

[Service Date May 7, 2012]

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND)	DOCKETS UE-111048 and
TRANSPORTATION COMMISSION,)	UG-111049 (<i>consolidated</i>)
)	
Complainant,)	ORDER 08
v.)	
)	REJECTING TARIFF SHEETS;
PUGET SOUND ENERGY, INC.,)	AUTHORIZING AND REQUIRING
)	COMPLIANCE FILING
Respondent.)	
.....)	

Synopsis: The Commission rejects previously suspended tariff sheets Puget Sound Energy, Inc. (PSE or the Company) filed on June 13, 2011, by which the Company proposed to increase electric rates by 8.1 percent and natural gas rates by 3.0 percent. In lieu of the Company’s proposed increases in rates, the Commission authorizes and requires PSE to file tariff sheets that will result in fair, just, reasonable and sufficient rates that will increase electric rates by approximately 3.2 percent and natural gas rates by approximately 1.3 percent.

The Commission reduces PSE’s overall rate of return but increases the percent of equity in the Company’s capital structure. This gives ratepayers the benefit of lower debt costs that reflect the Company’s financial strength while providing support to PSE’s ability to earn its authorized return during a period of heightened capital investment.

The Commission recognizes PSE’s current need to replace aging transmission and distribution infrastructure and to add cost-effective renewable resources to its portfolio of power production assets to meet Renewable Portfolio Standards mandated by the Energy Independence Act. This is exemplified in this case by the approval of PSE’s acquisition and construction of the first phase of the Lower Snake River wind power project as a prudent investment.

This Order requires PSE to update its power costs to a point contemporaneous in time with its effectiveness. This gives the Company’s customers the full benefit of declining natural gas prices that are a key driver of these costs. At the same time,

or not actually incurred, and earn its authorized returns on debt and equity, presumably including return of, and return on, anticipated debt issuances and capital investments that might or might not occur.

96 Our approach, unlike Dr. Olson’s forward-test year approach, strikes a balance that motivates PSE and the other utilities subject to our jurisdiction to carefully manage their costs and revenues going forward, and take full advantage of their opportunities to recover all fixed and variable costs including a reasonable return on prudent capital investments that are used and useful in providing service to customers in Washington.

97 While we have traditionally described our ratemaking practice as being based on the historic test year, a key operative part of this description is “based on.” In point of fact, our practice is quite forward looking and more a process sometimes referred to as a “hybrid test year.”¹²⁵ The Commission, for example:

- Approves pro-forma adjustments to test-year costs when the adjustments are adequately supported.
- Allows calculation of base power costs based on costs projected for the rate year based on data contemporaneous with the end of a general rate case (*i.e.*, at the beginning of the rate year).
- Accepts filings for updates to power costs “between rate cases.” For PSE, it allows for expedited power-cost-only rate cases (PCORCs) that adjust rates to reflect addition of new power resources, or fuels costs, without requiring a comprehensive rate proceeding .
- Allows new generation plant in rate base even when the new facilities are placed in service subsequent to the end of the test period.
- Has approved end-of-period rate base when this is shown to be appropriate.

¹²⁵ See Lowry, Mark Newton; Hovde, David;Getachew,Lullit;Makos, Matt, Edison Electric Institute, *Forward Test Years for U.S. Electric Utilities*, August 2010.

- Has allowed CWIP (Construction Work in Progress) in rate base.
- Has approved hypothetical capital structures to improve a utility's weakened financial condition.

98 In prior orders, the Commission has made clear that while its ratemaking practice starts with known data that are “historic” by definition, these data are adjusted using various approaches to set rates based on expected costs the utility will experience during the rate year following the effective date of the new rates.¹²⁶ The current case is no exception. Significantly more than half of PSE's cost of service is determined on a forward-looking basis in this proceeding, including:

- Power costs that alone represent more than half of PSE's overall cost of service. We determine these costs in rates based on a projection for the rate-year using gas price *forecasts* nearly contemporaneous with the date of this Order, not costs incurred during the test-year.
- A nearly \$780 million increase to rate base for plant investment in LSR-1 and associated transmission that did not become operational until 14 months after the close of the test-year and near the end of this proceeding.¹²⁷
- Pro-forma adjustments that reflect known and measurable increases to test year costs for such expenses as wages, pension contributions and property tax.

¹²⁶ *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-090704 and UG-090705, Order 11 at ¶¶ 22-33 (April 2, 2010) (PSE 2010 GRC Order); *WUTC v. Avista*, Dockets UE-090134 and UG-090135, Order 10 at ¶¶ 40-50 (December 22, 2009) (Avista 2009 GRC Order). In these cases, the Commission describes its modified historic test year approach to ratemaking without relabeling its practice as being one recognized by some as a “hybrid” method. The hybrid method we use draws on historic data, but modifies this data with projections, forecasts and estimates. In other words, it is a hybrid of historic test year and forward test year ratemaking.

¹²⁷ At hearing, PSE indicated that Lower Snake River was expected to go into commercial operation on February 29, 2012. Story, TR 1030:6.

write off approximately \$14 million in deferred costs that it currently is authorized to recover.³⁹⁹ Accordingly these facts inform our decision to reject Staff's proposed changes and retain the current Commission-approved mechanisms for storm damage cost recovery.

6. Contested Adjustments - Electric Only - Rate Base

a. Lower Snake River⁴⁰⁰

300 PSE proposes to reflect in rate base and operating expenses the first phase of its development of the Lower Snake River wind power project (LSR-1), which became operational during the pendency of this proceeding. PSE includes the expected output from this new generation plant in its AURORA power cost model run for the rate year. Thus, the Company's pro forma operating cost assumptions are included in its power cost adjustment.

301 When PSE made its initial filing in this case, it expected LSR-1 to be completed in April 2012. PSE, in its rebuttal filing, agreed with Staff that the in-service date should be moved up to mid-February 2012.⁴⁰¹ The facility actually went into operation on February 29, 2012, which all parties now agree should be considered its "in-service" date. This is a significant date, among other reasons, because, Construction Work in Progress (CWIP) ceases to accrue and depreciation commences when plant enters commercial operation.

302 Staff, based on the latest actual figures available at the time it filed its response testimony, proposes to limit capital additions to rate base for LSR-1 based on actual charges to CWIP as of October 31, 2011, and remaining contractual obligations.⁴⁰² This contrasts to, and is less than, PSE's addition of the amounts budgeted for

³⁹⁹ Staff Initial Brief ¶120.

⁴⁰⁰ Public Counsel and ICNU jointly propose a \$55 million reduction to revenue requirement based on their challenge to the prudence of PSE's acquisition of the Lower Snake River wind power project. We discuss their prudence challenge and proposed adjustment separately below in Section II.I.

⁴⁰¹ Garratt, Exh. No. RG-28CT at 21:17-18.

⁴⁰² Applegate, Exhibit No. RTA-1T at 5:4-13.

completion, as updated in its rebuttal case with more recent actual costs. Staff's position is that PSE's LSR-1 adjustment to rate base relies on forecasted costs that are not known and measurable.⁴⁰³ When Staff filed its response case, its proposed rate base, at \$644,066,095, was \$43,644,670 less than the \$687,710,765 PSE included in its supplemental filing.⁴⁰⁴ This remains Staff's proposal as of the filing of the parties' Initial Briefs.

303 The Company continued to update the information on LSR-1 as the case progressed. PSE's rate base for LSR-1, revised in its rebuttal case, is \$664,324,546.⁴⁰⁵ PSE's final proposed amount is \$669,984,171.⁴⁰⁶

304 Staff also recommends that the Commission reject PSE's pro forma property tax expense for LSR. Staff applies its reasoning from its general Property Taxes Adjustments, discussed above in Section II.C.3.c., and removes the Company's pro forma property taxes of \$2,967,101 for LSR-1.⁴⁰⁷ Staff states that PSE's calculation of pro forma property taxes for LSR-1 represents the product of multiple estimated values, including an adjusted total project cost, personal property tax electric discount rate, system ratio, and levy rate.⁴⁰⁸ Staff considers these not known and measurable and removes PSE's adjustment.⁴⁰⁹

305 Staff's proposals concerning LSR-1 essentially track those it made in Docket UE-090704 with respect to the Wild Horse Expansion project, which the Commission accepted.⁴¹⁰ Mr. Story emphasizes that in both cases Staff's treatment of the Plant Adjustment is inconsistent with its treatment of the Deferral Adjustment. Staff, in both proceedings includes the Company's estimates of completion costs and property

⁴⁰³ *Id.* at 5:17-23.

⁴⁰⁴ Applegate, Exhibit No. RTA-1T at 6:20; Exh. No. RTA-3.

⁴⁰⁵ Story, Exh. No. JHS-18T at 24:21-22; Exh. No. JHS-20, line 7.

⁴⁰⁶ PSE Initial Brief, Appendix H.

⁴⁰⁷ Applegate, Exh. No. RTA-1T at 5:4-13.

⁴⁰⁸ *Id.* at 5:7-13.

⁴⁰⁹ *Id.* at 5:11-13.

⁴¹⁰ *Washington Utilities and Transportation Commission v. Puget Sound Energy, Inc.*, Order 11 ¶¶229-232, Dockets UE-090704 and UG-090705 (April 2, 2010).

taxes in the Deferral Adjustment, but excludes them from the Plant Adjustment. Mr. Story testifies that:

The Commission may have overlooked the inconsistent logic in these two adjustments [in the prior case] as it was not discussed in testimony, which is why I am highlighting this issue in my testimony in this case. I believe it is important that the Commission not perpetuate this treatment of pro forma adjustments relating to production plant and should take another look at these adjustments in tandem, because the same issue arises in the current case in regard to the LSR adjustments.⁴¹¹

Mr. Story testifies that Staff has not explained in its testimony why it is appropriate to use CWIP costs through a date prior to the in-service date for a new resource and the estimated cost of completion for the same project in another adjustment.⁴¹²

306 *Commission Determination:* Although Staff's position is a principled one, based on the Commission's general reliance more on actual data than on forecasts when applying the known and measurable standard, the Commission has recognized previously the appropriateness of forward looking adjustments for production assets such as LSR-1.⁴¹³ Just as we allow updates for power costs during the pendency of a proceeding, even at the compliance stage, we also find it appropriate to allow PSE to

⁴¹¹ Story, Exh. No. JHS-18T at 9:17-10:3. Mr. Story discusses the impact of this treatment in the case of Wild Horse, as follows:

The Company's forecasted plant balance was \$98,431,202 through December 2009 and the Commission accepted Commission Staff's proposal to use \$90,388,143 that was closed to plant through August 2009. The actual amount closed to in-service in December 2009 was \$98,060,980. The impact on revenue deficiency for the difference between Commission Staff's estimate and the actual in-service amount was \$1,216,448. The impact on revenue deficiency for the difference between Company's estimate and the actual in-service amount was \$47,419. In effect the Company was penalized \$1.2 million so that customers would not be "overbilled" \$47 thousand.

Id. at 10:7-15.

⁴¹² *Id.* at 12:14-20.

⁴¹³ See *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-090704, *et al.*, Order 11 ¶ 23 (April 2, 2010) ("We have found this forward looking approach more appropriate when considering both power costs and production related assets.").

update the capital costs of its investment in LSR-1 with more recent available data, considering the plant's February 29, 2012, in-service date, prior to the close of the record.

- 307 It is important during this period of intensive capital investment by PSE to reflect the best available data in the Commission's rate base determinations. We caution that in the case of plant additions the best available data includes actual data available at or very close to the plant's in-service date, with sufficient detail for Staff and interested parties to review the need and prudence of such an investment during the pendency of the proceeding. We might, in a future case, find Staff's approach to be the better one if the expected in-service date of a proposed plant is not during the pendency of the case in which its addition to rate base is considered or, at least, before the effective date of rates that will recover the investment's costs, including return.
- 308 In this case, we have the benefit of an in-service date for LSR-1 (*i.e.*, February 29, 2012) that is sufficiently in advance of our determination of the issues that PSE's actual costs are known and demonstrated in this record. This is the amount of investment that should be reflected in rate base.
- 309 Similarly, as we discussed previously in our determination of the property tax adjustment, we have the benefit of knowing the actual property taxes for LSR-1 that PSE will pay during 2012 for the 2011 tax year. As in the case of property taxes generally, this is the amount that should be allowed for recovery in rates.

b. Regulatory Assets and Liabilities

- 310 Two production-related regulatory assets and liabilities adjustments are uncontested and are treated separately by all parties: Lower Snake River Transmission Deposits (*i.e.*, Adjustment 20.03) and Chelan PUD Payments (*i.e.*, Adjustment 20.09). PSE treats Lower Snake River deferred costs separately, as Adjustment 20.12. Staff includes these costs in this Adjustment 20.10 and contest the amount of the adjustment representing property tax. We discuss and determine the issue in this section of our Order. There are two other contested issues concerning PSE's regulatory assets and liabilities: