronted with increase after increase. This situation does not well serve the public interest and we encourage the development of thoughtful solutions.³⁴

This said, we turn to consideration of each of the three pending proposals and evaluate them on the record developed in these dockets.

C. Expedited Rate Filing (ERF)

1. Background

33 Faced with PSE’s evidence showing its continuing need for unusually high levels of capital investment in the foreseeable future to replace aging electrical and natural gas infrastructure, and to meet state-mandated renewable portfolio standards, Staff proposed in PSE’s 2012 GRC “an expedited form of general rate relief using a simple and straight-forward process to update the test period relationships between rate base and net operating income.”³⁵ Staff’s proposal was for a prompt filing after the

³⁴ 2011/2012 PSE GRC Order ¶ 507.

³⁵ See *Id.* ¶ 496 (citing *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049 (consolidated), Commission Staff Initial Brief ¶ 41).

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conclusion of the then-pending general rate case using the type of financial information required by Commission basis reports, or CBRs.³⁶

34 Staff envisioned that the filing would contain only restating adjustments, such as temperature normalization, with no request for a change in rate of return, except to update debt costs. This approach, in Staff's view, would mean that rates would be based upon known costs, but would capture changes to test year customer growth and load including any changes that result from conservation, and rate changes would be implemented to maximize the impact on financial results. Staff's proposal, in other words, was to establish a process that would allow a company's rates to be updated shortly after a GRC to address cost recovery issues arising from the regulatory lag that is an inherent part of the ten month GRC process in which rates are based on audited data from an historic test year.

35 In its Initial Brief in PSE's 2011/2012 GRC, Staff encouraged PSE to —take the initiative to implement Staff's proposal as soon as this case is completed.”³⁷ Staff offered —to meet with PSE to confirm mutual expectations of this filing if that will facilitate the process.”³⁸ The Commission, in its 2011/2012 PSE GRC Order, endorsed this idea:

If PSE accepts Staff's invitation —to meet with PSE to confirm mutual expectations” for a filing along the lines Staff suggests, or the Company on its own initiative makes such a filing, we certainly will give it fair consideration.³⁹

³⁶ WAC 480-90-257 and WAC 480-100-257, respectively, require regulated natural gas companies and electric companies to file within four months after the end of their fiscal year a report depicting normalized operations during the reporting period. These code provisions include detailed requirements for the reports.

³⁷ *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049 (consolidated), Commission Staff Initial Brief ¶ 46.

³⁸ *Id.*

³⁹ 2011/2012 PSE GRC Order ¶ 507 (May 7, 2012).

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Tacitly recognizing PSE's apparent reluctance to embrace Staff's proposal and anticipating opposition to it from Public Counsel and ICNU, the Commission also suggested an alternative:

Staff and PSE may enter into a broader discussion with other interested participants in the regulatory process and bring forward for consideration specific proposals that may satisfy a range of both common and diverse interests. In this connection, the Commission would be particularly interested in proposals that might break the current pattern of almost continuous rate cases. This pattern of one general rate case filing following quickly after the resolution of another is overtaxing the resources of all participants and is wearying to the ratepayers who are confronted with increase after increase. This situation does not well serve the public interest and we encourage the development of thoughtful solutions.⁴⁰

PSE, Staff and others met twice during the months following the entry of the GRC Order, but their discussions did not lead to an agreement for an expedited rate filing along the lines proposed by Staff.

36 The expedited rate filing concept again emerged in connection with the October 26, 2012, joint petition filed by PSE and the NWEC for an order authorizing PSE to implement electric and natural gas decoupling mechanisms.⁴¹ Noting the Commission's expressed willingness in the 2011/2012 PSE GRC Order to consider Commission Staff's conceptual proposal for an expedited rate filing to address regulatory lag," Mr. Piliaris testifies for PSE that if the Company's rates were set in such an expedited filing:

⁴⁰ *Id.*

⁴¹ *In the Matter of the Petition of Puget Sound Energy, Inc. and NW Energy Coalition For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697 and UG-121705, Prefiled Direct Testimony of Jon A. Piliaris (filed October 26, 2012), Exhibit No. JAP-1T at 25:15-26:11.

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Instead of using a general rate case test year as the basis for many of the calculations, the decoupling mechanisms would be calculated on the (presumably) more current test year reflected in the expedited proceeding.⁴²

According to Mr. Piliaris, this would mean reduced regulatory lag leading to smaller deferrals under the proposed decoupling mechanisms.⁴³

- 37 The idea of using an ERF to establish a starting point for applying the proposed decoupling mechanisms apparently took hold at the Company and was informally accepted and later formally endorsed by Staff. This we infer from the ERF now before the Commission with Staff's support. PSE's and Staff's testimonies make clear that the purpose of the ERF is not the same as what Staff proposed in PSE's 2012 GRC. The ERF proposed in these dockets is to be no more than a one-time update to the rates established in 2012.
- 38 The as-filed ERF would update the rates established in PSE's most recent general rate case using a modified CBR approach that PSE developed for the period ending June 30, 2012. PSE removed the power costs, purchased gas costs, and property tax components from the CBR, leaving only delivery charges. The CBR, prepared specifically for the purpose of the ERF, uses end-of-period rate base.⁴⁴ The result shows PSE has a demonstrated need for about a \$32 million, or 1.6 percent, increase to recover its investments and costs in electric delivery activities, but a small decrease of \$1.2 million, or 0.1 percent, for natural gas delivery.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ This is the single most important deviation from the usual requirements for a CBR, which require rate base to be stated on whatever basis the Commission approved in the Company's preceding GRC. In the 2011/2012 GRC, the Commission approved rate base using the average-of-monthly-averages, or AMA, methodology.

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2. Issues

a. End of Period Rate Base

39 Ms. Barnard testifies for PSE that the ERF “includes only the standard restating ratemaking adjustments, utilizing existing methodologies previously approved by the Commission” except that it moves rate base to end of period (EOP) amounts.⁴⁵ This is, however, a significant exception. According to Ms. Barnard “based on an electric rate base of \$2,621,991,642, a rate of return of 7.80 percent and an adjusted net operating income of \$184,563,096, the Company would have an overall [electric] revenue deficiency of \$32,163,102.”⁴⁶ Mr. Deen testifies for ICNU that “using AMA [average of monthly average] rate base in the revenue deficiency calculation would reduce the stated revenue deficiency from approximately \$32.2 million to \$18.6 million.”⁴⁷ Thus, PSE’s use of EOP rate base alone accounts for a significant amount—approximately 42 percent—of the revenue deficiency PSE identifies in its ERF filing.

40 ICNU argues that PSE’s use of EOP rate base, rather than AMA, violates WAC 480-100-257, which requires a CBR to use the same adjustments as were accepted a company’s most recent general rate case, which, in PSE’s case, means AMA. Although he supports the use of EOP rate base, subject to certain conditions, Mr. Dittmer testified for Public Counsel that he also has concerns about what this rule requires.⁴⁸ We believe that such concerns are misplaced. This rule imposes an annual reporting requirement so that the Staff can evaluate how the Company is performing financially relative to what the Commission approved in its most recent GRC. These reports are due within four months of the end of the Company’s fiscal year, or by the end of April. In adopting the CBR rule, the Commission did not intend to apply its concepts to all aspects of ratemaking. The use of the CBR here, particularly the

⁴⁵ Exhibit No. KJB-1T (ERF) at 6:7-10.

⁴⁶ *Id.* at 7:4-7

⁴⁷ Exhibit No. MCD-1T at 12:15-16.

⁴⁸ TR. 289:6-290:25.

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modified CBR the Company developed for the period ended June 30, 2012, was for a distinctly different purpose. Simply put, the CBR rule does not legally limit the means PSE can propose to use to update its rates through an ERF.

41 ICNU also argues that PSE's use of EOP also violates the matching principle because it does not adjust its customer count or revenue levels to *pro forma* year-end figures.⁴⁹ In this vein, Mr. Dittmer testified for Public Counsel that if use of end of period rate base is accepted as part of the ERF, the Commission should require "revenue annualization" to consider growth in customers throughout the historic test year."⁵⁰ Subject to this condition, Mr. Dittmer finds the use of end-of-period rate base in the ERF acceptable.

42 Mr. Dittmer testifies further that use of end of period customer counts properly matches costs and revenues. He opines that:

This is a proper "matching" adjustment routinely employed in jurisdictions that utilize a test-year-end approach to valuing rate base. Since the test year end Plant in Service has been designed and constructed to facilitate service for customers taking service at test year end, and the revenue requirement includes a full "annual" return on such test-year-end rate base value, it is a proper "matching" adjustment to reflect the "annualized" margins associated with test-year-end customers – even though a portion of those customers added "during the test year" did not take service throughout the entire historic test year.⁵¹

43 The adjustment that Mr. Dittmer recommends results in an increase in PSE's restated electric operating income of \$595,194.⁵² This is relative to total restated operating income of more than \$180 million. Standing alone, this would reduce the ERF

⁴⁹ ICNU Brief ¶ 21.

⁵⁰ Exhibit No. JRD-1T at 15:12-16.

⁵¹ *Id.* at 15:19-16:2.

⁵² Exhibit No. JRD-4 (compare PSE recommended ERF to Public Counsel recommended ERF at line 6 on page 1; this number is verified on page 2 in the "YE Customer Growth" column at line 34, showing Net Operating Income).

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revenue requirement on the electric side by \$959,455, to \$31,203,647. Application of the same adjustment to the gas results of operations increases the restated net operating income by \$1,156,892 and increases the revenue requirement surplus by \$1,861,946.⁵³

- 44 Ms. Barnard, on rebuttal, testifies that Mr. Dittmer's proposed adjustment fails to consider important factors such as additional bad debt, state utility tax, or the regulatory fees associated with the revenues that he proposes to include and does not annualize the depreciation expense that is also associated with the use of end of period rate base.⁵⁴ She says that if the test period is adjusted to annualize revenues based on year-end customer counts, then the adjustment should include the corresponding annualization of depreciation expenses associated with the end of period plant values. She alleges that had Mr. Dittmer included the end of period depreciation expense and reflected the additional taxes that would be associated with the incremental revenues, this specific adjustment would have reduced net operating income and therefore increased the revenue deficiency for electric operations.

Commission Determinations

- 45 The Commission has traditionally required that utility rates be established relying on the measurement of rate base using the AMA approach. The Commission, however, has occasionally recognized that the alternative approach of utilizing end-of-test period rate base may be appropriate in a variety of circumstances.⁵⁵ In a 1981 case,

⁵³ Exhibit No. JRD-5 (compare PSE recommended ERF to Public Counsel recommended ERF at line 6 on page 1; this number is verified on page 2 in the –YE Customer Growth column at line 32, showing Net Operating Income).

⁵⁴ Exhibit No. KJB-11T at 3:3 – 4:3.

⁵⁵ See, e.g., *WUTC v. Olympic Pipeline Company*, Docket TO-011472, Twentieth Supp. Order, ¶¶ 158-160 and 370 (September 27, 2002). In an earlier case involving PSE's predecessor on the electric side of its operations, the Commission stated that:

Historically, the commission has accepted the average rate base concept as being an appropriate tool in the measurement of earning levels. It has not, however, discounted the validity of year-end rate base where special conditions exist, such as unusual growth in plant at a faster pace than customer growth and customer rate-making treatment is deficient.

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WUTC v. Washington Natural Gas, the Commission drew on its early experience evaluating the relative merits of the two approaches and drew the following conclusions:

- (1) Average rate base is the most favored,
- (2) Year-end rate base is an appropriate regulatory tool under one or more of the following conditions:
 - (a) Abnormal growth in plant
 - (b) Inflation and/or attrition
 - (c) As a means to mitigate regulatory lag
 - (d) Failure of utility to earn its authorized rate of return over an historical period.⁵⁶

All of these conditions, which are somewhat interrelated, are present to one degree or another for PSE at this time.

46 Regarding high growth in capital expenditures to fund additional plant in service, the Commission has recognized over the past several years that the Company is faced with having to replace substantial amounts of aging infrastructure.⁵⁷ These plant additions have cost impacts that are directly affected by regulatory lag. The Commission stated in *Washington Natural Gas* that this lag —~~has~~ long been a concern of both the utilities and their regulators” that can have a ~~deleterious~~ effect,” and that

Washington Utilities & Transp. Commission v. Puget Sound Power & Light Co., 7 PUR4th 44, 50 (September 27, 1974). Although the Commission rejected end of test period rate base in this case, its express recognition as a valid approach belies ICNU’s argument that this is a ~~new~~ theory for electric regulation.” ICNU Brief ¶ 83.

⁵⁶ *WUTC v. Wash. Nat. Gas Co.*, 44 P.U.R. 4th 435, 438 (Sept. 24, 1981) (*Washington Natural Gas*).

⁵⁷ See, 2011/2012 PSE GRC Order ¶ 494 (May 7, 2012). See also, *In the Matter of the Joint Application of Puget Holdings LLC and Puget Sound Energy*, Docket U-072375, Order 08, ¶¶122-127 (December 30, 2008).

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as regulators we have the responsibility to mitigate that effect to the extent possible.”⁵⁸

47 Although we have no full-blown attrition study in this record, evidence there is ample evidence in the record of such earnings attrition, caused in substantial part by continuing growth in capital investments.⁵⁹ In PSE’s 2011/2012 GRC, the Commission stated specifically in connection with attrition, and more generally, that it was “open to considering” the “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.”⁶⁰

48 We therefore conclude that the use of EOP for electric and natural gas rate base is an appropriate way to mitigate the consequences of these conditions.

b. Cost of Capital

i. Should the Commission Adjust PSE’s Return on Equity to Reflect Current Financial Market Conditions?

49 Public Counsel and ICNU advocate that PSE’s currently authorized 9.8 percent rate of return on equity (ROE), established in the Company’s 2011/2012 GRC in May 2012, is outdated and should be reduced to reflect current conditions in financial markets. Mr. Hill, testifying for Public Counsel, says that capital costs have declined since then, based on his review of corporate bond yields.⁶¹ He recommends a 30 basis

⁵⁸ *Id.*

⁵⁹ PSE has not achieved its authorized rate of return for electric operations since 2006, and for natural gas operations since at least 2004. Mr. Schooley’s updated Exhibit No. TES-3 shows that even with the rate increase instituted in 2012, PSE’s electric earnings were about 70 basis points below the authorized rate of return granted in 2012. Its natural gas earnings were 30 basis points below. See, Exhibit No. TES-1T at 12:18-13:5.

⁶⁰ 2011/2012 PSE GRC Order ¶ 491 (May 7, 2012). See also *id.* at ii (The Commission recognizes throughout this Order, and specifically in connection with suggestions that the challenges evident in this period when PSE faces the need for unusually high levels of capital investment can be met by established ratemaking mechanisms such as the use of “end of period” rate base).

⁶¹ Exhibit No. SGH-1T, at 9, Chart 1. Current bond yields are about 125 basis points below that levels that existed in early 2011, and 50 basis points below the level in late 2011. Anecdotaly,

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point reduction to account for what he perceives to be a trend of generally decreasing capital costs in the financial markets.

50 Mr. Gorman, for ICNU, also focuses on utility bond yields as part of his risk premium analysis in support of a 50 basis point reduction in PSE's return on equity in the context of the ERF. Mr. Gorman testifies that current "A" rated utility bond yields are about 25 basis points lower than during the 2011/2012 GRC, while "Ba" rated bond yields have decreased over 40 basis points.⁶² Mr. Gorman says that such significant declines indicate that PSE's current capital cost is much lower as of the time he finalized his testimony (*i.e.*, April 2013), than when set by Commission order in May 2012.

51 Mr. Gorman estimates a present market return on equity of 9.30 percent.⁶³ His estimate is based on varied analyses, using a proxy group of electric utilities comparable in risk with PSE in order to derive discounted cash flow, capital asset pricing model, and risk premium market return studies, all based on up-to-date market conditions.⁶⁴ On the basis of this analysis, ICNU recommends the Commission set the Company's ROE in this case at 9.30 percent to reflect current market conditions.

52 PSE argues it is not appropriate to address return on equity in the context of the ERF.⁶⁵ PSE and Staff agree that a general rate case is the appropriate proceeding in which to examine this question.⁶⁶

53 PSE argues that its current authorized cost of equity is just that—current. Disputing the idea that its 9.8 percent return on equity is outdated, PSE states that it was set for

Mr. Hill cites a recent full cost of capital analysis he performed which concluded that a reasonable ROE range was from 8.5 to 9.5 percent for BBB-rated electric utilities.⁶¹

⁶² Exhibit No. MPG-1T at 12:8–10, Table 5.

⁶³ *Id.* at 13:3, 14:1–2, Table 6.

⁶⁴ *Id.* at 13:4–20, Exhibit No. MPG-3.

⁶⁵ PSE Brief ¶ 70.

⁶⁶ *Id.*; Staff Brief ¶ 38 (“Staff strongly believes that adjustments to return on equity or to capital structure are only appropriate within a general rate case, where the Commission can look at all the offsetting factors.”).

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the projected rate year May 2012 through April 2013, and was decreased from PSE's previously authorized return on equity of 10.1 percent. PSE suggests this 30 basis point reduction already accounts for the downward trend in financial market conditions that Mr. Gorman identifies.⁶⁷

- 54 PSE also cites to the Commission's recent approval, "just a few months ago," of the Avista general rate case settlement that included a return on equity of 9.8 percent—the same as currently in place for PSE—on a finding that this remains within the zone of reasonableness.⁶⁸ Given the recent adjustment of PSE's ROE in a general rate case, and the Avista ROE set at the same rate, PSE argues, the Commission should not adjust the Company's cost of capital in this proceeding.
- 55 Responding to the utility bond analyses of Mr. Gorman and Mr. Hill, PSE argues that they provide no evidence regarding the correlation of utility bond yields to equity returns.⁶⁹ That is, to the extent there is a relationship between the costs of debt instruments and costs of equity, these witnesses do not demonstrate what it is or how it supports the significantly different (*i.e.*, 50 basis points versus 30 basis points) adjustments to equity return that ICNU and Public Counsel advocate.
- 56 Although PSE did not put on a full cost of capital case, given its perspective that this is beyond the scope of the ERF proceeding, the Company did analyze Mr. Gorman's testimony and offers rebuttal from Mr. Doyle. Mr. Doyle testifies that PSE looked at the authorized return on equity for the regulated utilities within the holding companies in Mr. Gorman's proxy group:

⁶⁷ PSE Brief ¶ 73 argues that:

Bench Exhibit B-6C further supports the premise that PSE's current authorized return on equity of 9.8 percent should not be further reduced in this proceeding. The 9.8 percent return on equity ordered by the Commission in May 2012 was already below the average return on equity awarded in 2012 for both gas and electric utilities, according to the evidence in Exhibit B-6C. One could infer that the Commission already reflected the downward trend that Mr. Gorman now claims is occurring when it decreased PSE return on equity to 9.8 percent last year.

⁶⁸ *WUTC v. Avista*, Dockets UE-120436 and UG-120437, Order 09 ¶ 74 (December 26, 2012).

⁶⁹ PSE Brief ¶ 72.

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According to the SNL Energy database, the average authorized return on equity for the operating utilities within ICNU's proposed proxy group is 10.08%, and the average capital structure for the operating utilities within ICNU's proposed proxy group contains 48.80% equity. . . Thus, each of the average authorized return on equity and the average authorized capital structure of the operating utilities in ICNU's proposed proxy group is substantially higher than that advocated for PSE in this proceeding.⁷⁰

Mr. Doyle provides evidence that the average, considering only the first quarter 2013, remains at 9.88, which is still above PSE's current authorized return on equity.⁷¹

Commission Determination

57 We discuss below in connection with decoupling that the question of return on equity, contrary to PSE's assertions though Mr. Doyle, definitely is an issue in this proceeding. On the other hand, if this was a stand-alone ERF proceeding, the Commission⁷² is inclined to agree with PSE and Staff that it would be inappropriate to consider any part of the cost of capital other than demonstrable changes in debt. The ERF here, however, is joined with related proposals—decoupling and the rate plan—that make broader consideration of this issue appropriate.

⁷⁰ See Exhibit No. DAD-1T at 7:1-6; Exhibit No. DAD-3.

⁷¹ See Exhibit No. DAD-3.

⁷² In connection with this determination, Commissioner Jones takes a different perspective than Chairman Danner and Commissioner Goltz whose prevailing view is expressed in paragraphs 57 and 58 and noted here. The concept of an ERF outlined by Staff testimony in PSE's 2011/2012, which we endorsed in principle, expressly envisioned that PSE would not be allowed to request a change in rate of return, except to update debt costs. See PSE 2010/2011 GRC Order ¶ 496 (citing Exhibit No. KLE-1T at 82:21-83:8). PSE worked actively with Staff as it developed the ERF before us here. It is not surprising, therefore, that —PSE has not proffered a full cost-of-capital study.” Yet, Commissioner Jones takes the view that this means the Company failed to carry its burden of proof. See *infra*, Separate Statement of Commissioner Jones ¶ 3. Commissioner Jones finds PSE's argument that adjusting cost of capital is not appropriate within the ERF —unconvincing.” *Id.* The prevailing view, expressed in this Order, is that it is inappropriate to criticize PSE or claim that the Company has not carried its burden on cost of capital when the subject was not contemplated by PSE, Staff, or the Commission to be part of an ERF.

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58 Although it is not a unanimous decision,⁷³ the Commission finds on balance that the evidence in this case is simply too sparse to support a reduction in PSE's current authorized ROE to reflect current financial market conditions. The evidence takes us only to the point of finding that 9.8 percent now resides at the higher end within the range of reasonable equity return, in contrast to its more central position at the time it was set during PSE's 2011/2012 GRC. Indeed, the Commission implied as much in the recent Avista general rate case. There the Commission noted that equity returns continue to trend downward and said that if the case had been litigated instead of being resolved on the basis of a full settlement:

[The Commission] may very well have decided that an ROE of less than 9.8 would be warranted. However, we are convinced that, at the very least, 9.8 percent is within a zone of reasonableness, and we defer to the judgment of those parties that put on cost of capital evidence, both of which joined in the Settlement.⁷⁴

Given the evidence before us at this time we are not convinced that a 9.8 percent ROE is outside the zone of reasonableness. The record on the issue in this case lacks the depth and breadth of data analysis, and the diversity of expert evaluation and opinion on which the Commission customarily relies in setting return on equity. Accordingly, we determine that no adjustment should be made in these proceedings.

ii. Should the Commission Adjust the Level of Equity in PSE's Capital Structure?

59 The Company based the ERF revenue requirement on the capital structure approved in PSE's 2011/2012 GRC. In approving a 48 percent equity component in that case, the Commission said in its final order:

⁷³ See *infra*, Separate Statement of Commissioner Jones.

⁷⁴ *WUTC v. Avista*, Dockets UE-120436 and UG-120437, Order 09, ¶ 74 (December 26, 2012) (citing Edison Electric Institute, Rate Case Summary, Q3 2012 Financial Update, at 1. Phillip S. Cross, *How Much Is Enough? Utilities Face Rate Pressure As Financing Costs Hit Rock Bottom*, 150 Public Utilities Fortnightly 22 (November 2012)). Mr. Avera for Avista, Mr. Elgin for Staff and Mr. Gorman for ICNU filed cost of capital testimony in the Avista case.

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What the Company proposes here is the most likely actual capital structure during the rate year. Should this turn out not to be true, a contrary result may be taken into account when the Commission evaluates evidence presented in PSE's next general rate case.⁷⁵

Mr. Gorman testifies that the Company's actual common equity ratio over the past two years has been about 46 percent.⁷⁶ Considering the Commission's rationale for approving 48 percent equity in PSE's capital structure, ICNU argues that it is appropriate to reevaluate PSE's capital structure in the ERF, rather than awaiting the Company's next general rate case.

60 ICNU argued initially that we should rely on Mr. Gorman's testimony that the Company's actual capital structure as of December 31, 2012, included 46.64 percent common equity, with accompanying changes to short- and long-term debt (*i.e.*, to 1.65 percent and 51.71 percent, respectively).⁷⁷ Considering, however, Mr. Gorman's analysis of what he regards as the significantly stronger earnings manifested in the Company's latest CBR, filed on April 30, 2013, Mr. Gorman's final recommendation for a new common equity ratio is 46.14 percent, in conjunction with short-term debt cost of 2.68 percent.⁷⁸

61 PSE responds to Mr. Gorman, arguing that he has disregarded the Commission's determination in PSE's 2011/2012 GRC that the Company's capital structure and return should be viewed on a regulatory accounting basis rather than on a GAAP (generally accepted accounting principles) basis.⁷⁹ According to PSE, Mr. Gorman is mistaken when he testifies that —the capital structure used to set rates in PSE's last rate case was a hypothetical capital structure that included a larger common equity

⁷⁵ 2011/2012 PSE GRC Order ¶ 5.

⁷⁶ ICNU Brief ¶ 90 (citing Exhibit No. MPG-1T at 7:4–6, Table 3).

⁷⁷ *Id.* ¶ 91 (citing Exhibit Nos. MPG-1T at 8:6–10:6, MPG-5, MPG-6, MPG-7).

⁷⁸ *Id.* (citing Exhibit No. MPG-23T at 2:7–9, 3:1-17).

⁷⁹ PSE Brief ¶ 76.

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ratio than PSE's actual capital structure mix."⁸⁰ In support, PSE quotes the Commission's determination on this issue:

We find the evidence establishes that PSE's actual average capital structure during the test year was as portrayed by the Company through Mr. Gaines's testimony: 48.5 percent equity, 49.5 percent long-term debt and 2.0 percent short-term debt. Thus, the capital structure PSE proposes in this case contains slightly less equity than was in place during the test period.⁸¹

PSE notes in addition the Commission's statement in its 2011/2012 PSE GRC Order that:

Retaining PSE's current equity ratio of 46 percent *while the Company is actually capitalized at 48 percent* and may be experiencing attrition could be viewed unfavorably by the financial markets and rating agencies.⁸²

Finally, PSE quotes from the 2011/2012 PSE GRC Order that the Commission was: ~~persuaded~~ by Mr. Gaines's testimony responding to Mr. Gorman's concerns about removal of common equity supporting non-regulated subsidiaries and the adjustment to regulated common equity for OCI [other comprehensive income]."⁸³

Commission Determination

62 ICNU's arguments here are the same as it made through Mr. Gorman's testimony in PSE's 2011/2012 GRC. As in that case, failure to remove equity supporting non-regulated subsidiaries and OCI gives a misleading picture of PSE's regulated capital structure. As Mr. Doyle testified, ICNU and Public Counsel begin with capital structure and equity calculations determined on a GAAP basis, and they fail to adjust and reconcile items that are treated differently on the regulated side of the equation

⁸⁰ *Id.* (citing Exhibit No. MPG-1T 7:5-7).

⁸¹ *Id.* (quoting 2011/2012 PSE GRC Order ¶52).

⁸² *Id.* at footnote 101 (citing 2011/2012 PSE GRC Order ¶ 56 (PSE's emphasis)).

⁸³ *Id.*

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such as OCI, non-regulated subsidiaries and gains and losses from derivatives. Mr. Gorman's testimony simply does not support an adjustment to PSE's capital structure in the context of the ERF.

iii. Should the Commission Adjust PSE's Debt Costs?

63 PSE proposes to update its cost of long-term debt as part of this proceeding, in light of the current refinancing of certain pollution control bonds that was nearing completion at the time of the evidentiary hearing in these dockets.⁸⁴ PSE states that ~~because~~ the interest rate is known to PSE, it is reasonable to pass through to PSE's

customers these savings resulting from actual decreases in long-term debt costs.”⁸⁵ Mr. Doyle testified that “subject to finalizing [the] pricing, it looks like we’re going to be able to pass back to customers about 1.5 to 2 million dollars of annual interest savings per year.”⁸⁶

64 PSE states in closing on this point that “it does not make sense to speculate on the interest rate for future refinancing that may occur during the course of the general rate case stay-out period.”⁸⁷ This anticipates ICNU’s observation that rates under the ERF are proposed to be in effect for several years, during which time a number of PSE debt issuances are set to mature and be refinanced.⁸⁸ This, presumably, will be at lower market costs of debt. ICNU accordingly recommends that we require the Company “to document its intended course of action concerning these maturing debt issuances, as well as update its costs of long- and short-term debt.”⁸⁹

⁸⁴ PSE Brief ¶ 75 (citing Exhibit No. B-2 (PSE’s Response to Bench Request No. 2)); *see also* TR. 246:1-247:25.

⁸⁵ *Id.*

⁸⁶ TR. 247:18-21.

⁸⁷ PSE Brief ¶ 75.

⁸⁸ ICNU Brief ¶ 92 (citing Exhibit No. MPG-1T at 11:1-13).

⁸⁹ *Id.*

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Commission Determination

65 The Commission discussed the general parameters for an ERF, responding to Mr. Elgin's analysis in the last GRC Order. Although the ERF we consider here is different in significant respects than what Mr. Elgin proposed in that proceeding, the types of costs reflected track his proposal. Among other things, Mr. Elgin testified that in an ERF, PSE would not be allowed to request a change in rate of return, except to update debt costs for known changes.⁹⁰ This is a sensible recommendation. While equity costs are usually controversial and must be resolved on the basis of a considerable body of expert evidence, debt costs are usually readily observable based on the known costs of the Company's long-term and short-term debt instruments. We determine for these reasons that we should accept PSE's proposal and require the Company to adjust its debt costs in this proceeding reducing its overall revenue requirements in its filing in compliance with this Order.

c. Restating Adjustments

i. Transparency

66 Staff refers in its brief to the fact that Public Counsel's witness Mr. Dittmer raises a concern in his testimony that PSE excluded six restating adjustments the Commission ordered in the 2012 General Rate Case from its revised CBR ~~in~~ the interests of expediency.⁹¹ Mr. Dittmer acknowledges, however, that ~~this~~ omission probably does not have a material revenue impact.⁹² Mr. Schooley noted that collectively, had these minor adjustments been made, they would have increased PSE's revenue requirements.⁹³ It is perhaps for these reasons that no party advocates that the omitted restating adjustments should be made at this stage of the ERF.

⁹⁰ See 2011/2012 PSE GRC Order ¶ 496 (citing Exhibit No. KLE-1T at 81:5-22). The Commission, at Public Counsel's request, took official notice in this proceeding of Mr. Elgin's testimony in Dockets UE-111048 and UG-111049.

⁹¹ Staff Brief ¶ 16 (quoting Exhibit No. TES-1T at 8:21).

⁹² Exhibit No. JRD-1T, at 16-17.

⁹³ Schooley, Exhibit No. TES-1T, at 8-9 and footnote 6. The omitted minor adjustments would collectively decrease natural gas revenue requirements by \$156,777. *Id.*, at 10-11 and footnote 9.

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most likely to match rate year costs, thereby reducing the electric and natural gas revenue requirement by \$2.6 and \$1.3 million, respectively.⁹⁷

70 ICNU also recommends that incentive compensation be fully removed from the revenue requirement.⁹⁸ Again, PSE uses a four-year average expense (from 2009-2012) in its deficiency calculation for incentive compensation payouts.⁹⁹ ICNU argues that:

Including such expense within the ERF is improper because there is good cause to believe that it will not be a known and continuing expense; that is, PSE fails to affirmatively establish such certainty in direct testimony now, as well as in the 2011 GRC.¹⁰⁰

ICNU urges the Commission to reevaluate PSE's scheme of basing incentive compensation on financial goals, referring to Mr. Gorman's testimony that this:

Inherently creates scenarios in which management will be led to boost company profits at the expense of customer service, motivated by the prospect of personal gain through these incentives in conjunction with a fiduciary duty toward shareholders to maximize returns.¹⁰¹

PSE states that it calculated these adjustments consistent with the 2011/2012 GRC in which pension expense was not contested.¹⁰² In this case, ICNU proposes a new methodology that differs from the four-year average methodology on which PSE relied in the 2011/2012 proceeding. Recovery of incentive pay in rates, in part, was a contested issue in PSE's 2011/2012 GRC. The Commission determined that PSE's proposed recovery of incentive pay was appropriate.¹⁰³

⁹⁷ *Id.* (citing Exhibit No. KJB-1T (ERF) at 15:5–10).

⁹⁸ *Id.* ¶ 98.

⁹⁹ *Id.* (citing Exhibit No. KJB-1T at 24:1–15).

¹⁰⁰ *Id.*

¹⁰¹ ICNU Brief ¶ 100 (citing Exhibit No. MPG-1T at 16:23–17:2).

¹⁰² PSE Brief ¶ 33.

¹⁰³ 2011/2012 PSE GRC Order ¶123.

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Commission Determination

67 Although there is no contested issue for the Commission to resolve in this connection, we nevertheless are concerned that the omitted adjustments were not transparently presented in PSE's ERF filing. It is critically important in the context of experimenting with new forms of ratemaking that the Commission be fully informed and that the information it receives not be filtered on the basis of the Company's opinion that one factor or another is immaterial to the Commission's ongoing monitoring and evaluation of results. It is for this reason that we will require bi-annual CBRs from PSE between now and the time of the Company's next general rate case, and that these must reflect results considering all restating adjustments from the 2011/2012 GRC.

ii. Pension Expense and Incentive Compensation

68 ICNU argues that two restating adjustment that are reflected in PSE's revised CBR, namely pension expense and incentive compensation based on financial results, should be adjusted.⁹⁴ ICNU would have us reduce pension expenses by \$2.6 million for electric and \$1.3 million for natural gas, and reduce incentive compensation by \$6.5 million for electric and \$3.3 million for natural gas.⁹⁵

69 ICNU contends that the Company's pension expense determination is overstated and is not indicative of current contribution levels. According to ICNU, PSE bases its calculations on an average of the actual cash contributions for 2009 through 2012, which comes out to \$17.8 million.⁹⁶ ICNU says this is unreasonably high because of large contribution levels in 2009 and 2010. Absent justification for using the four year average, ICNU recommends that actual 2012 contributions be used, as that is

⁹⁴ ICNU Brief ¶ 96.

⁹⁵ *Id.* ¶¶ 96, 97, 100.

⁹⁶ *Id.* ¶ 97 (citing Exhibit No. KJB-1T (ERF) at 25:3–10).

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Commission Determination

71 The CBR model upon which PSE relies in its ERF, as Staff suggested in the 2011/2012 GRC, contemplates the use of ~~the~~ the necessary adjustments as accepted by the commission in the utility's most recent general rate case or subsequent orders.¹⁰⁴ Absent a showing for some reasoned basis to depart from this approach, it should be followed. This is particularly true in the case of expenses such as these that the Commission has treated consistently over time. We determine that ICNU's recommended adjustments to these expenses should be rejected.

iii. Federal Income Tax Rate

72 ICNU identifies as an issue the fact that PSE ~~is~~ is using a higher effective tax rate in calculating cost of service than it applies to its net operating income, 36 percent opposed to 35 percent, respectively.¹⁰⁵ ICNU's argument boils down to nothing more than a complaint that it was not until Mr. Marcelia's rebuttal testimony that PSE explains this apparent discrepancy.¹⁰⁶

73 Mr. Marcelia's explanation in his testimony is thorough and clear.¹⁰⁷ The statutory rate of 35 percent should be used whenever the income tax impact of a specific item is being evaluated, assuming that the item has a tax impact. There are some items for which there is no tax impact such as ~~permanent items~~ "permanent items" (e.g., amortization of Treasury Grants) and ~~flow through items~~ "flow through items." Flow through items, such as AFUDC¹⁰⁸ are timing differences for which no deferred taxes are provided. Permanent and flow through items essentially have a tax rate of zero, even though the statutory rate is 35 percent.

¹⁰⁴ WAC 480-100-257(2)(a).

¹⁰⁵ ICNU Brief ¶ 101.

¹⁰⁶ *Id.*

¹⁰⁷ Exhibit No. MRM-1T at 11:18-13:17.

¹⁰⁸ Allowance for Funds Used During Construction.

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74 Mr. Marcelia explains that:

The effective tax rate is calculated by taking the tax expense and dividing it by the related pre-tax income. The effective rate should be used to calculate tax expense when pre-tax income is the starting point. If the statutory rate were used, the effect of the permanent and flow through items would be eliminated. That would not be appropriate as the Company is entitled to recover those amounts in the rate making process.¹⁰⁹

He states in conclusion, ~~The~~ effective tax rate is the appropriate rate to use in this filing as that is the rate which captures the impact of permanent and flow through items.”¹¹⁰

75 Insofar as ICNU’s claim concerning lack of support, Mr. Marcelia testifies that ~~the~~ workpapers supporting Exhibit No. ___(KJB-5) in the ERF docket demonstrate this calculation. In addition, these calculations were reiterated in PSE’s Response to Public Counsel Data Request No. 017.”¹¹¹

Commission Determination

76 Mr. Gorman, on behalf of ICNU recommends reducing PSE’s revenue requirements by \$3.45 million for electric and \$1.66 million for gas on the basis that he does not understand PSE’s use of a 36 percent effective tax rate instead of the statutory rate of 35 percent. ICNU argues in support of this recommendation in its brief.¹¹²

77 Mr. Marcelia, however, provides through his rebuttal testimony a clear and credible explanation of why it is appropriate to use an effective tax rate rather than the actual marginal tax rate. We know from long experience that Mr. Marcelia’s explanation is correct from a regulatory accounting perspective. We therefore reject ICNU’s recommendation.

¹⁰⁹ Exhibit No. MRM-1T at 13:4-9.

¹¹⁰ *Id.* at 13:16-17.

¹¹¹ *Id.* at 13:12-14.

¹¹² ICNU Brief ¶ 101.

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3. Conclusion

78 In PSE's 2011/2012 GRC, the Company presented evidence showing that it continues to face the need for unusually high levels of capital investment. This may exacerbate the impacts of regulatory lag beyond a level that is appropriate. In response, Staff outlined an expedited form of general rate relief using a simple and straight-forward process to update the test period relationships between rate base and net operating income.¹¹³ Staff's proposal was that PSE could file an "expedited" rate case using an updated test year immediately following the determination of a fully contested rate case to update to the relationships between rate base, revenues and expenses, closing the gap between the test year and the rate year. The Company could not request a change in the rate of return, except to update debt costs for known changes. To reduce controversy, no other changes could be made from the previous rate case, other than restating adjustments.

79 The Commission, in its Final Order, responded to Staff's proposal at some length:

Commission Discussion: We are not called upon to make any specific determination in connection with Staff's proposal for "an expedited form of general rate relief." We nevertheless find it worthy of comment.

As suggested by the preceding discussion, the Commission recognizes the dynamic nature of the financial and economic tides that affect utilities, including PSE, and its customers. The Commission strives to maintain reasonable and appropriate flexibility in its regulatory process to address this ebb and flow. We appreciate Staff's willingness to bring forward the outline of a proposed process mechanism to help address the particular problems associated with PSE's current position in a cycle of capital investment that places unusually high demands on utilities from time to time as they face the need to maintain and replace significant amounts of aging infrastructure.

Again, however, we have no specific proposal before us. If PSE accepts Staff's invitation to meet with PSE to confirm mutual

¹¹³ *WUTC v. Puget Sound Energy, Inc.* Dockets UE-111048 and UG-111049 (consolidated) Elgin, Exh. No. KLE-1T 81:5-14. *See id.* ¶ 496.

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expectations” for a filing along the lines Staff suggests, or the Company on its own initiative makes such a filing, we certainly will give it fair consideration. Alternatively, Staff and PSE may enter into a broader discussion with other interested participants in the regulatory process and bring forward for consideration specific proposals that may satisfy a range of both common and diverse interests. In this connection, the Commission would be particularly interested in proposals that might break the current pattern of almost continuous rate cases. This pattern of one general rate case filing following quickly after the resolution of another is overtaxing the resources of all participants and is wearying to the ratepayers who are confronted with increase after increase. This situation does not well serve the public interest and we encourage the development of thoughtful solutions.¹¹⁴

Although the Commission would have preferred to see an expedited filing sooner after the conclusion of the 2011/2012 GRC, as Staff proposed, this did not occur. The Commission’s second preference would have been ~~—a~~ broader discussion with other interested participants” with the purpose of ~~—bring[ing]~~ forward for consideration specific proposals that may satisfy a range of both common and diverse interests.” This also did not occur. Yet, PSE and Staff were ultimately able to reach consensus on an approach included in the filing of an ERF on February 4, 2013, to which we give our fair consideration here.

80 As discussed above, the ERF largely adheres to ratemaking mechanisms the Commission identified in its Final Order as possible responses to regulatory lag, attrition and PSE’s recent history of persistent inability to earn its authorized return. In preparing the ERF, PSE used the Commission Basis Report and included only restating adjustments.¹¹⁵ PSE’s use of end of period rate base to establish ERF rates is an appropriate measure considering the Company’s specific circumstances and recent financial results. PSE did not make changes to cost of capital, other than its proposal late in the proceeding to update it for known changes in long-term debt

¹¹⁴ 2011/2012 PSE GRC Order ¶¶ 505-507.

¹¹⁵ At Staff’s request, PSE pro formed in the revenues resulting from the Final Order in the 2011 general rate case. Exhibit No. KJB-1T (ERF) at 8:8-1.1

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costs.¹¹⁶ The Company used the same methodology for rate spread and rate design as it did in its last general rate case. The ERF is a one-time true up for changes to delivery expenses and revenues from the test year in PSE's last general rate case, intended to minimize regulatory lag.¹¹⁷ We determine that the ERF should be approved as-filed, subject to the requirement that debt costs be updated as recommended by PSE's witness, Mr. Doyle.

D. Decoupling

1. Background

- 81 The Commission has a long history with decoupling. The Commission first approved decoupling for PSE's predecessor electric company, Puget Sound Power & Light Company, in 1991.¹¹⁸ This program was referred to as Periodic Rate Adjustment Mechanism or PRAM. The Commission monitored the program closely and, in 1993, determined it was achieving its primary goal of removing disincentives to the Company's acquisition of energy efficiency.¹¹⁹ However, in 1995, at the Company's request, the Commission approved discontinuance of the PRAM.¹²⁰
- 82 In 2005, the Commission conducted a rulemaking inquiry into the subject. After taking stakeholder comments and conducting a workshop, the Commission determined that ~~the~~ wide variety of alternative approaches to decoupling make it

¹¹⁶ Exhibit No. KJB-1T (ERF) at 4:10-13. *See also* Exhibit No. B-2 (PSE's Response to Bench Request No. 2).

¹¹⁷ *See* Exhibit No. TES-1T at 4:5-13.

¹¹⁸ *WUTC v. Puget Sound Power & Light Company*, Docket UE-901183-T and *In the Matter of the Petition of Puget Sound Power & Light Company for an Order Approving a Periodic Rate Adjustment Mechanism and Related Accounting*, Docket UE-901184-P, Third Supp. Order (April 1, 1991).

¹¹⁹ *Petition of Puget Sound Power & Light Company for an Order Regarding the Accounting Treatment of Residential Exchange Credits*, Docket UE-920433, *WUTC v. Puget Sound Power & Light Company*, Docket UE-920499 and *WUTC v. Puget Sound Power & Light Company*, Docket UE-921262 (consolidated), Eleventh Supp. Order at 10 (September 21, 1993).

¹²⁰ *See WUTC v. Puget Sound Power & Light Co., Third Supp. Order Approving Stipulations; Rejecting Tariff Filing; Authorizing Refiling*, Docket UE-950618, at 6 (Sept. 21, 1995).

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more efficient to address these issues in the context of specific utility proposals included in general rate case filings rather than through a generic rulemaking.”¹²¹

- 83 The following year, the Commission considered, and ultimately rejected as inadequate in scope and detail, a decoupling framework advocated by PacifiCorp.¹²² In 2007, the Commission approved a “pilot program” authorizing decoupling on the natural gas side of Avista Utilities’ operations.¹²³ This program, following full evaluation by the Commission, remains in effect.¹²⁴
- 84 The Commission also considered decoupling in Docket UG-060267 in which PSE proposed decoupling for its natural gas utility.¹²⁵ There, after reiterating the purpose of decoupling, the Commission said:

From a utility perspective, it is a means to ensure recovery of a significant part, or even all of its fixed costs regardless of reduced consumption. . . .

¹²¹ Rulemaking to Review Natural Gas Decoupling, Docket UG-050369, Notice of Withdrawal of Rulemaking (October 17, 2005).

¹²² See *WUTC v. PacifiCorp*, Docket UE-050684, Order 04, ¶¶ 108-110 (April 17, 2006), setting out the Commission’s basis for rejecting PacifiCorp’s decoupling proposal.

¹²³ *In re Petition of Avista Corp. for an Order Authorizing Implementation of a Natural Gas Decoupling Mechanism and to Record Accounting Entries Associated with the Mechanism*, Docket UG-060518, Order 04 (February 1, 2007).

¹²⁴ *WUTC v. Avista Corporation, d/b/a Avista Utilities*, Dockets UE-090134 and UG-090135 and *In the Matter of the Petition of Avista Corporation, d/b/a Avista Utilities for an Order Authorizing Implementation of a Natural Gas Decoupling Mechanism and to Record Accounting Entries Associated With the Mechanism* (consolidated), Docket UE-060518, Order 10 (December 22, 2009).

¹²⁵ *UTC v. Puget Sound Energy, Inc.*, Dockets UE-060266 & UG-060267, Order 08, ¶¶ 53-69 (January 5, 2007). The Commission ultimately rejected PSE’s natural gas decoupling proposal but did approve a three-year pilot electric energy efficiency incentive program for the Company (see ¶¶ 145- 158). The following week, however, the Commission conditionally approved a multi-party settlement in another company’s rate case that included a three-year natural gas pilot decoupling project. See *UTC v. Cascade Natural Gas Corp.*, Docket UG-060256, Order 05, ¶¶ 67-85 (January 12, 2007); see also Order 06 in that same docket (August 16, 2007) which approved the Conservation Plan required in the conditional approval of the decoupling pilot and Order 07 (October 1, 2007) which accepted an addendum to the Conservation Plan.

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Conservation advocates and others recognize decoupling as a potentially important tool to promote conservation. . . . We acknowledge that improved energy savings from cost-effective conservation, which we strongly support, is a highly appealing rationale for decoupling on its face. We emphasize, however, that decoupling is merely one regulatory tool in a larger toolbox of devices we might use to promote greater conservation.¹²⁶

85 In our 2010 Decoupling Policy Statement, the Commission expressed its support for full decoupling and provided utilities and other parties with guidance on the elements that a full decoupling proposal should include.¹²⁷ Essential to the policy was recognition that the mechanism should aid the company when revenue per customer decreases and aid the customer when revenue per customer increases. We stated that ~~we~~ believe that a properly constructed full decoupling mechanism that is intended, between general rate cases, to balance out both lost and found margin from any source can be a tool that benefits both the company and its ratepayers.”¹²⁸ By ~~decoupling~~ sales from revenues, a utility should no longer be encouraged to sell more energy, and conserve less, in order to earn more profit. Ending this so-called ~~throughput incentive~~ is the essence of a full decoupling mechanism.¹²⁹

86 PSE initially did not file proposals consistent with this policy. Instead, PSE advocated for a one-way mechanism, one designed to recover revenue losses due to conservation, and requiring true-ups to rates to make the company whole for such losses. In PSE’s 2010 rate case, this mechanism was called a ~~conservation phase-in adjustment~~.¹³⁰ In its 2011/2012 rate case, it was termed a ~~conservation savings~~

¹²⁶ In fact, while rejecting PSE’s gas decoupling proposal, the Commission authorized a three-year pilot direct incentive program for PSE’s electric utility, in which the company was rewarded or penalized for its conservation performance.

¹²⁷ See *In re WUTC Investigation into Energy Conservation Incentives*, Docket U-100522, Report and Policy Statement on Regulatory Mechanisms, including Decoupling, To Encourage Utilities To Meet or Exceed Their Conservation Targets at (Nov. 4, 2010) (Decoupling Policy Statement).

¹²⁸ Decoupling Policy Statement ¶27.

¹²⁹ See Regulatory Assistance Project, *Revenue Regulation and Decoupling: A Guide to Theory and Application*.

¹³⁰ *WUTC v. Puget Sound Energy*, Dockets UE-090704, UG-090705 ¶¶36-50 (April 2, 2010).

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adjustment.”¹³¹ These mechanisms did not account for revenue gains caused by added loads. Accordingly, these were not true “full decoupling mechanisms” as described in the Decoupling Policy Statement. The Commission rejected these proposals because they only worked one way – in favor of the company when revenues per customer decreased, but not in favor of the customer when revenues per customer increased.

87 In 2011/2012 PSE rate case, there were two proposals for full decoupling based on the guidance in the Commissions Decoupling Policy Statement. NWEAC proposed electric decoupling, and the Commission Staff, in response to a bench request, outlined a proposal as well. PSE, however, opposed such full decoupling arguing, in effect, that the throughput incentive was a good policy, as it served to encourage the sale of electricity for other purposes, such as electric vehicles.¹³²

88 The Commission rejected the NWEAC proposal, being unwilling to impose such a mechanism over the utility’s objections:

PSE’s opposition to full decoupling militates strongly against our accepting NWEAC’s recommendation regardless of the merit we might find on a close examination of its details. We determine that the Commission should not require PSE to implement full decoupling on this record.¹³³

The Commission noted, however, that it remained:

open to proposals for a full decoupling mechanism, even to one that may vary somewhat from what is described in our Policy Statement. As the Commission noted in the Policy Statement, the guidance provided “does not imply that the Commission would not consider other mechanisms in the context of a general rate case . . .” Decoupling Policy Statement ¶34. In other words the Policy Statement set forth the principles the Commission believed important to the design of such a

¹³¹ *WUTC v. Puget Sound Energy*, Dockets UE-111048, UG-111049 ¶¶457-82 (May 7, 2012).

¹³² PSE 2012 General Rate Case ¶450, n. 605.

¹³³ 2011/2012 PSE GRC Order ¶ 456.

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mechanism and the issues it expected to be addressed in any decoupling filing. It was not intended to set forth immutable doctrine on this issue or to negatively imply that we would be receptive to nothing else.¹³⁴

89 Following the resolution of the 2011/2012 PSE general rate case, the Company and the NWEAC crafted a joint decoupling proposal NWEAC describes as “build[ing] on and improv[ing] the Coalition’s 2011 proposal.”¹³⁵ PSE and NWEAC filed their petition seeking approval of full decoupling on October 25, 2012. There followed two stakeholder workshops and further discussions, during which it became apparent that the October 25 proposal did not in fact eliminate the throughput incentive.¹³⁶ Accordingly, PSE and NWEAC filed on March 4, 2013, an Amended Decoupling Petition and testimony in support of a modified decoupling proposal. So, at long last, PSE has endorsed a full decoupling mechanism. It is this proposal that we consider here.

90 The proposed decoupling mechanisms are essentially deferred accounting mechanisms. The Company defers the difference between its Allowed Delivery Revenue and the Actual Delivery Revenue received through its tariff rates to cover delivery costs. The resulting accumulated deferred balances are trued-up annually through a surcharge or credit to customers’ bills, subject to certain limitations.¹³⁷

91 Allowed Delivery Revenue is the level of revenue approved by the Commission to cover the costs associated with the Company’s electric and natural gas delivery system that are not otherwise recovered through its fixed charges (*e.g.*, basic charges). Allowed Delivery Revenue is calculated by multiplying Monthly Allowed Delivery Revenue per Customer by the number of customers served in the month. These calculations are performed separately for two groups of customers, Residential and Non-Residential, and separately for electric and natural gas service.¹³⁸

¹³⁴ *Id.* fn 617.

¹³⁵ NWEAC Brief ¶ 1.

¹³⁶ TR. 146:20-24.

¹³⁷ Exhibit No. JAP-1T (Decoupling) at 8:7-12.

¹³⁸ *Id.* at 9:4-8. Residential electric customers receive service under Tariff Schedules 7 and 7A. The non-residential electric customers are served under Schedules 24, 25, 26, 29, 31, 35, 40, 43,

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92 Actual Delivery Revenue is the level of revenue actually received through PSE's volumetric charges to cover the costs associated with its electric and natural gas delivery system, including basic and minimum charge revenue.¹³⁹ For each electric and natural gas rate group, the decoupling deferral amounts in each month are determined by subtracting the Allowed Delivery Revenue for each group from the Actual Delivery Revenue recovered from the same group in the same month. The difference, either positive or negative, is recorded in a deferred debit or deferred credit account. Because the calculation of the deferred balances relies on historical revenue that is recovered over a subsequent period, PSE and NWECA propose the accrual of interest on the cumulative deferred balances, positive or negative, at the Federal Energy Regulatory Commission rate of interest.¹⁴⁰

93 The cumulative deferred decoupling balances accrued by each rate group through the end of each calendar year will be amortized over a 12-month period through a decoupling tariff tracker rate schedule effective May 1 in the following year. The tracker rate adjustment (up or down) will be calculated separately for each rate group to clear that group's deferred balances. Subject to a 3 percent annual "soft cap" on rate increases, the rate adjustment for each electric and natural gas group will be calculated as a single cents per kilowatt-hour or cents per therm charge, respectively.¹⁴¹ Any difference between the amount projected to be cleared and the

46 and 49, and related schedules where customers are eligible to participate in the Bonneville Power Administration's Residential Exchange Program. Lighting customers, served on Schedules 51 through 59, and Retail Wheeling customers are excluded from the decoupling proposal.

Residential natural gas customers receive service under Tariff Schedules 23 and 53. The non-residential customers are served under Schedules 31, 41, 85, 85T, 86, 87 and 87T. Gas water heater rental, gas lighting and special contract customers are excluded from the decoupling proposal.

¹³⁹ Exhibit No. JAP-1T (Decoupling) at 28:11-14; Exhibit No. JAP-8T at 7:1-2.

¹⁴⁰ *Id.* at 29:8-16; Exhibit No. JAP-8T at 7:12-14. The current interest rate is 3.25 percent. Federal Energy Regulatory Commission, *Interest Rates* (available at <http://www.ferc.gov/legal/acct-matts/interest-rates.asp>). The FERC interest rate is also used for PSE's PGA and PCA mechanisms.

¹⁴¹ *Id.* at 29:19-30:5.

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amount actually cleared through the application of the tariff tracker will be added to the amount to be cleared in the subsequent rate period.¹⁴²

2. Issues

94 Staff supports the PSE/NWEC Amended Decoupling Petition. Kroger, Nucor Steel, and ICNU oppose it. To the extent the Commission approves decoupling for PSE, these parties all have recommendations for conditions. NWIGU initially opposed the application of decoupling to non-residential natural gas rate schedules for essentially the same reasons Kroger and Nucor Steel are opposed. NWIGU later joined the Multiparty Settlement, discussed earlier, which the Commission rejects. The Energy Project takes no position on the merits of decoupling but discusses the impact of the proposal, along with the ERF and rate plan, on low income customers and argues for additional funding for PSE's low income assistance programs. Public Counsel does not oppose full decoupling so long as an appropriate adjustment is made to cost of capital. This support, however, is couched in the context of Public Counsel's alternative rate plan that eliminates the fixed annual increases in delivery costs that affect the level of allowed revenue per customer under the PSE/NWEC rate plan proposal. While to this extent Public Counsel's support for decoupling is somewhat equivocal, Public Counsel opines in briefing this matter that:

Full decoupling is a more balanced approach that provides more fairness to customers than the earlier proposal in this docket. With a cost of capital adjustment, it is generally consistent with the Commission's Policy Statement on decoupling.¹⁴³

95 A number of the arguments raised by those opposed to the decoupling mechanisms that PSE and NWEC propose are couched in terms of the failure of one aspect or another of the proposals to meet the "requirements" set out in the Commission's 2010 Decoupling Policy Statement. While we address these arguments individually below, it is appropriate to emphasize that interpretive and policy statements are advisory

¹⁴² *Id.* at 30:6-10. This is very similar to the process already being successfully used in the Company's Purchased Gas Adjustment ("PGA") mechanism and Schedule 120 conservation rate filings.

¹⁴³ Public Counsel Brief ¶ 51.

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only.¹⁴⁴ They are “advisory statements” and “have no legal or regulatory effect.”¹⁴⁵ Such statements generally set forth the Commission’s preferences or clear guidelines in certain policy-related matters after extensive deliberation in a workshop setting. We recognize that the proposed decoupling mechanisms vary in certain respects from the Decoupling Policy Statement but this is not a sufficient legal basis for rejecting the mechanisms. Moreover, as the Commission stated in its Final Order in PSE’s 2011/2012 GRC, the Decoupling Policy Statement did not set forth “immutable doctrine” on the issue of decoupling.¹⁴⁶

a. *Should Decoupling Only Be Proposed in the Context of a General Rate Case?*

96 ICNU argues that “PSE’s decision to request a decoupling mechanism outside of a GRC is contrary to the Policy Statement, which anticipates consideration of proposals from an electric utility only in the context of a general rate case.”¹⁴⁷ Although not entirely clear, ICNU’s argument appears to be that decoupling cannot be considered outside of a general rate case because such a mechanism cannot be fairly evaluated unless all factors affecting the Company’s revenue requirements and rates are open to review.

97 The Commission’s rationale for preferring consideration of decoupling in the context of a general rate case was to facilitate consideration of the impact on return on equity of any reduced risk to the company as a result of the decoupling mechanism under consideration.¹⁴⁸ Here, the parties had available to them the detailed discussion of cost of capital in the recent PSE 2011/2012 GRC, and they presented evidence and argument on the impact on that return in connection with this decoupling proposal. The Amended Decoupling Petition filed on March 4, 2013, presents essentially the same decoupling proposal sponsored by NWECC in PSE’s 2011/2012 GRC, and the

¹⁴⁴ RCW 34.05.230(1) (“Current interpretive and policy statements are advisory only.”).

¹⁴⁵ *Wash. Education Ass’n v. Wash State Public Disclosure Comm’n*, 150 Wn.2d 612, 619 (2003); see also *Pac. Gas & Elec. Co. v. Fed Power Comm’n*, 506 F.2d 33, 38-39 (D.C. Circ. 1974).

¹⁴⁶ 2011/2012 PSE GRC Order ¶456 footnote 617.

¹⁴⁷ ICNU Brief ¶ 110.

¹⁴⁸ Decoupling Policy Statement ¶18, n. 33.

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issue of impact on return on equity was discussed there as well. We deal with the impact on ROE below, in section II.D.2b.

Commission Determination

98 We determine that PSE and NWECC filing their petition outside the context of a general rate case is not a reason to reject it. The record is sufficient and the matter can be given full and fair consideration in the context presented.

b. Cost of Capital

99 Several parties recommend that the Commission should reduce PSE's authorized return on equity, or reduce the relative proportion of equity in PSE's capital structure, if decoupling is approved. Nucor Steel and Kroger argue that the return on equity applicable to electric and gas delivery rate base should be reduced by 25 basis points in the ERF to reflect the reduction in PSE's risk due to decoupling.¹⁴⁹ ICNU also recommends a reduction of 25 basis points to account for decoupling on top of Mr. Gorman's proposal to reduce equity return by 50 basis points to recognize the downward trend in capital costs in financial markets generally. Public Counsel argues for a 50 basis point reduction to PSE's return on equity to account for decoupling. This would be in addition to Mr. Hill's proposed 30 basis point reduction to account for current capital market costs that are generally lower than when the Commission approved PSE's current return on equity of 9.8 percent in May 2012.

100 These arguments are grounded in the concept that implementing decoupling shifts risk from the Company to its ratepayers while reducing volatility in the Company's revenue recovery. The Commission has recognized this idea previously, both in the Decoupling Policy Statement and in recent cases. In PSE's 2011/2012 GRC, for example, the Commission cited this theory as set out in its Decoupling Policy Statement:

¹⁴⁹ Kroger Brief at 10; Nucor Steel Brief at 9.

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By reducing the risk of volatility of revenue based on customer usage, both up and down, such a mechanism can serve to reduce risk to the company, and therefore to investors, which in turn should benefit customers by reducing a company's debt and equity costs. This reduction in costs would flow through to ratepayers in the form of rates that would be lower than they otherwise would be, as the rates would be set to reflect the assumption of more risk by ratepayers.¹⁵⁰

Staff acknowledges this point, and adds that the Policy Statement includes guidance that a full decoupling mechanism should "evaluat[e] the impact of the proposal on risk to investors and its effect on the utility's ROE."¹⁵¹ It is Staff's position in this case, however, that this includes no specifics regarding the timing of such an adjustment.¹⁵² Staff states that it "strongly believes" adjustments to return on equity or capital structure should be made only in a general rate case, where the Commission can look at all the offsetting factors.

101 Staff also recommends that the Commission wait until it has actual, empirical evidence based on PSE's experience with the decoupling mechanisms in operation for a period of time until it files its next general rate. This, Staff says, will allow the Commission to make a reasoned decision, rather than to simply reduce the rate of return in this proceeding based on an inadequate record. Staff quotes Mr. Schooley's testimony on this point at length:

The claim that decoupling reduces risk for regulated utilities has theoretical appeal, but is at best hypothetical and unsupported by empirical evidence. Here we have the opportunity to test that hypothesis. This full decoupling program will compare the financial revenues determined by multiplying the number of customers by the delivery revenues per customer versus the cash collected through volumetric rates intended to generate the same level of dollars. The magnitude of the refunds and surcharges will be direct evidence of the volatility dampened by the decoupling program. Given that this program addresses only delivery costs it cannot be extrapolated to the

¹⁵⁰ PSE 2011 GRC Final Order, ¶ 446.

¹⁵¹ Staff Brief ¶ 37 (citing Decoupling Policy Statement ¶¶ 27 and 28).

¹⁵² *Id.* ¶ 38.

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full impact on the utility's rate of return. However, it will be a good measure of decoupling's impact on the one-half to one-third of the revenues represented by the delivery of gas or electricity. It is important to understand these impacts on real world operations before establishing an "adjustment" to rates of return.¹⁵³

NWEC agrees with Mr. Schooley that there is a lack of evidence in the current record supporting a reduction in PSE's return on equity. Illustrating this point, NWEC quotes the following colloquy from our hearing record:

COMMISSIONER JONES: Okay. Last question and then I'm done. Decoupling ROE impact issue. You have a recommendation at a minimum of 25 basis points. Mr. Gorman, you have the same recommendation in the last case; correct?

THE WITNESS [ICNU Witness Mr. Gorman]: Yes.

COMMISSIONER JONES: 25 basis points. But what — what evidence backs that up? I guess that's what I'm going to drive at. Is that just your gut feeling of doing this for 20 years, and looking at the evidence, both from this case and in other jurisdictions, of full electric decoupling, that that's — because, as you say, you didn't have time to do a full-blown study on this; right?

THE WITNESS [Mr. Gorman]: That's right.¹⁵⁴

Mr. Gorman continued, explaining that the basis for his 25 basis point adjustment is the spread between the yields on single-A and B-double-A utility bonds.¹⁵⁵ Nucor Steel and Kroger's recommendation for a 25 basis point reduction, on the other hand, is based on the fact that this is "consistent with other state commission" that have ordered ROE reductions in a range of 10 to 50 basis points.¹⁵⁶ Mr. Hill bases his 50

¹⁵³ *Id.* ¶ 39 (quoting Exhibit No. TES-4T at 5:6-18).

¹⁵⁴ TR. 206:3-15.

¹⁵⁵ TR. 207:10-24.

¹⁵⁶ Kroger Brief at 10; Nucor Steel Brief at 9.

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basis point reduction proposal on an analysis he performed in a PSE general rate case in 2006, but did not bring forward into the record of this proceeding.¹⁵⁷

102 NWEAC contends that neither Mr. Gorman nor any other witness has provided any evidence or analysis supporting a specific ROE reduction as a result of decoupling. Rather, ICNU and Public Counsel's arguments rely on a small handful of Commission decisions that reduce a company's ROE in conjunction with the adoption of a decoupling mechanism, and on the theoretical prospect that the market may determine that a decoupled utility bears less risk.¹⁵⁸ NWEAC's witness, Mr. Cavanagh, accuses ICNU's and Public Counsel's witnesses of "berry picking" from the national record to identify "a handful of cases at the extreme of the range canvassed in full" in a national study he includes as an exhibit to his testimony.¹⁵⁹ He testifies that:

A recent, nationwide study finding that the vast majority of Commission decisions approving decoupling mechanisms—60 out of 76—include no prospective adjustment to a company's ROE, and 9 include only a 10 basis point reduction (with 4 of those 9 resulting from settlement agreements).¹⁶⁰

Mr. Cavanagh, who is a nationally recognized expert on the subject of decoupling, testifies further that there is simply no empirical evidence in any jurisdiction on the rate impacts of decoupling mechanisms and its specific correlation to the utility's cost of capital.¹⁶¹

Commission Determination

103 It seems apparent that decoupling the recovery of fixed costs from throughput in the manner PSE and NWEAC propose in their Amended Decoupling Petition reduces PSE's risk of fully and timely recovering its fixed costs. In addition, it reduces

¹⁵⁷ See Exhibit No. SGH-1T at 11:12-18.

¹⁵⁸ NWEAC Brief ¶ 16.

¹⁵⁹ See Exhibit No. RCC-4T at 6; see also Exhibit No. RCC-5.

¹⁶⁰ NWEAC Brief ¶ 14 (citing Exhibit No. RCC-4T at 6:7-13; Exhibit No. RCC-5 at 14).

¹⁶¹ See TR. 173:24 to 174:15; see also Exhibit No. RCC-2T at 22:2-17.

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volatility and smoothes the Company's cash flow. The benefits that flow from these factors may improve PSE's bond ratings, thereby reducing its overall cost of capital consistent with the analyses by Mr. Gorman and Mr. Hill that are grounded in differences in bond yields that are tied to ratings. However, there is no empirical evidence in the record demonstrating this effect even though many state commissions have approved natural gas decoupling and, to a lesser extent, electric decoupling.

- 104 In terms of the arguments that implementing decoupling reduces the Company's cost of equity there again is no empirical evidence to show this is so. Indeed, the record does not even fully support the proposition that equity markets recognize and respond to the forms of risk reduction that accompany the implementation of decoupling mechanisms. While this cannot be said to disprove the theory that decoupling reduces risk and, therefore, cost of capital, the more important point from the Commission's perspective is that absent evidence actually demonstrating the theory's effect in practice on either the debt or equity markets there is no evidentiary basis upon which the Commission can order a reduction in the Company's cost of capital.
- 105 Even if PSE's bond ratings improve in response to our approval of decoupling and reduce the Company's cost of debt, this effect will occur only prospectively. Experience going forward with decoupling in place for PSE as various of its debt instruments mature over the next several years will provide valuable information to the Commission. This information may support a reduced cost of capital, or adjustments to PSE's capital structure, at the time of the Company's next general rate case.
- 106 Similarly, at the time of PSE's next general rate case, parties may bring forth evidence showing that equity markets do, in fact, respond to the implementation of decoupling in the case of publicly traded companies. If such companies are sufficiently similar to PSE to be included in a proxy group when determining cost of equity using traditional approaches, then the Commission might have a sustainable basis for adjusting PSE's cost of equity. In terms of the record in this proceeding, however, the only witness who performed cost of equity analyses using these approaches recommends a reduced return on equity for PSE not because of the

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arguable effects of decoupling on his results, but because of changes in capital markets generally since the time of PSE's 2011/2012 GRC.

107 The Commission determines that the record in this proceeding does not support an adjustment to PSE's equity return. This does not necessarily lay the matter to rest. The Commission may yet, on an adequate record in a future proceeding, find that such an adjustment is warranted to compensate for the shift of risks from PSE to its ratepayers that unquestionably is a result of implementing decoupling.¹⁶²

c. Must the Decoupling Proposal Be Based upon Conservation Target Achievement?

108 PSE commits to accelerate its acquisition of energy efficiency resources as part of the Amended Decoupling Petition.¹⁶³ The Company will accelerate its acquisition of cost-effective electric efficiency resources to achieve 105 percent of the targets set by the Commission. Considering current conditions in natural gas markets, a similar commitment is not feasible. Gas prices, at this time, are simply too low to leave much room for implementing additional cost-effective conservation efforts. PSE does, however, agree to participate in the Northwest Energy Efficiency Alliance study on gas conservation. By including a commitment to increase electric energy

¹⁶² Commissioner Jones disagrees with the Commission's prevailing view on this issue and would reduce PSE's authorized ROE. Separate Statement ¶10. While Chairman Danner and Commissioner Goltz do not disagree with certain of the conceptual underpinnings of his proposal, they are not willing to extrapolate a percentage reduction from the evidence presented. They note that the wide range of proposals for a risk reduction adjustment by three witnesses (*i.e.*, 25 basis points to 50 basis points) is not supported by empirical evidence or, indeed, any evidence that meets the substantial competent evidence standard. Moreover, these proposals were counter to testimony by other witnesses arguing that no reduction in authorized ROE is warranted.

Commissioner Jones recommends a 30 basis point reduction, but he offers no explanation for selecting this level between what Mr. Hill and Mr. Gorman propose in terms of risk adjustment to ROE (*i.e.*, 50 basis points and 25 basis points, respectively), or the reasons for rejecting the testimony arguing against an ROE reduction. His colleagues respond that there always is some element of subjectivity in determining an appropriate ROE, but the opinion testimony on which Commissioner Jones relies is too subjective for use as a rationale for an ROE reduction. In their opinion, it is more appropriate to consider the impact on ROE of this decoupling mechanism in the context of a fully developed record, with more objective facts and data, in PSE's next general rate case.

¹⁶³ See Amended Petition for Decoupling at 17.

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efficiency, and to study ways to improve gas energy efficiency, the joint proposal ensures that not only will the decoupling mechanism remove barriers to increased acquisition of energy efficiency, it will in fact lead to concrete increases in efficiency as well.¹⁶⁴

109 ICNU argues that PSE's commitments fall short of what the Decoupling Policy Statement requires.¹⁶⁵ ICNU focuses on the Policy Statement's suggestion that revenue recovery by the company under the mechanism will be conditioned upon a utility's level of achievement with respect to its conservation target.¹⁶⁶ ICNU quotes additionally from the Commission's decoupling discussion in its Final Order in PSE's 2011/2012 GRC. There the Commission said that implementation of decoupling to remove any financial disincentive to conservation in a fair and balanced manner was the motivation behind our Policy Statement.¹⁶⁷ ICNU, considering these remarks by the Commission, asserts that because PSE's Decoupling proposal does not condition recovery upon conservation achievement should be sufficient basis, standing alone, to justify its rejection.¹⁶⁸

110 ICNU continues at some length in its brief on this subject.¹⁶⁹ Its arguments, however, focus on broader issues related to PSE's statutory obligation to achieve all cost effective conservation and alleged deficiencies in the rate plan, rather than the decoupling mechanism. In other words, these arguments are beside the point here.

Commission Determination

111 As stated earlier, the Commission's Decoupling Policy Statement does not impose requirements. This provides a sufficient basis, standing alone, to justify our rejection of ICNU's arguments.

¹⁶⁴ NWECA Brief ¶ 26.

¹⁶⁵ See ICNU Brief ¶ 112.

¹⁶⁶ *Id.* (citing Decoupling Policy Statement ¶ 28).

¹⁶⁷ 2011/2012 PSE GRC Order ¶ 455.

¹⁶⁸ ICNU Brief ¶ 112.

¹⁶⁹ See *Id.* ¶¶ 113-116.

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112 In any event, PSE and NWEAC do, in fact, respond to the Commission's guidance on the question of conservation target achievement with the commitments outlined above. That ICNU finds these commitments unsatisfactory is no reason to reject the Amended Decoupling Petition. Insofar as the Commission's statement in its 2011/2012 PSE GRC Order concerning its underlying purpose of the Decoupling Policy Statement, there is no doubt that decoupling on a revenue per customer basis removes entirely the so-called throughput incentive. With these decoupling mechanisms in place, PSE will be truly indifferent to volumetric sales on which its recovery of fixed costs will no longer depend. Rather, with the disincentive to conservation removed, PSE and NWEAC anticipate greater efforts by the Company to increase energy efficiency in its operations.

d. Found Margin

113 Referring to the Commission's Decoupling Policy Statement observation that a full decoupling mechanism should balance out both lost and found margin from any source, Nucor Steel and Kroger complain that the proposed decoupling mechanisms do not fully recognize found margin as an offset to the lost margin that is charged to customers.¹⁷⁰ They argue that the decoupling mechanisms recognize found margin only to the extent that it may affect allowed revenue per customer and do not recognize found margin associated with growth in the number of customers. According to these parties, the full benefit of incremental fixed cost recovery associated with new customers accrues solely to PSE. They recommend that the mechanisms should be modified to incorporate any found margin associated with growth in customer count as a credit against the decoupling balancing account.

114 ICNU makes a similar point in the context of its argument that per-customer decoupling should not be authorized. ICNU says that new customers entering an actual rate class will never be accounted for as found margin because the revenue requirement would grow with each new customer contributing to under performance by the class.

¹⁷⁰ Nucor Steel Brief at 7-8; Kroger Brief at 14-15.

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115 PSE says that ICNU, Nucor Steel, and Kroger are not correct in asserting that growth in customers constitutes found margin because they fail to acknowledge that PSE incurs substantial costs to serve new customers and that the additional revenue from new customers has repeatedly fallen short of overcoming the Commission-determined revenue deficiencies for PSE over the past decade.¹⁷¹ Moreover, PSE argues, ~~the~~ Joint Decoupling Proposal offers ample protections to ensure that PSE does not unjustly benefit due to revenues from new customers.”¹⁷² Although PSE does not say so in its brief, we take this as a reference to the earnings cap, discussed elsewhere in this Order.

Commission Determination

116 Our record on the question of found margin is sparse and based on speculation concerning what the future may hold. We recognize that there is some potential for PSE to capture found margin from new customers that will more than offset the cost of serving those customers. However, it seems equally plausible that PSE’s cost per customer will continue to increase and outstrip increased revenue from new customers. Mr. Higgins’s analyses supporting the first result depend on assumptions regarding customer growth and unvarying usage per customer that are unsupported by any actual data. Mr. Piliaris’s analyses and conclusions supporting the second result are based on historic trends that may or may not continue into the future. Given the uncertain future, the Commission will wish to monitor carefully the actual results of customer growth in terms of earnings over the next several years and rely on the protection of the earnings test, as modified by this Order, that will keep any excess earnings that may be attributable in part to customer growth from becoming a windfall for PSE. For the present, we determine that the potential that there will be found margin due to customer growth is too uncertain to establish a basis for rejecting or conditioning the decoupling mechanisms.

¹⁷¹ PSE Brief ¶ 43 (citing Exhibit No. JAP-24T at 5:11-16).

¹⁷² *Id.*

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e. Non-Residential Customer Class

- 117 Kroger and Nucor Steel point out that PSE and NWEC recognize in their Amended Decoupling Petition that it is not appropriate to include every tariff schedule in the non-residential customer class. On the electric side, for example, lighting and retail wheeling customers are excluded from the decoupling mechanism. On the gas side, PSE and NWEC propose to exclude gas lighting, gas water heater rentals, and special contracts. Nucor Steel argues gas transportation customers, like electric wheeling customers, should also be excluded.
- 118 The exclusion of electric wheeling customers, however, is based on the fact that Schedule 449 Direct Access customers pay for the majority of their contribution to PSE's costs through PSE's "Open Access Transmission Tariff (OATT).¹⁷³ Many retail wheeling customers take service only at transmission voltage, meaning the Company incurs virtually no distribution costs to serve them.
- 119 There is not a parallel situation on the natural gas side of PSE's operations. Mr. Piliaris testifies for PSE that the Company has the same throughput incentive with gas transportation customers as it does with its gas sales customers.¹⁷⁴ This is because the rates charged to transportation customers for gas delivery mirrors the rates charged to similar sales customers and recovers fixed delivery costs through variable charges. Therefore, PSE has the same motivation for increased energy consumption by transportation customers as it does for sales customers.
- 120 In addition, non-residential gas customers have a significant amount of flexibility to move between sales and transportation rate schedules. Excluding gas transportation customers from decoupling would introduce the potential for customers to migrate between sale and transportation schedules simply to avoid decoupling surcharges or

¹⁷³ Exhibit No. MCD-1T at 42:18-20.

¹⁷⁴ Exhibit No. JAP-24T at 14:19-15:5.

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to benefit from decoupling rate rebates. Other customers in the affected schedules would be negatively impacted.¹⁷⁵

- 121 Kroger and Nucor Steel would additionally exclude large commercial and industrial sales customers from decoupling. They argue that maintaining a “fixed-cost recovery per customer” target is not an appropriate rate design objective for customer classes that have heterogeneous populations with a wide range of usage levels. Kroger and Nucor Steel prefer changes to rate design, rather than decoupling, as the better approach to protect PSE’s ability to recover its fixed costs from large non-residential customers. Kroger argues that if as much of the Company’s fixed costs as practicable are recovered from customer and demand charges for demand-billed customers, this addresses the problem of under recovery because revenue from demand charges is not as sensitive to changes in average customer usage as revenue from kilowatt-hour charges. Kroger, however, does not take this suggestion beyond stating the principle. There is no detailed proposal supported by appropriate evidence upon which the Commission could order changes to PSE’s tariffs as a substitute for decoupling.
- 122 The second reason Kroger advocates exclusion of larger non-residential electric customers (*i.e.*, those with greater than 350 kW demand) from PSE’s decoupling mechanism is Kroger’s claim that the methodology PSE proposes for calculating the amount of the rider for non-residential customers overstates PSE’s actual revenue loss on a per customer basis. The metric that PSE proposes to use to measure “actual” revenues-per-customer for non-residential customers is imputed based solely on changes in kilowatt-hour sales, even though a substantial portion of the revenues collected for delivery service from demand-billed customers is in the form of demand charges. To the extent that revenue sensitivity of PSE’s demand revenues is less than that of kilowatt-hour revenues, this imputation will overstate the changes in revenue-per-customer attributable to changes in use-per-customer for demand-billed customers. Kroger says the likelihood of this overstatement is increased because PSE’s tariff contains demand ratchets for some Tariff schedules, which further dampens the volatility of revenues collected from the demand charge.

¹⁷⁵ *Id.* at 16:12-19.

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- 123 Kroger discusses that demand and energy charges track completely different types of costs. Energy charges bill a customer for its total kWh usage in a month and demand charges bill a customer for its peak kW usage in a month or, in the case of PSE's demand ratchet rates, peak usage over a 12-month period. Kroger says there is no reason to assume, as PSE does, that a reduction in kWh sales will be proportionate to a reduction in kW billed. Demand revenue is more stable than energy revenue because it is generally easier and more common for a customer to reduce the total kWh it uses in a month than it is for a customer to reduce its peak demand, especially when a demand ratchet provision is in place.
- 124 PSE does not agree that demand charge revenue is fixed. Mr. Piliaris testifies that even if PSE were to agree in concept that a portion of demand charge revenue is fixed, Kroger presents no analysis to determine what portion of demand should be considered fixed. Even if that portion could be determined, there is no analysis showing how Kroger's proposal would be implemented within the decoupling mechanism, or what would be the effect. Mr. Piliaris says that, given the speculative and preliminary nature of Kroger's proposal, it should be rejected ~~at~~ this time."¹⁷⁶
- 125 In a similar vein to Kroger, Nucor Steel argues the gas decoupling mechanism should be modified to remove all contract firm revenues. 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, and pay, for a fixed amount of firm service. Nucor Steel argues that this treatment overstates the imputed revenue impact of a change in average throughput per customer.
- 126 NWIGU originally supported Nucor Steel's positions on these issues via its own witnesses' testimony. However, just before the evidentiary hearing, NWIGU elected to join in the Multiparty Settlement in exchange for concessions from PSE and

¹⁷⁶ *Id.* at 19:4.

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NWEC that would have, if approved, excluded industrial customers on Schedules 85, 85T, 87 and 87T from decoupling. As a consequence of our determination in a separate order entered today that the Multiparty Settlement should be rejected as a matter of law PSE and NWEC are under no obligation to follow through on this commitment.

Commission Determination

- 127 There undoubtedly is significant heterogeneity in the non-residential customer class. Members of this customer class have different—in some instances vastly different—levels of demand. Some non-residential customers have the capability to react nimbly to changed economic conditions, ratcheting their demand for power or gas up or down as general market conditions improve or deteriorate. Others have less flexibility. Some customers are more weather sensitive than others. Many non-residential customers undertake their own conservation efforts and are not even eligible to participate in Company conservation programs and initiatives. These factors raise questions about the suitability of decoupling that relies exclusively on average revenue per customer.
- 128 Against these factors we consider what alternatives the record supports. Including these customers in the decoupling mechanisms should better enable PSE to recover its fixed costs, but we have one example in the record of a utility for whom this theory did not prove out in practice.¹⁷⁷ Generally, the Commission is receptive to changes in rate design that might better enable PSE to recover its fixed costs from non-residential customers by including in demand and customer rates more of the fixed costs of providing them service. These sorts of changes, however, should be supported by a detailed cost of service study and such other evidence as may be needed to protect both the company and its customers. We have no such evidence in the current record.
- 129 The Commission determines that we should not at this time exclude from the decoupling mechanisms non-residential customers other than electric lighting and retail wheeling customers, and gas lighting, gas water heater rentals and special contracts. However, we strongly encourage customers such as Kroger and Nucor

¹⁷⁷ See Exhibit KCH-1T at 25:7-26:25.

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Steel, and trade organizations such as ICNU and NWIGU, to engage in meaningful dialogue with PSE, Staff and others who take an interest, and with the Commission, to monitor carefully how decoupling is working out in practice. It may be that there are alternatives for some, or all, non-residential customers that are better suited to meeting decoupling's goals than are the current decoupling mechanisms. The Commission remains open to hearing fully supported alternative proposals for fixed cost recovery from the non-residential class of customers, or subsets of the class.

4. Conclusion

130 The Commission's issuance of its Decoupling Policy Statement in November 2010 was a milestone in what NWECA's witness, Mr. Cavanagh, described during our evidentiary hearing in PSE's 2011/2012 GRC as —a 30-year conversation with this Commission” on the subject.¹⁷⁸ The utilities we regulate, including PSE, have participated in this robust conversation. The utilities have consistently argued that without some measure to recover lost margin due to conservation, they face a financial —disincentive” to conservation, which they nevertheless are required by statute to implement to the extent it is cost-effective to do so. The Commission, in the Decoupling Policy Statement, affirmatively invited the utilities it regulates to file decoupling proposals as part of a general rate case.¹⁷⁹ In light of this, the Commission was surprised that PSE did not include a full decoupling proposal in its 2011/2012 GRC filing.

131 In a Bench Request in that proceeding, the Commission invited the parties to address decoupling:

In the interest of having a more complete record concerning the issues raised by [the Company's] proposal, the Commission requests that Staff examine full decoupling, as discussed in the Decoupling Policy Statement, as an option for [the Company]. In response to this Bench Request, Staff should provide the Commission with a discussion of the critical elements that a full decoupling proposal should contain,

¹⁷⁸ 2012 PSE GRC Order ¶ 438 (citing TR. 428:11-12).

¹⁷⁹ Decoupling Policy Statement ¶28 (internal cites omitted).

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consistent with the Decoupling Policy Statement, including consideration of lost sales revenues that are potentially offset by avoided costs and other benefits. It should also indicate whether, based on the information it supplies the Commission, it believes that the Commission could make a final decision on a decoupling proposal by the end of this rate proceeding or whether more process may be necessary or desirable.

Although the Commission directed these bench requests to Staff, it invited PSE and all other parties to respond, if they wished.

132 NWEC, in response filed testimony supporting implementation of a full decoupling mechanism for PSE. Ultimately, in the face of strong opposition from PSE, the Commission determined that it should not impose the mechanism NWEC proposed.

133 In this proceeding, when questioned by the Bench concerning the difference between the decoupling mechanism in this case and the decoupling mechanism that NWEC proposed in the last general rate case, Mr. Cavanagh testifies:

I would describe them as structurally very similar. The important differences are that the revised proposal is more comprehensive. It encompasses both electricity and natural gas. It encompasses more customer classes, which we took to be responsive to the Commission's guidance. It includes low-income bill support and weatherization assistance, and which Mr. Eberdt can speak to, but which for the coalition is an important additional element and a strengthening. And finally, it includes a commitment by the Company to enhanced energy efficiency performance, both in terms of the electric target actually being raised, and on the natural gas side, participation in a market transformation initiative from the Northwest Energy Efficiency Alliance. I think those are the most important differences.¹⁸⁰

134 The Commission found in its 2012 PSE GRC Order that “NWEC’s proposal responds to and incorporates many elements discussed in the Commission’s Decoupling Policy Statement.”¹⁸¹ The Commission also said the NWEC proposal largely follows the

¹⁸⁰ TR. 146:7-25.

¹⁸¹ 2012 PSE GRC Order ¶ 450.

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guidance of the Decoupling Policy Statement. In rejecting the NWEK proposal in 2012, the Commission noted that it:

remains open to proposals for a full decoupling mechanism, even to one that may vary somewhat from what is described in our Policy Statement. As the Commission noted in the Policy Statement, the guidance provided —~~do~~ not imply that the Commission would not consider other mechanisms in the context of a general rate case . . .” In other words the Policy Statement set forth the principles the Commission believed important to the design of such a mechanism and the issues it expected to be addressed in any decoupling filing. It was not intended to set forth immutable doctrine on this issue or to negatively imply that we would be receptive to nothing else.¹⁸²

135 The Amended Decoupling Petition presents a decoupling mechanism that follows the Commission’s guidance in the Decoupling Policy Statement in significant regards. As Mr. Cavanagh testifies, the joint proposal by NWEK and PSE:

is entirely consistent with, and in some ways an improvement upon, the revenue decoupling mechanism proposed in my original testimony in PSE’s 2011 general rate case Docket No. UE-111048/UG-111049.¹⁸³

He continues:

PSE and the Coalition worked intensively together to craft a decoupling proposal that is consistent with the Coalition’s proposal in PSE’s 2011 general rate case and the Commission’s Decoupling Policy Statement, and that better addresses PSE’s concerns regarding the effects of conservation and decoupling on PSE’s ability to recover its costs of service.¹⁸⁴

136 In our view, these efforts succeeded. We determine for all the foregoing reasons that the Commission should approve the NWEK/PSE Amended Decoupling Petition and

¹⁸² *Id.* ¶ 456, footnote 617.

¹⁸³ Exhibit No. RCC-1T at 2:10-13.

¹⁸⁴ *Id.* at 3:12-17.

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allow the proposed electric and natural gas decoupling mechanisms to become effective as filed.

E. The Rate Plan

137 The rate plan, presented as part of the Amended Decoupling Petition, is a series of predetermined annual rate increases implemented through fixed escalation factors: 3.0 percent applied to electric delivery costs and 2.2 percent applied to natural gas delivery costs.¹⁸⁵ It is designed ~~to~~ afford the Company the ability to avoid the need to file a general rate case over the next two to three years.”¹⁸⁶ 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

¹⁸⁵ In its ~~“Guide”~~ on decoupling, the Regulatory Assistance Project recognizes that a full decoupling mechanism could add an adjustment to ~~“increase or decrease overall growth in revenues between rate cases”~~ or to adjust the revenue per customer number. Regulatory Assistance Project, *Revenue Regulation and Decoupling: A Guide to Theory and Application* §5.4, at 19-20 (2011) (~~“RR Guide”~~). The RAP Guide refers to such an adjustment as a ~~“k-factor.”~~ We view the PSE and NWECC proposal as being broader than a simple adjunct to their decoupling proposal and we treat it accordingly. Thus, we refer in this Order to ~~“escalation factors”~~ rather than ~~“factors”~~ recognizing the broader purpose of their application in the context of the rate plan.

¹⁸⁶ Exhibit No. JAP-8T (Decoupling) at 3:15-17. As PSE notes in its Brief:

Both the electric and natural gas K-factor values represent a weighted average escalation factor based on the percentage of non-production related revenue requirements for the following: 1) non-production rate base, 2) depreciation expense and 3) all other operating expenses, which include O&M, Customer Service and Administrative and General expenses. The ~~“all other operating expenses,”~~ which comprises 50 percent of the electric ERF revenue requirement and 44 percent of the natural gas ERF revenue requirement, is based on the CPI less productivity factor. The rate base and depreciation expense components of escalation factors are based upon the historical compound growth rate in these costs as shown in the approved general rate case compliance filings from 2006 through 2011. See Barnard, Exh. No. KJB-1T (Decoupling) 6:8-15; Exh. No. KJB-4T (Decoupling) at 1. Ms. Barnard testified that historical trends are a fair representation of PSE’s anticipated investment through the general rate case stay-out period. See Barnard, Exh. No. KJB-1T (Decoupling) 8:19-9:14; Exh. No. KJB-5 (Decoupling).

PSE Brief ¶ 50, footnote 66.

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case before April 1, 2015, but would file it no later than April 1, 2016, unless otherwise agreed to by the parties in the Company's last general rate case.

138 The decoupling proposal is tied mechanistically to the proposed rate plan in that the fixed escalation factors in the rate plan would be applied to each year's allowed revenue per customer. Indeed, as Kroger, Nucor Steel and Public Counsel all make clear, 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 rate plan and the proposed decoupling mechanism ~~are~~ conceptually distinct, independent features that should be evaluated on their own merit."¹⁸⁷

139 While we agree with this proposition, we are mindful too of PSE's observation that the rate plan escalation factors are a key component to the Company's overall proposal that PSE views as an essential part of its effort to ~~break~~ the current pattern of almost continuous rate cases," a key policy goal the Commission identified in the Company's 2011/2012 GRC.¹⁸⁸ Thus, we must take care when analyzing the rate plan on its own merits and not lose sight of the context in which we consider the parties' arguments.

1. Issues

a. Are the Escalation Factors in the Rate Plan Adequately Supported?

140 The rate plan's opponents advance two principal lines of argument. Public Counsel argues that the escalation factors in the rate plan are a form of attrition adjustment that is inadequately supported because PSE did not provide an attrition study.¹⁸⁹ ICNU appears to argue along similar lines, but conflates in a somewhat confusing manner the rate plan and decoupling mechanisms when addressing the annual escalation

¹⁸⁷ Kroger Brief at 2; Nucor Steel Brief at 5-6. Public Counsel supports decoupling but opposes the rate plan and offers an alternative rate plan that does not involve fixed escalation factors. *See* Public Counsel Brief ¶¶ 69-73.

¹⁸⁸ PSE Brief ¶ 47 (citing 2011/2012 PSE GRC Order ¶ 507).

¹⁸⁹ *See* Public Counsel Brief ¶¶ 22-23.

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feature of the rate plan and asserts that ~~—~~attrition is a much better term to describe the purpose and mechanics of the decoupling proposal.”¹⁹⁰ We accordingly focus our discussion below on Public Counsel’s arguments.

141 The second line of argument is more direct. Public Counsel and Kroger contend that PSE’s determination of the escalation factors is flawed because it is based on a ~~—~~“lewed” data set and fails to account adequately for potential future income tax related offsets to rate base.

i. Are the Escalation Factors a Form of Attrition Adjustment Lacking the Required Support?

142 Attrition is a term, as noted in the Commission’s Final Order in PSE’s 2011/2012 GRC, that is ~~—~~often loosely applied to any situation in which a rate-regulated business fails to achieve its allowed earnings.”¹⁹¹ The Commission noted, in addition, that Staff used the term in the context of the general rate case to capture the problem of ~~—~~the erosion of a company’s rate of return over time when the historical test period relationship in revenues, expenses and rate base accepted by the Commission in a rate case does not hold during a future rate year.”¹⁹²

143 Looking back to the Commission’s discussion of attrition in the context of PSE’s general rate case, Public Counsel argues that the Company’s case in an entirely different context here ~~—~~falls far short of providing the empirical evidentiary support required to establish attrition.”¹⁹³ This is simply not true. Contrary to what Public Counsel says, the Commission did not reject ~~—~~PSEs inadequately supported claims of earnings erosion.”¹⁹⁴ In the paragraph from the PSE 2011/2012 GRC Order that Public Counsel cites for this assertion, the Commission, in fact, said:

¹⁹⁰ ICNU Brief ¶ 104.

¹⁹¹ 2011/2012 PSE GRC Order ¶ 484, footnote 658.

¹⁹² *Id.* footnote 659.

¹⁹³ Public Counsel Brief ¶ 23.

¹⁹⁴ *Id.*

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As PSE makes abundantly clear, it has not put before us in this general rate case a request for an attrition adjustment. Thus, we face no need to make a determination whether one is needed to address the Company's more general claim of under-earning relative to its authorized return.¹⁹⁵

Public Counsel's argument continues in this vein,¹⁹⁶ discussing Staff's contentions in the 2011/2012 GRC that the Commission, as quoted above, expressly disavowed the need to resolve. Public Counsel closes this argument with the assertion that:

The [general rate case Final] Order, issued in May 2012 only ten months before the filing of the K-Factor, was clear that while the Commission was open to considering an attrition allowance in a future case, an attrition allowance request would need to be based on an attrition study.¹⁹⁷

This, again, misrepresents what the Commission said in its 2011/2012 GRC Order. In fact, what the Commission concluded at the end of its discussion of attrition is that:

Unfortunately, the literature provides little in the way of detailed guidance about how these remedies should be calculated or implemented. Nor do we find readily available any comprehensive analyses of the effectiveness and fairness of these individual measures when applied in real-world circumstances. Considering this, we are reluctant to be at all prescriptive in terms of establishing parameters defining how, or stating criteria by which, such remedies might be fashioned and judged. We emphasize that the Commission remains open to, and will consider fairly, specific proposals supported by adequate evidence showing them to be an appropriate response to PSE's economic and financial circumstances including, if demonstrated, under earnings due to attrition.¹⁹⁸

144 Public Counsel next turns to discussion of the Commission's recent order in an Avista Utilities' (Avista) general rate case. As Public Counsel observes, Avista –expressly

¹⁹⁵ 2011/2012 PSE GRC Order ¶ 489.

¹⁹⁶ See Public Counsel Brief ¶ 23.

¹⁹⁷ *Id.*

¹⁹⁸ 2011/2012 PSE GRC Order ¶ 491.

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requested an attrition adjustment, the first such request for many years in Washington.”¹⁹⁹ Public Counsel, drawing on Mr. Dittmer’s testimony, says that Avista’s request was supported by —a detailed attrition study” and a —cross-check analysis” based on —projections for plant additions, depreciation expense, and Accumulated Deferred Income Taxes through the first rate effective period.”²⁰⁰ Staff also presented an attrition study, albeit with different results. The case ultimately was resolved by the Commission’s order conditionally accepting a —black box” settlement.²⁰¹

145 Public Counsel acknowledges the Commission’s statements in the Avista order that:

In the context of the Settlement . . . we have not had the opportunity either to articulate the appropriate standards by which to assess a proposed attrition adjustment [or] evaluate thoroughly the evidence in support of such an adjustment.

* * *

[W]e intend to clarify the conditions wherein attrition can be considered when setting rates. As noted above, the Settlement has limited our opportunity to do so here. Accordingly, we will in the near future initiate an inquiry into the appropriate use of

¹⁹⁹ Public Counsel Brief ¶ 24

²⁰⁰ *Id.* (citing Exhibit No. JRD-IT at 26:4-11).

²⁰¹ *WUTC v. Avista*, Dockets UE-120436 & UG-120437, Order 09, consolidated with *WUTC v. Avista*, Dockets UE-110876 & UG-110877, Order 14 (December 26, 2012) (“*Avista* 2012 GRC Order”). In its Order, the Commission explains that:

This means that the settling parties agree on some important components in the rate case, such as revenue requirements, cost of capital, capital structure, and rate spread and rate design, but the Settlement does not articulate the —give and take” process that produced these results. Put another way, the settling parties agree to firm end-result numbers without indicating which parties’ adjustments or issues have been included in the final numbers.

Id. ¶ 28. As to attrition, —the settling parties have explicitly not agreed to a specific attrition allowance.” *Id.* ¶ 33.

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attrition analysis in setting rate, including the appropriate methodology to use in preparing attrition studies.²⁰²

146 Despite acknowledging these statements, Public Counsel, in apparent criticism of the annual escalation factors provided in the rate plan that are the operative factors in what he calls “attrition decoupling,”²⁰³ says that “[i]n contrast to the Avista 2012 GRC, neither PSE, nor Commission Staff, purport to have conducted or presented an attrition study in this docket.”²⁰⁴

Commission Determination

147 The Commission’s recent discussions of attrition adjustments in its Avista 2012 GRC Order make several points abundantly clear. First, while the parties’ respective attrition analyses are not described in detail, it is apparent that Avista and Staff took different approaches and reached different results. Although the Commission refused “to endorse either of the different attrition methodologies,” it nevertheless determined that “[t]he record evidence supports a finding of attrition in the near term.”²⁰⁵ Public Counsel points us to the related point that the Commission has yet to “articulate the appropriate standards by which to assess a proposed attrition adjustment.”²⁰⁶

148 Despite the Commission’s expressed inability to “evaluate thoroughly the evidence in support of such an adjustment” it approved revenue increases for Avista because it “agree[d] with the Company and Staff that the proposed 2013 rate increase is based significantly on attrition.”²⁰⁷ The Commission found too that “[r]uch of the attrition is based on continued capital investment by Avista.”²⁰⁸

²⁰² Avista 2012 GRC Order ¶¶ 70 and 77. See Public Counsel Brief ¶ 25.

²⁰³ Public Counsel Brief ¶ 22.

²⁰⁴ Public Counsel Brief ¶ 26 (citing Exhibit No. JRD-1T at 27:18-21).

²⁰⁵ Avista 2012 GRC Order ¶ 12.

²⁰⁶ Avista 2012 GRC Order ¶ 70

²⁰⁷ *Id.*

²⁰⁸ *Id.* ¶ 71.

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- 149 As in the Avista case, we determine that the trending analysis on which PSE bases the rate plan escalation factors supports their approval as an appropriate measure to address earnings attrition going forward. That is, PSE's analysis of actual historical trends in the growth rates of revenues, expenses, and rate base to estimate the erosion in rate of return caused by disparate growth in these categories that PSE will experience absent application of these escalation factors supports the adjustments.
- 150 Finally, again as in Avista,²⁰⁹ there are other factors that support the "end result" in terms of rates that will be established, in part, based on the rate plan escalation factors.²¹⁰ The rate plan provides a degree of relative rate stability, or at least predictability, for customers for several years. The rate plan is an innovative approach that will provide incentives to PSE to cut costs in order to earn its authorized rate of return. Moreover, the lack of annual rate filings will provide the Company, Staff, and other participants in PSE's general rate proceedings with a respite from the burdens and costs of the current pattern of almost continuous rate cases with one general rate case filing following quickly after the resolution of another.²¹¹

ii. Is PSE's determination of the escalation factors flawed?

- 151 Kroger and Public Counsel question PSE's determination of the rate plan escalation factors because, as Public Counsel puts it:

PSE has not provided credible evidence that the growth in rate base suggested by the historic analysis can be supported by projections of growth in Plant in Service, Accumulated Depreciation *and* Accumulated Deferred Income Taxes. This means that the rate base

²⁰⁹ *Id.* ¶ 76.

²¹⁰ Ultimately, it is the "end result," not the means of getting to it, that is the test of whether proposed rates are fair, just, reasonable, and sufficient. *See People's Org. for Washington Energy Resources v. WUTC*, 104 Wn.2d 798, 811, 711 P.2d 319 (1985), *citing Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S.Ct. 281, 88 L.Ed. 333 (1944).

²¹¹ *See* PSE 2012 GRC Order ¶507.

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used in calculating the K-Factor is overstated and does not provide a basis for establishing fair, just, and reasonable rates.²¹²

152 Mr. Dittmer testified for Public Counsel that growth in Accumulated Deferred Income Taxes (ADIT), and hence the potential growth in offset to rate base, could be significant given the impact of utilizing the Net Operating Loss (NOL) Carryforward-related ADIT.²¹³ This supposition, however, depends on an assumption that a significantly higher utilization of NOL Carryforward amounts can be expected in calendar years 2014 and 2015 relative to 2013. Public Counsel concludes on this basis that it: ~~therefore~~ appears probable that [PSE witness] Ms. Barnard understates the impact of utilization of the NOL Carryforward in projecting rate base growth in Exhibit No. KJB-17.”²¹⁴

153 Discussing this exhibit, however, Ms. Barnard refers to Mr. Marcelia’s testimony that it is nearly impossible to forecast when the benefits associated with the NOL may reverse. Even so, ~~for~~ illustrative purposes,” she excluded the NOL in her exhibit, which demonstrates that even if the entire benefit associated with the NOL was to be utilized in 2013, the increase in forecasted rate base would still exceed the level supported through customer growth and, therefore, using the historical trend in the growth of rate base is appropriate.

154 PSE criticizes Public Counsel’s analysis because it relies on speculation about probable ~~significant growth~~” in accumulated deferred income tax relating to possible utilization of prior period NOL.²¹⁵ PSE argues that there is no assurance that the NOL will turn around over the course of the rate plan, as Public Counsel assumes. If bonus depreciation continues at the 50 percent rate or higher, as has been the case for the past five years, then the NOL is not projected to turnaround. ~~Moreover,~~” PSE says:

²¹² Public Counsel Brief *Id.* ¶ 36.

²¹³ *Id.* ¶ 35. Public Counsel notes that: —NOL (Net Operating Loss) Carryforward-related ADIT results in an addition to rate base. On the other hand, the utilization or *reversal* of NOL Carryforward-related ADIT *reduces* rate base valuation.”

²¹⁴ Public Counsel Brief ¶ 35.

²¹⁵ PSE Brief ¶ 57.

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Public Counsel commits a simple but significant error by assuming that the entire NOL relates to property that is the subject of this filing. It does not. It includes production property as well as non-production property. The speculative NOL reversals are predicated on Company-wide estimates of taxable income—which includes much beyond the scope of this filing.²¹⁶

155 Kroger makes a somewhat different point arguing that PSE's measurement of the growth in rate base does not take into account that rate base in 2011 was skewed upward because the Company could not fully reflect ADIT that would have otherwise applied as an offset to rate base in that year.²¹⁷ ADIT, Kroger explains, was truncated in 2011 because PSE registered a net operating loss for tax purposes that year and therefore could not fully utilize the bonus tax depreciation deduction otherwise available to the Company. Kroger finds this significant because ~~had~~ ADIT not been truncated in 2011 due to the artifact of PSE's net operating loss, rate base would have been lower.²¹⁸ Adjusting for this circumstance, Kroger argues, reduces Ms. Barnard's estimated 1.046 growth factor for non-production costs on the electric side of PSE's operation to 1.0322 over the 2007-2011 period.²¹⁹

156 To make his adjustment, Mr. Higgins uses a shorter time span (*i.e.*, 3.25 years instead of 5) to evaluate growth rates and he removes the NOL balance from the 2011 GRC results. With reference to Mr. Marcelia's testimony, Ms. Barnard testifies that:

Removal of the NOL benefits (i) is one sided since PSE did not receive the tax benefit of bonus depreciation; (ii) would represent a normalization violation of the Internal Revenue Service Code, and (iii)

²¹⁶ *Id.* ¶ 58.

²¹⁷ Kroger Brief at 5.

²¹⁸ *Id.*

²¹⁹ The escalation factors PSE proposes to use in the rate plan, 1.030 for electric and 1.022 for natural gas, are set at levels negotiated with Staff as PSE and NWEC prepared to file their Amended Decoupling Proposal. According to Ms. Barnard, the actual historical data upon which she relied support escalation factors of 1.046 (*i.e.*, 4.6 percent growth in costs) for electric and 1.038 (*i.e.*, 3.8 percent growth in costs) for natural gas.

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is contrary to the Commission's direction regarding the appropriate treatment of the NOL in PSE's 2011 general rate case.²²⁰

In addition, Ms. Barnard testifies that —it is important to evaluate the growth rates over a period of at least five years to avoid the volatility and distortion that can occur over a shorter time horizon.”²²¹ Finally, Ms. Barnard points out that even using Mr. Higgins's approach, the growth factors he identifies for electric and natural gas non-production costs, 3.29 and 3.22 percent, respectively, yield escalation factors that are higher than, and therefore support, the rate plan escalation factors of 1.030 and 1.022.²²²

Commission Determination

157 We do not find persuasive the arguments that PSE has used inappropriate data, or has failed to take into account factors such as ADIT that might affect the level of growth in PSE's non-production rate base during the rate plan period, as argued by Kroger and Public Counsel. PSE fairly represents what the data show. While various results can be read into these data, PSE's analyses are straightforward and easy to follow. PSE presents and defends the escalation factors in the rate plan showing that even accepting its opponents' arguments for the sake of discussion, the factors used in the rate plan are less than recent historical trends.

²²⁰ Exhibit No. KJB-11T at 30:6-11.

²²¹ *Id.* at 30:11-13.

²²² Ms. Barnard tacitly accepts Mr. Higgins's point that the escalation factors his analysis suggests undercut PSE's and Staff's claims that the escalation factors in the rate plan represent a —stretch goal” that will provide an incentive for PSE to operate efficiently. She points out, however, that there is an additional stretch factor affecting the 50 percent of the Company's non-production costs as to which the growth factor applied is based on CPI (Consumer Price Index) less a productivity factor adjustment. Ms. Barnard testifies that despite levels of historical growth of 4.7 percent for electric and 2.2percent for gas over the 2006-2011 time frame, the escalation factor for non-production plant related O&M is fixed at 1.9percent during the rate plan, a level significantly below the actual historical growth experienced over the past five years. —With O&M expense providing 50% of the weighting,” she testifies, —the use of the CPI alone represents a stretch goal.” Exhibit KJB-11T at 31:4-5.

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158 We determine that the escalation factors reasonably represent the levels of growth in non-production costs that PSE may expect over the term of the rate plan.

b. Does the Earnings Test Adequately Protect Customers?

159 The Amended Decoupling Petition modifies the original proposal by adding an earnings test that would allow the Company to earn up to 25 percentage points over its authorized rate of return,²²³ and then, if earnings exceed that amount, the Company and ratepayers would share —50%” and earnings exceeding that limit.²²⁴ PSE claims this proposal —provid[es] an appropriate safeguard to customers,” which can allay concerns that the Company will greatly exceed its rate of return.”²²⁵

160 ICNU submits that, if decoupling is approved, customers will be better safeguarded by an earnings test that allows PSE to earn its authorized rate of return, and ~~not~~ by allowing PSE to comfortably‘ or moderately‘ exceed its authorized rate of return— or however else PSE would describe something just short of greatly‘ exceeding ROR.”²²⁶

161 We share somewhat the concerns of ICNU. However, one of the purposes of a multi-year rate plan is to provide incentives to the company to cut costs, and allowing the company the potential to earn in excess of its authorized rate of return creates just such an incentive.

162 We are mindful of our rejection in Avista’s most recent general rate case of a ~~hard~~ cap” on earnings that Avista offered in settling the case. In its Final Order in the proceeding, the Commission explained:

In the course of consideration of the Settlement, Avista proposed a cap on its earnings at the 9.8 percent ROE level. We decline to accept that

²²³ PSE’s authorized rate of return is 7.80 percent. Hence, the earnings test sharing threshold under the Amended Decoupling Petition is 8.05 percent.

²²⁴ Exhibit No. JAP-8T (Decoupling) at 19:10–13.

²²⁵ *Id.* at 19:18–20.

²²⁶ ICNU Brief ¶ 124.

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offer. It would send the wrong signal to the Company. Under ratemaking theory applied by this and other state commissions for decades, companies should have every incentive to manage the company efficiently in order to earn more for the company shareholders. We should not set an artificial cap on earnings that could diminish the incentive for efficient management. Further, if Avista were to “overearn” through savings efforts, those savings would become the new norm in the next rate case which would serve to benefit ratepayers in the future. Indeed, the Company’s efforts to save money through efficiency are a key element to earning its allowed rate of return.²²⁷

163 We find this reasoning equally cogent here. We hope, and frankly expect, PSE to earn its authorized rate of return and do so by instituting effective cost-cutting measures. In long run, those savings will be captured in the Company’s authorized revenue requirement and the savings passed onto ratepayers.

164 However, we do not agree with the precise formulation of this “cap” as proposed by PSE. We determine elsewhere in this Order that the record does not support a 25 or more basis point reduction in PSE’s rate of return to reflect the reduced risk the Company will face in terms of revenue recovery during the rate plan period. However, we do determine that the currently authorized 9.8 ROE, which we determined to be in the middle of the range of reasonableness in PSE’s last rate case, now at best is in the higher end of that range.

165 Accordingly, we determine that to the extent PSE’s earnings exceed its currently authorized rate of return (ROR) of 7.80 percent (which will be adjusted slightly downward on its compliance filing due to lower long-term debt costs), the Company and consumers should share 50 percent each of such potential over-earning. The balance should be returned to customers over the subsequent 12-month period.

²²⁷ *WUTC v. Avista*, Dockets UE-120436 and UG-120437 (consolidated), Order 09 ¶79 (December 26, 2012).

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c. Are Multiple ERF Proceedings a Better Means to Achieve the Same Ends?

166 Public Counsel offers an alternative rate plan to that proposed in the Amended Decoupling Petition. Public Counsel says this is ~~in~~ recognition of the Commission's guidance in PSE's last general rate case, encouraging stakeholders to consider alternative approaches to address the frequency of rate cases.²²⁸ Public Counsel's alternative plan includes the following components:

- *ERF proceedings.* To address any earnings shortfall attributable to providing delivery service between rate cases, PSE would be allowed to file up to two additional expedited rate filings (ERF) prior to its next general rate case.
- *Full decoupling.* Public Counsel supports full decoupling provided there is a reduction of the cost of equity capital to reflect the shift in risk to ratepayers. This would address concerns of the NW Energy Coalition and others regarding the throughput incentive.
- *Cost of capital adjustment.* In testimony of Mr. Stephen Hill, Public Counsel recommends a return on equity of 9.0 percent, to reflect the shift in risk resulting from full decoupling as well as PSE's ability to seek rate increases through expedited rate filings.
- *One additional PCORC.* Beyond the recently-filed PCORC, PSE would be allowed to file one more additional PCORC during the term of the rate plan.
- *Rate Plan/Rate Case Stay out.* In light of the expedited rate relief and ability to file an additional PCORC, PSE would be prohibited from filing a general rate case before April 1, 2015, but would be required to do so no later than April 1, 2016, like the plan offered by PSE and included in the Multiparty Settlement.²²⁹

²²⁸ Public Counsel Brief ¶ 71.

²²⁹ *Id.* ¶ 70.

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167 Public Counsel argues that the benefits of serial ERF proceedings are significant when compared to the PSE/NWEC rate plan's reliance on the use of fixed annual escalation factors. According to Public Counsel, the ERF is more transparent, examines known costs, and considers actual changes to customer growth and capital investment. Granting full decoupling mechanisms for electric and natural gas operations, subject to the modifications Public Counsel advocates, would address the throughput incentive.²³⁰

168 Even with these asserted advantages, however, Public Counsel argues it is necessary to explicitly recognize reduction in risk, PSE's ability to seek expedited rate relief, and the general trend in cost of capital by reducing PSE's authorized cost of equity by 80 basis points to 9.0 percent, as recommended by Mr. Hill.²³¹

Commission Determination

169 We commend Public Counsel for its affirmative response to the Commission's encouragement to stakeholders to bring forth innovative approaches to ratemaking. The Commission appreciates the fact that Public Counsel devoted its resources to the development of ideas for the use of alternatives to frequent general rate cases. We agree that serial ERF proceedings, an idea consistent with what Staff proposed in PSE's 2011/2012 GRC, are a viable approach to address regulatory lag and attrition in the context of a multi-year rate plan.

170 However, between the two policy approaches—Public Counsel's multiple ERF plan and the PSE/NWEC single ERF and rate plan, which Staff endorses—we prefer the latter considering the record before us. This is for two reasons. First, Public Counsel's alternative rate plan is conditioned on our ordering adjustments to PSE's cost of capital. As described above, we do not find adequate support in the record for such an adjustment. Second, as discussed at several points in this Order, we believe the rate plan will better provide incentives to the company to implement operational efficiencies that ultimately will benefit the ratepayers. Therefore, we determine that Public Counsel's alternative rate plan should be rejected.

²³⁰ *Id.* ¶ 72.

²³¹ *Id.*

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2. Conclusion

171 The use of fixed annual escalation factors to adjust PSE's rates is a viable approach to reduce the impacts of regulatory lag and attrition during a multi-year general rate case stay-out period. The escalation factors provide PSE an improved opportunity to earn its authorized return, but are set at levels that will require PSE to improve the efficiency of its operations if it is to actually earn its authorized return. This is a critically important consideration underlying our approval of the rate plan.

172 Although PSE's experience over the past five years arguably justifies a delivery-related escalation factor as high as 4.06 percent for electric, PSE uses a three percent escalation factor. Similarly, for natural gas, although PSE's experience over the past five years arguably justifies an annual delivery-related escalation factor of 3.8 percent, PSE uses a 2.2 percent escalation factor. PSE relied on the forecasted average Consumer Price Index (CPI) for the 2013 to 2015 period less a one-half percent productivity factor for operating expense as the escalation factor for approximate half of the costs adjusted under the rate plan, which is significantly below PSE's actual growth in operating expenses over the past five years.²³² This escalation factor is significantly lower than PSE's historical level of delivery expenses. It follows that PSE will be required to increase the efficiency of its operations during the rate plan stay-out period. Absent the rate plan, PSE could, and most likely would file one or more general rate cases seeking full recovery of its delivery expenses that historical data show to have been higher than the CPI less productivity factor.

²³² The escalation factors represent a weighted average based on the percentage of non-production related revenue requirements for the following: 1) non-production rate base, 2) depreciation expense and 3) all other operating expenses, which include Operations and Maintenance, Customer Service, and Administrative and General expenses. The "all other operating expenses," which comprises 50 percent of the electric ERF revenue requirement and 44 percent of the natural gas ERF revenue requirement, are adjusted based on the CPI less a 0.5 percent productivity factor. The rate base and depreciation expense components of the escalation factors are based on the historical compound growth rate in these costs as shown in PSE's approved general rate case compliance filings from 2006 through 2011. See Exhibit No. KJB-1T (Decoupling) 6:8-15; Exhibit No. KJB-4T (Decoupling) at 1.

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173 We are satisfied on the basis of the record that our approval of the rate plan strikes a reasonable balance and will result in rates that are fair to customers and the company, leaving PSE with an improved opportunity to earn its authorized return while protecting customers by requiring PSE to improve the efficiency of its operations thus building savings that, over the long term, will keep rates lower than they otherwise might be.

F. Low-Income Customer Bill Assistance

174 The Commission is keenly aware that any rate increase, no matter how small, has a disproportionate impact on PSE's low-income customers. We hear repeatedly in public comment hearings throughout the state about the challenges those in the low-income community face in paying their utility bills on time. In this case, for example, Ms. Geraldine Miles of Kent wrote: —This is to let the Commission know that I am so opposed to another rate increase. As a senior citizen on a very fixed income, this is hard to survive.”²³³

175 Addressing the problem more broadly, Mike and Kay Tuben wrote:

PSE continues to ask for increases in rates. The people of this state are still reeling from the depression that this country is struggling to pull itself out of. PSE wants increases, yet many remain on wage freezes. Our family has not had a wage increase since 2008. I urge the Commission to take current economic conditions when considering this latest request.²³⁴

176 The Energy Project appears before the Commission in many cases affecting customer rates, including this proceeding. The organization strives to participate actively in all phases proceedings such as this one, advocating consistently for increased funding for low-income assistance programs that are a feature of PSE's tariff, among others.

²³³ Exhibit No. B-1, Attachment —Comments Received by UTC,” at 13.

²³⁴ Exhibit No. B-1, Attachment —Comments Received by Public Counsel,” at 1.

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177 The Amended Decoupling Proposal addresses this issue:

Issues surrounding PSE's low-income conservation program were discussed at length in PSE's 2011 general rate case. As discussed in that proceeding, PSE already provides low-income ratepayers with programs aimed at achieving a level of conservation that is comparable to that achieved by other ratepayers, which meets the low-income guidance set forth in the Commission's Decoupling Policy Statement. In addition, this amended petition continues to propose that electric low-income conservation funding be increased by approximately \$500,000 annually, which will further allow the Company to provide low-income ratepayers targeted programs aimed at achieving a level of conservation comparable to that achieved by other ratepayers. Finally, to mitigate concerns about the impact of the modified decoupling proposal on low-income customers, PSE proposes that low-income bill assistance program funding be increased in proportion to the residential bill impacts of this proposal on August 31, 2013, and each August 31 thereafter, until the decoupling mechanisms cease operation.

We approve these proposals to help offset any possible disparate impact of decoupling on PSE's low-income consumers. We find, however, that our record supports the need for additional funds to help offset the disproportionate impact of the ERF, decoupling and the rate plan on these customers.

178 Before the Energy Project provided any responsive testimony in these dockets, the Company and PSE reached the Multiparty Settlement. The settlement included an additional \$500,000 for low-income energy efficiency.²³⁵ Initially that settlement did not address possible further bill assistance for low-income customers. In his response testimony, Mr. Ebert stated the Energy Projects opposition to the settlement because it did not, in his view, do nearly enough to protect the low-income ratepayers.²³⁶ PSE was able to expand the number of settling parties, drawing the Energy Project's support, by agreeing to some further funding that would increase the bill assistance program by \$1.5 million, bringing the total program

²³⁵ See Exhibit No. CME-1T at 6.

²³⁶ See Exhibit No. CME-1T.

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to \$21.7 million.²³⁷ In addition, PSE's investors offered to provide \$100,000 per year for low-income energy efficiency funding.²³⁸

179 Because we determine in a separate order entered today that the Multiparty Settlement should be rejected as a matter of law, PSE is under no obligation to follow through on these commitments.²³⁹ However, we find in Mr. Eberdt's response testimony on behalf of the Energy Project rather compelling evidence that additional funds are required for the low-income bill assistance program to help offset the disproportionate impact of the ERF, decoupling, and the rate plan.

180 Mr. Eberdt shows specifically that the rate plan stay-out requirement exacerbates the impact on low-income customers.²⁴⁰ He estimates that PSE will collect an additional nearly \$4,000,000 from low-income households now participating in the HELP low-income program during the term of the rate plan. Participants in this program include only about 10 percent of the low-income households in PSE's service territory.²⁴¹ Noting the reductions in federal bill assistance programs, and the increased number of households facing possible "disconnection crises,"²⁴² Mr. Eberdt recommends an increase of funding of \$5,000,000 over a three year period so that the low-income agencies can serve additional clients.²⁴³

181 It is difficult to dispute the need that Mr. Eberdt describes. Indeed, Staff confirms that need and the desirability of addressing it.²⁴⁴

²³⁷ PSE Brief ¶83.

²³⁸ *Id.*

²³⁹ *In the Matter of the Petition of Puget Sound Energy, Inc., for Approval of a Power Purchase Agreement for Acquisition of Coal Transition Power, as Defined in RCW 80.80.010, and the Recovery of Related Acquisition Costs, Docket UE-121373, Order 07 (June 25, 2013).*

²⁴⁰ Exhibit No. CME-1T at 4.

²⁴¹ *Id.*

²⁴² *Id.* at 3

²⁴³ *Id.* at 6.

²⁴⁴ Exhibit No. DJR-1T at 12:10-13:15.

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182 We determine that the disparate impact of any rate increases on low income customers warrants additional support for those customers beyond what is included in the Amended Decoupling Petition. Considering the impact of a three-year rate plan, as demonstrated in Mr. Eberdt's response testimony, we determine that an additional amount of \$1.0 million per year should be added to PSE's low income bill assistance program.²⁴⁵ We accordingly will condition our approval of the ERF, decoupling, and the rate plan on this additional level of funding being provided.²⁴⁶

G. Property Tax Tracker

183 PSE proposed a Property Tax Tracker in its ERF.²⁴⁷ This is consistent with the Commission's Final Order in PSE's 2010/2011 general rate case in which the Commission directed PSE to bring forward a proposal that will allow for property taxes—no more and no less—to be recovered in rates by means of a rider.²⁴⁸ No party has opposed the Property Tax Tracker. We determine that PSE should be authorized and required to file tariff sheets to implement the property tax tracker as proposed in Ms. Barnard's testimony.

H. Miscellaneous

1. PSE's Rate Requests Constitute a General Rate Case under Commission Rules.

184 ICNU and Public Counsel argue that PSE's ERF tariff, and the PSE/NWEC Amended Petition for approval of decoupling and a rate plan, should be rejected because the combined effect of approving these proposals results in an initial increase in rates to

²⁴⁵ We cannot order PSE's investors to follow through on their offer in the Multiparty Settlement to provide an additional \$100,000 per year for energy efficiency funding. Additional funding at this level, or more, remains an option for PSE to consider as a gesture of goodwill, not just to the low-income customers, but to the ongoing energy efficiency goals of the State of Washington.

²⁴⁶ Programs for low-income bill assistance and energy efficiency measures are chronically underfunded. The Commission is open to agreed proposals for additional increases in such funding during the term of the rate plan. These should be timed so that any rate impact is reflected concurrently with the rate plan's annual adjustments.

²⁴⁷ Exhibit Nos. KJB-9 and KJB-10.

²⁴⁸ 2011/2012 PSE GRC Order ¶143.

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some customers that are slightly more than 3.0 percent. ICNU and Public Counsel argue this means the Commission must consider its joint proceedings in these matters as if PSE had filed a general rate case, subject to special procedural rules in WAC 480-07, Subpart B: General Rate Proceedings.

- 185 These arguments ignore the purpose of the Subpart B special rules. ~~The~~ special requirements in subpart B are designed to standardize presentations, clarify issues, and speed and simplify processing.”²⁴⁹ The efficiencies promoted by these special rules are important in the context of a tariff filing that opens the utility to a comprehensive and detailed review of all of its rates, terms and conditions of service, raising a host of complex issues including cost of capital and capital structure, numerous restating adjustments and pro forma adjustments, rate spread and rate design, prudence reviews of significant resource acquisition decisions, and others.
- 186 PSE’s most recently completed general rate case, for example, required the Commission to resolve more than 35 contested restating and pro forma adjustments and to consider an equal number of uncontested adjustments when determining rates. Three parties presented full cost of capital and capital structure cases, advocating significantly different results through the testimonies and numerous exhibits of several expert witnesses and requiring more than twenty pages of discussion in the Commission’s Final Order. The case presented additional issues related to rate spread and rate design, meter and billing performance standards, service quality and low-income bill assistance. The Commission resolved several prudence issues requiring review of thousands of pages of documentary evidence. The Commission also considered five policy issues, including significantly Staff’s proposal of an expedited rate filing that might follow in the wake of the general rate proceeding, and detailed evidence from Staff and NWECA on full decoupling, and other approaches that the Commission recognized as potentially offering a way to ~~break~~ the current pattern of almost continuous rate cases.”²⁵⁰ The Commission observed in this connection that:

²⁴⁹ WAC 480-07-500(3).

²⁵⁰ PSE 2011/2012 GRC Order ¶ 507.

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This pattern of one general rate case filing following quickly after the resolution of another is overtaxing the resources of all participants and is wearying to the ratepayers who are confronted with increase after increase. This situation does not well serve the public interest and we encourage the development of thoughtful solutions.²⁵¹

187 ICNU and Public Counsel ignore that a key underlying purpose of the joint filing by PSE and NWECA of a full decoupling proposal in October 2012, the Company's ERF in February 2013 and the amended decoupling and rate plan filing, in March 2013, is to respond to the Commission's invitation to parties to present innovative approaches to ratemaking that would avoid the complex process of a general rate case and the need to invoke the special rules in WAC 480-07, Subpart B.

Commission Determination

188 It may be true that the combined effect of the ERF, decoupling and the rate plan will result in rate increases that meet the three percent threshold criterion in the definition section of the special rules. The Commission, however, from the outset of its consideration of each of these matters, left no room for doubt in anyone's mind that they would not be consolidated and would not be treated as a general rate case. ICNU's and Public Counsel's arguments that this is a reason to reject the filings are strained, at best. To the extent these matters, considered jointly, might be considered a general rate case, the Commission effectively waived the application of WAC 480-07, Subpart B by following procedures tailored to the process needs they presented.²⁵²

189 One of the key purposes behind these filings was to provide the means to avoid yet another general rate case close on the heels of PSE's 2011/2012 GRC and the need for general rate case after general rate case going forward. Our resolutions of the issues in this Order, following the processes we determined to be most appropriate

²⁵¹ *Id.*

²⁵² WAC 480-07-110 provides that "[t]he commission may modify the application of procedural rules in this chapter during a particular adjudication consistent with other adjudicative decisions" without requiring express notice or other process.

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considering the scope and nature of filings, do precisely that. We recognize this is somewhat of an experiment in new and innovative ratemaking mechanisms, and we have been careful to provide the parties adequate opportunities to inform our decisions through the development of a record and briefing of the issues. We have accomplished this taking fully into account the requirements of the Administrative Procedure Act and our procedural rules.

190 The Commission determines for these reasons that it should reject ICNU's and Public Counsel's arguments that are grounded on the idea that our joint consideration of these matters should have been processed as a general rate case under WAC 480-07, Subpart B.

2. Power Cost Only Rate Case (PCORC) Requirements

191 Albeit couched only in the context of the Multiparty Settlement, we follow our general practice of liberally construing parties' filings, including briefs, and consider ICNU's complaint that what PSE and NWECA propose ~~allows~~ for Power Cost Only Rate Case (PCORC) rate cases without the protection of a follow-up GRC.²⁵³ ICNU argues ~~this~~ can only be changed in the PCORC Docket by amending Order 12 in Docket No. 011570.²⁵⁴ Public Counsel makes similar arguments.²⁵⁵

192 These arguments are wide of the mark. What the Amended Decoupling Petition actually provides ~~with respect to the PCORC~~ is that:

PSE will request waiver of the requirement to file a general rate case within three months after issuance of the final order in a PCORC, and with such waiver, PSE shall not be prohibited from filing consecutive PCORCs during the general rate case stay-out period.²⁵⁶

²⁵³ ICNU Brief ¶ 18.

²⁵⁴ *Id.*

²⁵⁵ Public Counsel Brief ¶¶ 87-89.

²⁵⁶ Amended Decoupling Petition ¶ 20, footnote 20.

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Commission Determination

193 A request that the Commission waive a requirement, whether established by order or rule, is not tantamount to request to alter or amend the order or rule.²⁵⁷ We reject ICNU's argument.

194 Since we do not otherwise address the question whether to grant PSE a waiver, or exemption from, the requirement that the Company must file a general rate case within three months after issuance of the final order in a PCORC, we do so here. We determine we should grant PSE's request. It is necessary to waive this requirement to enable the rate plan that we approve in this Order considering that PSE has a PCORC pending now²⁵⁸ and considering also our requirement in separate order entered today in Docket UE-121373 that PSE must file a PCORC timed so that any incremental power costs PSE incurs beginning on December 1, 2014, under a certain purchase power agreement can be recovered fully and timely in rates.²⁵⁹

3. Procedural Schedule

195 PSE and NWECC filed their Initial Decoupling Petition on October 25, 2012. Six days later, on November 1, 2012, Public Counsel filed its Notice of Appearance in the docket. ICNU, the same day, filed its Petition to Intervene and on November 6, 2012, filed comments including detailed arguments opposing the petition both substantively and procedurally.

196 The Commission brought the Petition to its regularly scheduled open meeting on November 8, 2012, for a preliminary presentation and discussion. PSE agreed to provide information requested by the Commissioners at the open meeting, as well as

²⁵⁷ See WAC 480-07-110 Exemptions from and modifications to commission rules; conflicts involving rules.

²⁵⁸ PSE filed a PCORC in Docket UE-130617 on April 25, 2013.

²⁵⁹ *In the Matter of the Petition of Puget Sound Energy, Inc., for Approval of a Power Purchase Agreement for Acquisition of Coal Transition Power, as Defined in RCW 80.80.010, and the Recovery of Related Acquisition Costs, Docket UE-121373, Order 07 (June 25, 2013).*

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in response to informal data requests from interested persons. The Commission also invited proposals on the procedure the Commission should use to review and make a determination on the Petition.

197 Public Counsel responded to the Commission's invitation saying that:

Public Counsel does not object to an informal preliminary period of review. Ultimately, in order make a final decision regarding this or a modified proposal, Public Counsel believes the Commission will need to set it for hearing to allow for development of the necessary factual record.

* * *

Public Counsel has no objection to the Commission conducting a preliminary informal workshop process. The policy issues around decoupling have been extensively explored in previous Commission dockets. The process should consist of one or more technical conferences intended to facilitate gathering facts, performing analysis, and gaining understanding of the mechanics and impact of the proposal. The process should include the opportunity for all parties to conduct discovery about the proposal.

* * *

The foregoing informal process may result in an all-party consensual agreement around this or a modified proposal. If that does not occur, in order for the Commission to resolve disputed matters and make a decision, it will need a record upon which to make findings of fact. The petitioners have already filed testimony and evidence in support of the proposal. Information gathered in the informal phase could be incorporated in the record by stipulation. Other parties should be permitted that opportunity also, through an adjudicative hearing process, in the event that matters remain in dispute after the initial workshops.²⁶⁰

²⁶⁰ *In the Matter of the Petition of Puget Sound Energy, Inc. and NW Energy Coalition For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to*

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198 All of the process Public Counsel outlined ensued. The Commission analyzed and considered the filing in a series of stakeholder workshops and open public meetings. Stakeholders had the opportunity to conduct discovery on a consensual basis. When it became apparent to the Commission that Staff and PSE were engaged in bilateral settlement negotiations that were unlikely to lead to —an ~~h~~-party consensual agreement” the Commission set the decoupling petition for hearing.

199 Public Counsel also included in its initial comments in the decoupling dockets remarks concerning the possibility of an ERF:

Coordination with the PSE Expedited Rate Filing (ERF) Proposal. As it acknowledges in its testimony in this docket, PSE has been meeting with stakeholders regarding a potential expedited rate filing (ERF) proposal to be filed with the Commission. Both this decoupling proposal and the potential ERF are intended to address issues related to asserted earnings attrition. It would be much more efficient and productive for the Commission and parties to consider both proposals at the same time, given the overlapping policy and technical issues.²⁶¹

200 PSE made its ERF filing on February 1, 2013. As in the case of the decoupling petition, the ERF included prefiled direct testimony by PSE’s witnesses. Public Counsel and ICNU again entered their respective appearances within days after the filing. They, and other stakeholders, participated actively during the early stages of informal process before the Commission, including discussion at an open meeting on March 5, 2013, during which the Commission requested parties to submit written proposals outlining procedural options for the ERF. The Commission considered the proposals it received during the same open meeting on March 14, 2013, at which it set the decoupling dockets for hearing. The Commission suspended the ERF tariffs and set the dockets for hearing. Following the open meeting, the Commission gave notice that it would conduct a joint prehearing conference on March 22, 2013. During the

Record Accounting Entries Associated with the Mechanisms, Dockets UE-121697 and UG-121705, Public Counsel’s Comments (November 21, 2012).

²⁶¹ *Id.*

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prehearing conference, the presiding Administrative Law Judge established a procedural schedule allowing for approximately eight weeks of formal process, including opportunities for discovery, prefiled response testimony, prefiled rebuttal testimony, evidentiary hearings, a public comment hearing and briefing by the parties.

201 Public Counsel argues that the eight weeks of formal process afforded the parties of a fair opportunity to review PSE filings and to prepare and present its case.²⁶²

The schedule allowed parties one day short of 8 weeks from the initial prehearing conference to the evidentiary hearing to develop their cases. The schedule allowed only 19 calendar and 13 business days (dated from the prehearing conference) to issue and review discovery and prepare and file expert testimony. Parties had one week (5 business days) to review rebuttal testimony and prepare for hearing, and 3 and ½ business days to provide cross-exhibits.²⁶³

202 ICNU also complains about the procedural schedule in its brief, but does not develop a cogent argument on this point.²⁶⁴

Commission Determination

203 The procedural schedule was designed appropriately to strike a balance between PSE's proposal to conclude these proceedings within a few weeks after they were set for hearing and Public Counsel's proposal for an extended schedule of about six months. The ERF was designed to be, and is in fact, straightforward. The filing raises few issues. The most contentious issue, whether to address and adjust cost of capital, was raised by Public Counsel and the Intervenors despite the general understanding that an ERF is not an appropriate docket to consider it.

204 While cost of capital is an appropriate issue to consider in the context of decoupling, the expert witnesses focused far less attention, and developed no substantive

²⁶² Public Counsel Brief ¶¶ 90-91.

²⁶³ *Id.* ¶ 90.

²⁶⁴ ICNU Brief ¶¶ 27 and 36.

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evidence, on the issue in this context. We agree that the record could have been better developed on this point, but the fact that the parties elected to orient their focus on cost of capital in the direction of the ERF and not to the task of bringing forward empirical evidence to support their theories concerning the impact of decoupling on cost of capital is not a result of the parties having too little time.

205 The record in this proceeding includes more than 130 exhibits, including testimony from 18 witnesses. The parties had adequate opportunities to conduct discovery. There was a significant period of informal discovery in which PSE committed to, and did, cooperate in providing information in addition to its prefiled testimony and exhibits. This information was provided to the Commission and stakeholders, some of whom later became parties, before these matters were set for hearing. During the period from March 14, 2013, when these dockets became formal adjudicatory proceedings under the APA, until the discovery cut-off date of April 10, 2013, PSE responded to numerous data requests. The Commission also allowed the parties to conduct depositions, which is a ~~decidedly~~ uncommon [practice] in Commission proceedings.²⁶⁵ The parties had ample opportunity to conduct cross-examination during our evidentiary hearing, but elected to take little advantage of their opportunity. The parties had enough time to write and file extensive briefs: ICNU's brief runs to 59 pages of text, one short of the maximum allowance. Public Counsel's brief is 49 pages in length. In short, we have a very fully developed record in these dockets, protestations from Public Counsel and ICNU notwithstanding.

206 As we anticipated at the outset of our formal process, following on the heels of significant informal process, the schedule in this proceeding proved to be workable

²⁶⁵ *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-13137 and UG-130138 (consolidated) and *In the Matter of the Petition of Puget Sound Energy, Inc. and NW Energy Coalition For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets UE-121697 and UG-121705 (consolidated), Order 05 ¶ 6 (April 16, 2013). See *In re: Waste Management of Wash., Inc.*, Docket TG-120033, Order 06 at ¶ 5, (Nov. 5, 2012) (~~Depositions are infrequently authorized in Commission adjudicative proceedings and generally are reserved for circumstances in which that form of discovery is the most efficient and least burdensome means of obtaining relevant information.~~”).

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and did not cause prejudice to any party. All parties exhibited cooperation and made diligent effort to ensure that a full and adequate record was developed.

4. Jefferson County

207 ICNU touches briefly on the point that PSE sold its assets that it formerly used to provide service to customers in Jefferson County to the Jefferson County PUD, but fails to adjust the rate base and the revenues attributable to this former service.²⁶⁶ The reason for this, as Ms. Barnard explained at hearing, is that the assets remained in rate base as of June 30, 2012, the end of the ERF test year.²⁶⁷ ICNU argues that PSE should be required to make a pro forma adjustment in its ERF for this —known and measurable” change. The ERF, however, is not generally an appropriate vehicle for making this sort of known and measurable change. Unlike a restating adjustment, a pro forma adjustment can require considerable investigation and analysis, unsuitable in the context of an expedited rate case designed only to update rates following a general rate case in which pro forma adjustments are considered and made.

208 In any event, the Jefferson County sale arguably is not a suitable candidate as a known and measurable event in the context of this proceeding. Ms. Barnard testified that there is a 90-day true-up period after the April 1, 2013, closing of the transaction, which concludes on or about July 1, 2013. PSE will make a filing with the Commission after the 90-day true up period is concluded. It will not be until then that the effects of the Jefferson County sale are fully known and measurable.

209 PSE says, too, that it expects the reduction in its electric delivery system costs in Jefferson County will be offset by a commensurate reduction in rate revenue from Jefferson County customers.²⁶⁸ Also, based on PSE preliminary analysis, the rate base per customer in Jefferson County is slightly less than the rate base per customer for all PSE customers. Thus, the loss of the Jefferson County customers will have a

²⁶⁶ ICNU Brief ¶ 22.

²⁶⁷ See TR. 260:9-264:10.

²⁶⁸ PSE Brief ¶ 81 (citing Exhibit No. KJB-11T at 21:15-17).

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negligible impact on the rate base per customer for PSE's remaining customers.²⁶⁹ The transfer of PSE's service territory reduces the number of customers PSE serves and reduces the allowed revenue in the decoupling mechanism. It follows, PSE argues, that ICNU's concerns that the Company's decoupling accounting is somehow distorted due to the sale of the Jefferson County service territory is not supported by the record.

Commission Determination

210 PSE's sale of assets in Jefferson County is an issue for another day, in another proceeding that will consider the disposition of PSE's gain on sale and other matters. This filing is anticipated on or about July 1, 2013, after a 90-day true-up period following the April 1, 2013, closing of the transaction. It is appropriate that PSE made no adjustment in the context of these dockets to account for this sale of assets.

I. Reporting Requirements

211 PSE states in its brief that "[t]he Commission will have available significant information to monitor PSE's performance during the course of the rate case stay-out period."²⁷⁰ We appreciate this reaffirmation. We take it to mean more than that PSE will continue to file the reports that it is already required to file. Mr. Johnson testified at hearing, for example, that PSE does not object to providing annual reports documenting the infrastructure replacement and capital expenditures during the previous year²⁷¹ and is willing to engage with the Commission, Commission Staff and other parties to determine what additional reporting might be helpful.²⁷² We take this to mean that PSE will engage actively with Staff and, if requested, with the Commission, to develop the outline of a report, or reports, supported by appropriate

²⁶⁹ *Id.* (citing Exhibit No. KJB-11T at 21:19-22:4; Exhibit No. KJB-15).

²⁷⁰ PSE Brief ¶ 84.

²⁷¹ *See* TR. 141:1-3.

²⁷² *See* TR. 180-6-19.

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data that will provide the Commission on an annual basis a clear understanding of the impacts of decoupling and the operation of the rate plan, both positive and negative.

- 212 We accept Mr. Johnson's offer to provide annual reports documenting PSE's infrastructure replacement and capital expenditures during the previous year. As in the case of the attrition-based rate increases we approved in the 2012 Avista GRC, we deem it desirable to monitor here PSE's progress in achieving its plan for capital expenditures during the term of the rate plan so that the ratepayers can be assured that the rate increases designed to assist the Company in making these investments can continue to be justified. Since our record lacks detailed documents showing planned capital expenditures we will require that they be filed within 30 days after the date of this Order. Each year, at the time of PSE's earnings review we will expect to receive a report showing actual results during the preceding 12 months relative to planned expenditures.
- 213 We think more frequent reporting than is currently required also is in order. We will require PSE to file two Commission Basis Reports each year rather than one. This will assist us in monitoring, among other things, PSE's actual rate of return on a regulated basis. The Commission Basis Report provides PSE's actual and restated results of operations, including operating revenues, rate base, net operating income and restating adjustments and is the foundation for the earnings sharing mechanism that is proposed to provide balanced and appropriate safeguards against excessive overearning during the stay-out period.
- 214 We approve the rate plan in part because it is an innovative approach that will provide incentives to PSE to cut costs in order to earn its authorized rate of return. It is important that the Commission monitor how, and how well these incentives, operate to improve efficiency and reduce costs that ultimately will mean rates to customers that are lower than they would be absent these gains in efficiency. As Mr. Schooley testified, the key to additional reporting is that it provides helpful information to the Commission.²⁷³ Again, we expect PSE and Staff to work together to develop

²⁷³ See Schooley TR. 179:24-180: 5.

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reporting protocols that will keep the Commission informed about PSE's cost cutting and efficiency initiatives during the term of the rate plan.

- 215 The Commission will wish to review these reports with PSE, Staff, and interested stakeholders in the exercise of our continuing jurisdiction over this matter. The Commission will schedule periodic, at least annual, work sessions at which PSE will be asked to present a status report on cost-cutting and other efficiency initiatives. Consistent with our authority to require reports from investor-owned utilities, we may require PSE to file prior to any such work session a report detailing the Company's efforts and the success of such efforts.

FINDINGS OF FACT

- 216 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary of those facts, incorporating by reference pertinent portions of the preceding detailed findings:
- 217 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including electrical and gas companies.
- 218 (2) Puget Sound Energy, Inc., (PSE) is a ~~public service company,~~ an ~~electrical~~ "public service company" and a ~~gas company,~~ "gas company," as those terms are defined in RCW 80.04.010 and as those terms otherwise are used in Title 80 RCW. PSE is engaged in Washington State in the business of supplying utility services and commodities to the public for compensation.
- 219 (3) PSE's current rates are insufficient to yield reasonable compensation for the electric and gas services it provides in Washington.

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- 220 (4) The record does not support an adjustment to PSE's cost of capital or capital structure except to the extent of a demonstrated reduction in the cost of long-term debt. PSE's current authorized overall rate of return should be adjusted downward from 7.80 percent to 7.77 percent to reflect lower capital costs for long-term debt at 6.16 percent. Evidence of trends in financial markets suggests that PSE's current authorized rate of return on equity, 9.8 percent, is at the upper end of may be regarded as a reasonable range for such returns.
- 221 (5) PSE's electric revenue deficiency demonstrated in the context of the ERF dockets (*i.e.*, Dockets UE-130137 and UG-130138) is \$31,138,511 and its natural gas revenue surplus is \$1,717,826.
- 222 (6) PSE requires relief with respect to the rates it charges for electric service and natural gas service provided in Washington State so that it can recover its natural gas service and electric service revenue deficiencies demonstrated in the context of its ERF.
- 223 (7) The decoupling mechanisms and rate plan proposed via the PSE/NWEC Amended Decoupling Petition will result in rates during the term of the rate plan that are fair, just and reasonable and sufficient. Implementing decoupling and the rate plan will better enable the PSE to recover its authorized return during the term of the rate plan, if the Company implements appropriate efficiency and cost-cutting measures.
- 224 (8) The rates approved in the context of the ERF establish an appropriate baseline for the application of decoupling and the rate plan escalation factors.
- 225 (9) PSE's low-income bill assistance program requires additional funding during the term of the rate plan of at least \$1.0 million per year.
- 226 (10) The rates, terms, and conditions of service that result from this Order are fair, just, reasonable, and sufficient.
- 227 (11) The rates, terms, and conditions of service that result from this Order are neither unduly preferential nor discriminatory.

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- 228 (12) The decoupling mechanisms and rate plan proposed via the PSE/NWEC Amended Decoupling Petition will result in rates during the term of the rate plan that will be fair, just and reasonable and sufficient. Implementing decoupling and the rate plan will better enable the PSE to recover its authorized return during the term of the rate plan, if the Company implements appropriate efficiency and cost-cutting measures.
- 229 (13) PSE's proposed property tax tracker will recover the property taxes the Company actually pays on an ongoing basis—no more and no less.

CONCLUSIONS OF LAW

230 Having discussed above all matters material to this decision, and having stated detailed findings, conclusions, and the reasons therefore, the Commission now makes the following summary conclusions of law, incorporating by reference pertinent portions of the preceding detailed conclusions:

- 231 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, these proceedings.
- 232 (2) PSE carried its burden to prove that its existing rates for electric service and natural gas service provided in Washington State are insufficient to yield reasonable compensation for the service rendered.
- 233 (3) PSE requires relief with respect to the rates it charges for electric service and natural gas service provided in Washington State.
- 234 (4) PSE's current authorized overall rate of return should be adjusted to reflect lower capital costs for long-term debt at 6.16 percent. This reduces PSE's overall return from 7.80 percent to 7.77 percent.
- 235 (5) PSE should be authorized and required to make a compliance filing in Dockets UE-130137 and UG-130138 (consolidated) to recover its revenue deficiency of \$31,138,511 for electrical service provided to its customers in Washington.

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- 236 (6) PSE should be authorized and required to make a compliance filing in Dockets UE-130137 and UG-130138 (consolidated) to implement its revenue surplus of \$1,717,826 for natural gas service provided to its customers in Washington.
- 237 (7) The Commission should approve as being in the public interest the PSE/NWEC Amended Decoupling Petition and require PSE to make appropriate compliance filings to implement the electric and natural gas decoupling mechanisms and the rate plan, subject to the condition that the earnings test is modified to provide for equal sharing between PSE and its customers of any earnings that exceed the Company's adjusted overall rate of return of 7.77 percent.
- 238 (8) PSE should be required to increase the funding for its low-income bill assistance program by \$1.0 million per year during the term of the rate plan.
- 239 (9) The rates, terms, and conditions of service that will result from this Order are, and will be prospectively during the term of the rate plan, fair, just, reasonable, and sufficient.
- 240 (10) The rates, terms, and conditions of service that will result from this Order are, and will remain during the term of the rate plan, neither unduly preferential nor discriminatory.
- 241 (11) The property tax tracker PSE proposes in the ERF dockets complies with the Commission's directive in its Final Order in PSE's 2011/2012 GRC requiring PSE to bring forward such a mechanism for the Commission's consideration. It is in the public interest for this tracker to be approved and the Commission should order PSE to make an appropriate compliance filing to implement the tracker.
- 242 (12) The Commission Secretary should be authorized to accept by letter, with copies to all parties to this proceeding, a filing that complies with the requirements of this Order.

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- 243 (13) The Commission should retain jurisdiction over the subject matters and the parties to this proceeding to effectuate the terms of this Order.

ORDER

THE COMMISSION ORDERS THAT:

- 244 (1) The proposed tariff revisions PSE filed on February 1, 2013, in Dockets UE-130137 and UG-130138 (consolidated), which were suspended by prior Commission order, are approved, subject to adjustment to reflect the lower cost of long-term debt, which has the effect of reducing PSE's overall rate of return to 7.77 percent.

- 245 (2) PSE is authorized and required to file tariff sheets that are necessary and sufficient to effectuate the terms of this Final Order, including

- Determinations of a revenue deficiency of \$31,138,511 for electrical service and a revenue surplus of \$ 1,717,826 for natural gas service in Dockets UE-130137 and UG-130138 (consolidated) after adjustment to reflect PSE's lower cost of long-term debt.
- The property tax tracker mechanism proposed via Exhibit Nos. KJB-9 (electric) and KJB-10 (natural gas).
- The decoupling mechanisms as-filed in Dockets UE-121697 and UE-121705, subject to modification of the earnings test to provide for equal sharing between PSE and its customers of any earnings that exceed the Company's adjusted overall rate of return of 7.77 percent.
- The rate plan, including its as-filed annual escalation adjustments.

PSE must file the required tariff sheets at least two business days prior to their stated effective date, which shall be no sooner than July 1, 2013.

- 246 (3) PSE will be subject to reporting requirements as discussed in the body of this Order.

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- 247 (4) PSE is required to increase its low-income billing assistance program funding by \$1.0 million per year during the term of the rate plan.
- 248 (5) The Commission Secretary is authorized to accept by letter, with copies to all parties to this proceeding, a filing that complies with the requirements of this Final Order.
- 249 (6) The Commission retains jurisdiction to effectuate the terms of this Final Order.

Dated at Olympia, Washington, and effective June 25, 2013.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

PHILIP B. JONES, Commissioner

JEFFREY D. GOLTZ, Commissioner

NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.

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SEPARATE STATEMENT OF COMMISSIONER JONES

- 1 In these filings, Puget Sound Energy (PSE or Company) proposes to implement three distinct and significant ratemaking mechanisms. First, PSE proposes an expedited methodology for adjusting its operations and maintenance costs through an expedited rate filing (ERF) and a separate tracker for property taxes. Second, the Company asks to implement a revenue-per-customer decoupling mechanism in order to sever, or decouple, the link between the amount of energy it sells and the revenue it is allowed to earn. Third, the Company asks to implement a rate plan, increasing allowed delivery revenue annually by a fixed amount, or escalator.
- 2 I support these new approaches as an experiment in addressing regulatory lag and as one means of providing the Company an opportunity to earn its allowed rate of return. However, I firmly believe the Company's return on equity (ROE) should be lowered to reflect current capital market conditions and the adoption of full electric and natural gas decoupling. Ratepayers should share the benefits of lower costs in capital markets and decoupling's reduction in earnings volatility for PSE that will likely create more rate volatility for consumers.

The Company has not met its burden of proof.

- 3 In a rate proceeding before this commission, the Company bears the burden to demonstrate that its proposal, including its cost of capital, is reasonable and in the public interest. The ERF and decoupling proposals before us represents a substantial shift in the way that the commission sets PSE's rates. Here, PSE has not proffered a full cost-of-capital study to satisfy its burden even though an expert testified that a cost of capital study can be completed in as little time as one week. Instead, the Company relies on testimony provided by other parties and a simple, yet unconvincing, argument that adjusting its cost of capital is not appropriate within the ERF. This does not meet the Company's burden to demonstrate that its current cost of capital is appropriate in light of recent capital market conditions, its risk profile with full electric decoupling, and the three or four year length of the rate plan. I believe the simplest and most transparent way to reflect these changes is to reduce ROE modestly, and to do it now.

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Current market conditions warrant an adjustment of PSE's return on equity.

4 I believe that there is sufficient evidence in the record before us today to adjust the Company's ROE. When setting a Company's cost of equity, we have stressed the importance of examining a variety of models including a capital asset pricing model, discounted cash flow analysis, and risk premium market return analysis. ICNU witness Gorman performed a complete study that incorporated all of these models that we typically examine when setting a return on equity. Mr. Gorman relies primarily on a discounted cash flow analysis for his recommendation, a reliance I believe is appropriate in light of today's financial markets. Public Counsel witness Hill did not perform a cost of equity study in these proceedings, but did provide a summary of a recently completed study and compared his results to PSE's currently authorized ROE.

5 The Commission set the Company's ROE in PSE's most recent general rate case using data collected prior to December 2011. I believe that this data and analysis are outdated for use in setting rates today. Witnesses Hill and Gorman conclude rates of return today are lower than during the time of the Company's most recent general rate case. I find their analysis leading to a thirty and fifty basis point reduction of ROE due to changes in financial market conditions to be reliable, and their arguments compelling. PSE's failure to submit a cost of capital study in these dockets should not prevent us from adjusting the Company's equity return. Accordingly, I rely on the evidence provided by intervener witnesses to conclude that such a downward adjustment to ROE is reasonable

The implementation of decoupling reduces the Company's risk and should be accompanied by a reduction of the Company's return on equity.

6 The proposals presented to us do not simply adjust rates to account for regulatory lag and the Company's current investments, it also represents the first time that the Company proposes and supports a full electric and gas decoupling proposal.

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- 7 Since the decoupling proposal before us guarantees revenues and reduces risks for the Company, the need for an examination of decoupling's effect on the utility's ROE is clear. Our policy statement on decoupling explicitly stated a utility proposing a decoupling mechanism should provide evidence evaluating the impact of the mechanism on risk to investors and ratepayers, including its effect on the utility's return on equity. Public Counsel, ICNU, and Kroger conclude, to varying degrees, that risk is shifted and emphasize that decoupling eliminates risks due to fluctuations in sales for any reason (i.e., weather, price elasticity, and economic cycles).
- 8 When ratepayers bear more risk, the Company's ROE should decrease concomitantly. Public Counsel witness Hill recommends a 50 basis point reduction for decoupling. ICNU witness Gorman and Kroger witness Higgins recommend a 25 basis point reduction. PSE did not follow our policy statement's guidance and failed to include evidence evaluating the risk reduction impact of the decoupling proposal. NW Energy Coalition witness Cavanagh discusses the risk impact of decoupling in his rebuttal testimony, supporting the parties' common position that an adjustment to ROE is not appropriate now. Mr. Cavanagh, however is not a cost of capital expert and should not be expected to carry the Company's burden in this area. The report Mr. Cavanagh attaches to his testimony is not the type of in-depth Company-specific analysis that we rely on to adjust a utility's ROE. The study is a survey of other commissions' decisions on decoupling mechanisms.
- 9 Based on the record analyzing the effect of decoupling on risk, as well as our guidance on this issue in our Policy Statement, I would adjust the Company's ROE at this time. The Company proposes to evaluate the impact of the mechanism on its risk profile at the end of the rate plan in 2015 or 2016. I would not wait until that distant date to make an ROE adjustment. I feel that the evidence clearly supports making a downward adjustment to PSE's ROE now in order to provide ratepayers some relief over the long duration of this rate plan.
- 10 In conclusion, I join my colleagues in supporting the adoption of these proposals to reduce regulatory lag and the Company's revenue volatility as it carries out conservation activities and upgrades its distribution infrastructure. Yet the adoption of these mechanisms will engender a significant shift in risks from the Company to its

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customers. Therefore, it is only fair and reasonable to include an ROE reduction when adopting the Company's proposals. To account for the risk impact of decoupling and market conditions, I would adjust the Company's return on equity by 30 basis points, or 9.5% for ROE, which is higher than the recommendations of Gorman and Hill. Therefore, if one were to adopt my ROE adjustments, the overall rate-of-return (ROR) would be 7.63%, compared to the Company's final proposal of 7.77%. I think such a reduction is modest and constitutes a balanced outcome that would reflect, to some extent, these mechanisms' substantial shifting of risks from the Company to ratepayers.

PHILIP B. JONES, Commissioner

1 DATED at Portland, Oregon this 24th day of July, 2013.

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