**EXHIBIT NO. ___(JAP-8T)**
**DOCKET NO. UE-121697/UG-121705**
**JOINT DECOUPLING ACCOUNTING PETITION**
**WITNESS: JON A. PILIARIS**

**BEFORE THE**
**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| **In the Matter of the Petition of**<br><br>**PUGET SOUND ENERGY, INC. and NW ENERGY COALITION**<br><br>**For an Order Authorizing PSE To Implement Electric and Natural Gas Decoupling Mechanisms and To Record Accounting Entries Associated With the Mechanisms** | **Docket No. UE-121697**<br>**Docket No. UG-121705** |

# PREFILED SUPPLEMENTAL DIRECT TESTIMONY (NONCONFIDENTIAL) OF JON A. PILIARIS ON BEHALF OF PUGET SOUND ENERGY, INC.

**MARCH 1, 2013**

**PUGET SOUND ENERGY, INC.**

**PREFILED SUPPLEMENTAL DIRECT TESTIMONY (NONCONFIDENTIAL) OF JON A. PILIARIS**

**CONTENTS**

**PUGET SOUND ENERGY, INC.**

**PREFILED SUPPLEMENTAL DIRECT TESTIMONY (NONCONFIDENTIAL) OF JON A. PILIARIS**

## I. INTRODUCTION

**Q. Are you the same Jon A. Piliaris who provided in this proceeding prefiled direct testimony, Exhibit No. ___(JAP-1T), and supporting exhibits on October 25, 2012, on behalf of Puget Sound Energy, Inc. ("PSE" or the "Company")?**

A. Yes.

**Q. What is the purpose of this supplemental direct testimony?**

A. The purpose of this supplemental direct testimony is to present proposed modifications to the joint proposal originally filed by PSE and the NW Energy Coalition ("the Coalition") on October 25, 2012, for electric and natural gas revenue decoupling mechanisms. This supplemental direct testimony presents an overview of the modified proposal being put forth in the Company's jointly-filed amended accounting petition. It also briefly revisits the features of the original decoupling proposal that have been retained in the amended petition and discusses how the remaining features of the decoupling proposal have been modified. It provides an illustration of how these new decoupling mechanisms would work in practice, as well as the proposed allowed revenue per customer over the initial term of the decoupling mechanisms. The testimony concludes with a few observations regarding how the modified decoupling proposal better meets the criteria put forth by the Washington Utilities and Transportation Commission

("Commission") in its *Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, To Encourage Utilities To Meet Or Exceed Their Conservation Targets*[1] ("Decoupling Policy Statement").

**Q. Why are the Joint Parties bringing forward these modifications to the original proposal at this time?**

A. Since the original filing of this proposal, PSE, the Coalition, and other stakeholders have been engaged in a process of formal and informal discovery, which has included two technical workshops hosted by the Commission on November 8, 2012, and January 15, 2013. Since that time, stakeholders in this process had an opportunity to gain a deeper understanding of the proposal and shared their views and concerns regarding the decoupling proposal in these informal settings. These discussions highlighted opportunities for broader agreement between PSE, the Coalition, and Commission Staff. The modifications presented in this testimony, which are also supported by Commission Staff[2] and the Coalition[3], memorialize this agreement.

**Q. Aside from Commission Staff and the Coalition, did PSE engage other stakeholders in the development of this modified proposal?**

A. Other stakeholders participated in the technical conferences that have taken place since the original filing, and they undertook discovery but otherwise were not

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[1] Docket No. U-100522 (November 4, 2010).

[2] See the Prefiled Direct Testimony of Deborah J. Reynolds, Exhibit No. ___(DJR-1T).

[3] See the Prefiled Supplemental Testimony of Ralph C. Cavanagh, Exhibit No. ___(RCC-3T).

involved in the development of this modified proposal. However, PSE anticipates engaging these other stakeholders over the coming weeks in technical conferences and stakeholder discussions with the goal of finding common ground and additional support for this proposal.

## II. OVERVIEW OF OVERALL PROPOSAL

**Q. Can you please summarize the new proposal being filed in the Company's amended petition.**

A. Yes. There are two primary components to the proposal, a rate plan for electric and gas customers, as well as a modified pair of gas and electric decoupling mechanisms. The intent of the rate plan is to afford the Company an ability to "break the current pattern of almost continuous rate cases."[4] The intent of the modified decoupling proposals is to address the concerns raised by stakeholders with the originally-filed decoupling mechanisms.

**Q. Please describe the proposed rate plan?**

A. The rate plan is a series of predetermined annual increases in authorized rates or allowed revenues intended to afford the Company the ability to avoid the need to file a general rate case over the next two to three years. This rate plan will apply to all PSE customers taking tariffed gas and electric service, including customers

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[4] *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-111048 and UG-111049, Order 98, ¶507 (May 7, 2012).

not subject to the modified decoupling mechanisms discussed below.[5]

**Q. What is the rate plan period?**

A. As part of this proposal, and subject to certain caveats, PSE intends to file its next general rate case no sooner than April 1, 2015 and no later than April 1, 2016, unless otherwise agreed to by the parties in PSE's last general rate case. This means that the rate plan period would extend at least through March 2016 and possibly through March 2017.

**Q. How does the decoupling proposal fit within this rate plan?**

A. The proposed modified decoupling mechanisms are intended to work in conjunction with the rate plan by allowing for predetermined annual increases in the allowed revenue per customers through the rate plan period. These increases will be tied to a common metric for increasing rates or allowed revenues. As discussed later in this testimony, as well as in the testimony of Ms. Katherine J. Barnard, Exhibit No.___(KJB-1T), this common metric is the K-factor.

## III. OVERVIEW OF MODIFIED DECOUPLING PROPOSAL

**Q. Have you developed a detailed description of the operation of the proposed decoupling mechanisms?**

A. Yes. The First Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-9), outlines the specific operation of the proposed electric mechanism, and the Second Exhibit to the Prefiled

[5] The rates charged to customers taking service under special contracts will continue to be governed by their contracts.

Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-10), provides the same discussion for the proposed gas decoupling mechanism.

**A. <u>Proposal Elements That Have Not Changed</u>**

**Q. Please describe the main features of the original PSE-NWEC Joint Proposal that remain.**

A. The following summarizes the significant elements of the original proposal that have been retained as part of this modified proposal.

- <u>Revenue Per Customer</u>: With one exception, which will be discussed later, the modified proposal continues to use the same basic revenue per customer approach outlined in the original proposal.[6]

- <u>K-Factor</u>: There continues to be a K-factor that increases the Company's allowed revenue per customer, over time, albeit a different one than originally proposed.

- <u>Energy Supply</u>: Electric production and gas supply costs continue to be excluded from the revenue per customer calculation.[7]

- <u>Deferral Accounting</u>: There continues to be an annual reconciliation of allowed and actual delivery revenue for the prior calendar year, with a true-up of deferrals and associated interest expense occurring over a 12-month period.[8]

- <u>Weather</u>: There continues to be no proposed adjustment of allowed delivery revenue for the effects of weather.[9]

- <u>Approved Return on Equity ("ROE")</u>: There continues to be no proposed prospective adjustment to PSE's approved ROE in Docket Nos. UE-111048 and UG-111049 (the "2011 GRC"), as

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[6] Exhibit No. ___(JAP-1T), at page 8, line 17, through page 12, line 5.

[7] *Id.*

[8] *Id.*, page 29, line 6, through page 30, line 10.

[9] *Id.*, page 36, lines 5-9.

part of the proposed decoupling mechanisms.[10]

- Conservation Achievement: As part of the modified proposal, PSE continues to offer to exceed its biennial conservation targets that are set in accordance with RCW 19.285 by 5.0 percent and voluntarily submit to the financial penalties for failing to meet this higher level of conservation achievement.[11]

- Low-Income Conservation: The modified proposal continues to increase electric low-income conservation funding by approximately $500,000 annually.[12]

- Rate Increases: Rate increases associated with the recovery of allowed delivery revenue in the modified decoupling proposal continue to be limited to 3.0 percent each year.[13]

- Third-Party Evaluation: Although slightly modified as a result of other modifications to the original proposal, this proposal continues to include a third-party evaluation of the proposed decoupling mechanism as described in the original accounting petition.

**Q. Please summarize the significant modifications to the original decoupling proposal.**

A. The following summarizes the significant modifications to the original decoupling proposal.

- Baseline Delivery Revenue Per Customer: The baseline for determining the allowed delivery revenue per customer will be based on rates approved in the Company's Expedited Rate Filing in Docket Nos. UE-130137 and UG-130138 (the "ERF").

- K-Factor Calculation: The K-factors used to annually increase allowed delivery revenue per customer in the electric and gas decoupling mechanisms will now be set at a predetermined level.

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[10] *Id.*, page 33, lines 3-20.

[11] *Id.*, page 36, line 10, through page 37, line 11.

[12] *Id.*, page 37, line 17, through page 38, line 11.

[13] *Id.*, page 39, lines 7-19.

- Allowed Delivery Revenue: The calculation of allowed delivery revenue will now include basic and minimum charge revenue.

- Initiation of Deferrals: Deferrals are now requested to commence on May 1, 2013.

- Timing of Increases to Allowed Delivery Revenue: Beginning in 2014, the modified proposal increases allowed revenue on January 1 of each year.

- Timing of Rate Increases: The modified proposal sets new rates each May 1 to recover a projection of allowed delivery revenue over the following 12-month period, as well as decoupling-related deferrals and interest accrued from the prior calendar year.

- Interest on Decoupling Deferrals: Deferrals will accrue interest at the Federal Energy Regulatory Commission ("FERC") rate of interest.[14]

- Application to Customers: In addition to the customers included in the original proposal, the modified decoupling proposal now extends the application of the gas decoupling mechanism to include all customers taking tariffed gas transportation service. Customers taking lighting, retail wheeling or gas hot water heater rental service, while not included in the decoupling mechanisms, are addressed elsewhere in this proposal.

- Duration: At a minimum, the decoupling mechanisms will now remain in effect until the effective date of rates approved in PSE's next general rate case, which will be filed no sooner than April 1, 2015, and no later than April 1, 2016, unless otherwise agreed to by the parties in PSE's last general rate case.

- Earnings Test: The modified proposal endorses an earnings test.

- Low-Income Bill Assistance: The modified proposal includes an associated increase in low-income bill assistance.

- Gas Conservation: PSE agrees to participate in the market transformation study for gas conservation that is being planned by the Northwest Energy Efficiency Alliance ("NEEA").

[14] 18 CFR 35.19a.

## B. Baseline Revenue Per Customer

**Q. Why has the modified proposal changed the baseline revenue per customer?**

A. As noted in PSE's prefiled direct testimony, the proposed decoupling mechanisms work equally well when tied to the results of a GRC or an expedited rate filing.[15] Since PSE has now filed the ERF, it is appropriate to derive the baseline revenue per customer from the results of that proceeding. In fact, as noted in the prefiled testimony, refreshing the test period has the advantage of reducing the weight put on a K-factor for PSE to recover its costs.[16]

## C. New K-Factor

**Q. How has the proposal for the K-factor changed from the original proposal?**

A. Instead of basing the calculations of the K-factor on Company-sponsored conservation not reflected in the most recent test year used to set rates, they are now set at predetermined levels. The annual K-factor adjustment for the electric decoupling mechanism is proposed to be 1.03. The annual K-factor adjustment for the gas decoupling mechanism is proposed to be 1.022.

**Q. What is the basis for these K-factors?**

A. Please see the Prefiled Direct Testimony of Ms. Katherine J. Barnard, Exhibit No. ___(KJB-1T), for the basis of these K-factors.

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[15] Exhibit No. ___(JAP-1T), page 26, lines 3-8.
[16] *Id.*, page 26, lines 8-11.

**Q. Why is the approach to deriving the K-factor now changing?**

A. The approach to deriving the K-factors is changing for several reasons. First, it became apparent during the discussions with stakeholders, particularly during the technical workshops, that there was reluctance to deriving the K-factors based on reported conservation achievement. Second, as also discussed in the technical conferences, concerns were raised that the original K-factor did not sufficiently eliminate the Company's throughput incentive. Fixing the K-factor at a predetermined level addresses these concerns. Third, the scope of this decoupling proposal has been expanded to include a general rate case stay-out period of between two to three years.[17] As discussed in Ms. Barnard's direct testimony, the proposed K-factors make this possible.

**Q. Does the new K-factor conform with industry-accepted practice for revenue decoupling?**

A. Yes. The new formulation of the K-factor follows very closely with the description of a K-factor provided in Section 5.4 of *Revenue Regulation and Decoupling: A Guide to Theory and Application*, published in June 2011 by the Regulatory Assistance Project ("RAP Manual"). Section 5.4 of the RAP Manual describes the K-factor as "an adjustment used to increase or decrease overall growth in revenues between rate cases." It goes on to note that "a successful

[17] The Company retains the right to file for interim rate relief under the standard set forth in *WUTC v. Pacific Northwest Bell Telephone Company*, Cause No. U-72-30. The Company also retains the right to file for revenue-neutral rate design changes to existing rate schedules and to file rate schedules for new products and/or services to accommodate the evolving needs of its electric and gas customers.

revenue [K-factor] function would be one that keeps the utility's actual revenue collection as close as possible to its actual cost of service throughout the period between rate cases." As discussed in the Prefiled Direct Testimony of Katherine J. Barnard, Exhibit No.___(KJB-1T), this aligns well with the intent of the K-factor in this case. In application, the RAP Manual suggests that the K-factor could be used "as an adjustment to the RPC allowed revenue determination." As discussed elsewhere in this testimony, as well as the associated exhibits, this is how the K-factor is being applied in this modified proposal (i.e., to allowed revenue per customer).

**D. Allowed Delivery Revenue Per Customer**

**Q. How has the calculation of allowed delivery revenue per customer changed in the modified proposal?**

A. In contrast to the original decoupling proposal, the calculation of allowed delivery revenue per customer now includes revenue from basic and minimum charges.

**Q. Why was this change made to this calculation?**

A. In the original decoupling proposal, the application of the K-factor was intended to address the effects of conservation on PSE's ability to recover its fixed costs through volumetric charges. As part of the modified proposal, the K-factor is now meant to address the Company's cost recovery more broadly. A component of the Company's growth in costs includes cost categories recovered through basic and minimum charges. Therefore, it is appropriate to extend the application of the K-factor to also recover these growing costs.

**Q. Please illustrate the new calculations of allowed revenue per customer.**

A. The tables that follow conceptually illustrate these modified calculations.

**Table 1 – Calculation of Electric Annual Allowed Volumetric Delivery Revenue Per Customer ("RPC")**

| | |
|---|---|
| | Pro forma Test Year Total Revenue |
| − | PCA Costs |
| = | Test Year Allowed Delivery Revenue |
| ÷ | Number of Customers |
| = | Test Year Allowed Delivery RPC |
| X | K-Factor |
| = | K-factor Adjusted Allowed Delivery RPC |
| − | Test Year Basic and Minimum Charge RPC |
| = | Annual Allowed Volumetric Delivery RPC |

**Table 2 – Calculation of Natural Gas Annual Allowed Volumetric Delivery Revenue Per Customer**

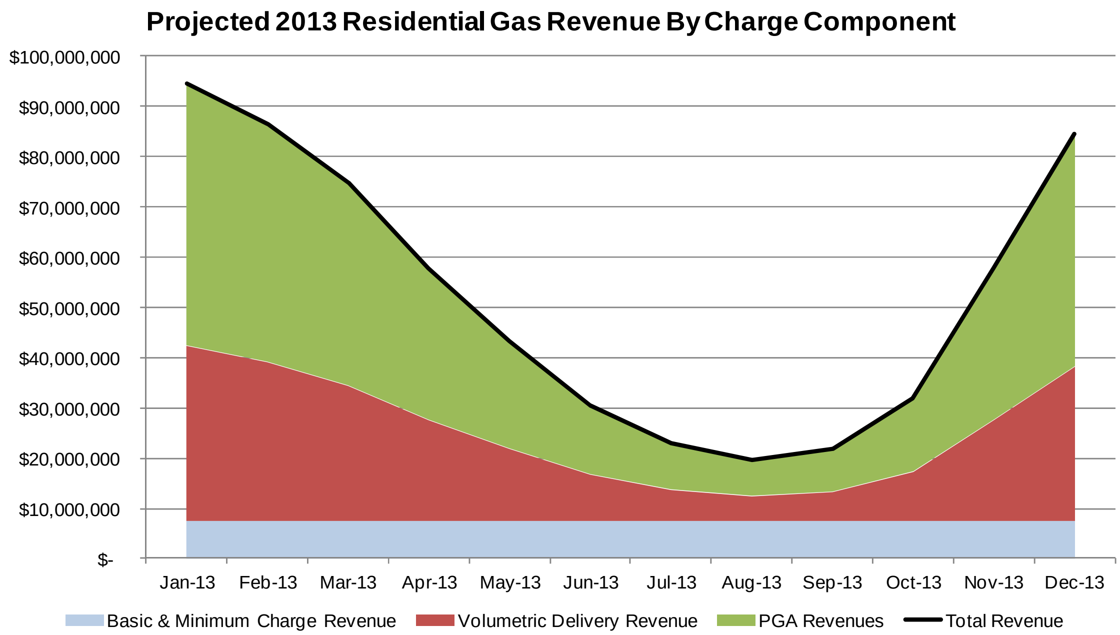
| | |
|---|---|
| | Pro forma Test Year Margin Revenue |
| ÷ | Number of Customers |
| = | Test Year Allowed Delivery RPC |
| X | K-Factor |
| = | K-Factor Adjusted Annual Allowed Delivery RPC |
| − | Test Year Basic and Minimum Charge RPC |
| = | Annual Allowed Volumetric Delivery RPC |

**Q. Why is basic and minimum charge revenue included in the allowed delivered revenue calculation?**

A. As noted earlier, one part of the Company's allowed revenue increase is related to increases in costs recovered through basic and minimum charges. However, as part of the modified proposal, basic and minimum charges will not be changed as part of decoupling-related rate adjustments. Therefore, the incremental basic and minimum charge revenue needs to be factored into the allowed revenue calculations so that it can be recovered through future increases in the other rate components, primarily energy and demand charges.

**Q. Why was the basic and minimum charge RPC subsequently excluded from the Annual Allowed Volumetric Delivery RPC?**

**A.** One intent of decoupling is to decouple revenue from sales. This is already accomplished by the basic and minimum charges, which are charged on a fixed monthly basis irrespective of energy sales. Moreover, as discussed later in this testimony, the Annual Allowed Volumetric Delivery RPC is proposed to be shaped across months in proportion to test year energy sales to minimize the deferrals created when comparing allowed revenue to actual revenue. If basic and minimum charges were left in the calculation of Annual Allowed Volumetric Delivery RPC, revenue from basic and minimum charges would also be shaped to test year energy sales. This would be counterproductive to the intent of minimizing deferrals, since "allowed" basic and minimum charge revenue would have a seasonal shape whereas the actual basic and minimum charge revenue would be relatively flat. This is illustrated in the graph below, where monthly basic charge revenue is shown to be much more stable than the delivery revenue that is derived volumetrically.




**E. <u>Timing of K-Factor Increases</u>**

**Q. Please explain how the modified proposal changes the timing of increases to allowed delivery revenue per customer.**

A. In the original decoupling proposal, allowed delivery revenue per customer was reset each May 1, following the determination of the new K-factors. In the modified proposal, since the K-factor is pre-determined, allowed delivery revenue per customer can be reset beginning May 1, 2013, when deferrals are requested to begin, and each January 1 thereafter. The K-factor is applied to the allowed delivery revenue each January 1 until the rates from PSE's next general rate case go into effect.

**Q. Why was the timing of the increases in allowed delivery revenue per customer moved to January 1?**

A. PSE's ERF proposal relies on end-of-period results for the 12-months ending June 30, 2012, for setting new rates. To mitigate the lag in cost recovery beyond this period, allowed revenues are proposed to increase each January 1 to improve the matching of revenues and costs each calendar year.

## F. Timing of Rate Increases

**Q. Please explain how the modified proposal changes the timing of rate increases.**

A. The original decoupling proposal deferred differences between actual delivery revenue, tied to volumetric rates, and allowed delivery revenue, tied to allowed delivery revenue per customers. Rates were then proposed to change, beginning on May 1, to reflect the deferred revenue accrued through the end of the prior calendar year. In effect, this created a 16-month lag in the cash recovery of deferred revenue accrued over each calendar year.

The modified proposal sets new rates each May 1 to recover a projection of allowed delivery revenue over the following 12-month period, as well as decoupling-related deferrals and interest expense accrued over the prior calendar year. Assuming perfect foresight, this approach significantly reduces the lag in the cash recovery of allowed revenue to the deferrals accrued between the time new allowed delivery revenue per customer goes into effect (January 1) and the time new rates go into effect (May 1).

**Q. Should there be concerns with the use of projections to set rates each May 1?**

A. No. Any deviations between the projections used to set new rates and the actual results will be trued up in the following year. Ultimately, PSE will be limited to no more or less than the delivery revenue per customer allowed by the Commission. The use of projections simply allows the Company to minimize the anticipated deferrals. This approach has been used successfully in PSE's Purchased Gas Adjustment ("PGA") mechanism and electric and gas Conservation Schedule 120, which also recover a projection of costs, subject to true-up.

**Q. Are there other reasons why the timing of rate increases moved up?**

A. Yes. During the discussions of the original proposal with various stakeholders, concerns were raised regarding the interest rate used in association with the decoupling deferrals. This modified proposal equitably addresses these concerns. The Company is willing to accept a lower interest rate in exchange for significantly closing the gap between the timing of the recognition and recovery of allowed revenue.

**Q. Does this affect the procedural schedule for this mechanism?**

A. No. PSE will continue to make filings no later than April 1 of each year to set the new tariff Schedule 139 rates, with effective dates of May 1 of each year.

## G. Interest on Deferrals

**Q. Please describe how the proposal has been changed regarding interest on decoupling deferrals.**

A. Instead of using PSE's after-tax rate of return grossed up for taxes, the modified proposal uses the FERC interest rate, which is currently 3.25 percent.[18]

**Q. Why was this change made?**

A. As mentioned previously, a better matching between the recognition and recovery of allowed revenue warrants a lower rate of interest. The FERC interest rate is also used for PSE's PGA mechanism, which recovers a projection of gas supply costs, and its Power Cost Adjustment ("PCA") mechanism, which recovers a projection of power supply costs.

## H. Application to Customers

**Q. To which customers do the modified decoupling proposals apply?**

A. Two groups of electric rate schedules in the current tariff book are subject to the modified electric decoupling mechanism. The first group is comprised solely of residential customers (Schedules 7 and 7A). The second group is comprised of non-residential customers served under Schedules 24, 25, 26, 29, 31, 35, 40, 43, 46 and 49, as well as the 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

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[18] Federal Energy Regulatory Commission, *Interest Rates* (available at http://www.ferc.gov/legal/acct-matts/interest-rates.asp).

Wheeling customers are excluded from the decoupling mechanism proposal, but are included in the broader rate plan.

Two groups of natural gas rate schedules in the current tariff book are subject to the modified gas decoupling proposal. The first group is comprised solely of residential customers (Schedules 23 and 53). The second group is comprised of non-residential customers served under Schedules 31, 41, 85, 86 and 87, including customers taking tariffed gas transportation service. Gas water heater rental and gas lighting customers are excluded from the decoupling mechanism proposal, but are included in the broader rate plan.

**Q. Why are customers taking lighting, retail wheeling and gas hot water rental service excluded from the proposed decoupling mechanisms?**

A. In the case of PSE customers taking lighting or gas hot water rental service, these customers are excluded from the proposed decoupling mechanisms because all of their revenues is received from fixed charges (i.e., their rates are already decoupled from energy sales). In the case of customers taking retail wheeling service, a vast majority of their cost of service is being recovered through PSE's Open Access Transmission Tariff. The remainder is substantially made up of fixed basic charge revenues and a small amount of revenue derived from the Distribution Service charge.

**Q. Do any PSE customers continue to be excluded from this mechanism?**

A. Yes. PSE's gas customers served under special contract are excluded from this mechanism, as the rates for these customers are governed by contract. This is consistent with the treatment of these customers in PSE's previous general rate cases.

**Q. Has the modified decoupling proposal changed how a "customer" is being defined?**

A. No. However, the source of this information will now be the customer counts reported to the Commission in PSE's Quarterly Results of Operations.

## I. Duration of Mechanisms

**Q. Has the proposed duration of the decoupling mechanisms changed?**

A. Yes. The original proposal was that the decoupling mechanisms remain in effect for no less than five years.[19] Under the modified proposal, the decoupling mechanisms will initially remain in effect until new rates from PSE's next general rate case go into effect, which will be made no sooner than April 1, 2015, and no later than April 1, 2016, unless otherwise agreed to by the parties in PSE's last general rate case. This shortens the initial length of this mechanism by one to two years.

**Q. Can the decoupling mechanisms continue to operate beyond PSE's next general rate case?**

A. Yes. PSE contemplates that these mechanisms can continue to operate upon request for its continuation within PSE's next general rate case, subject to approval by the Commission.

[19] Exhibit No. ___(JAP-1T), page 39, lines 1-3.

**Q. What will happen to the remaining decoupling deferrals if the mechanisms are discontinued?**

A. If either or both mechanisms are discontinued, the amounts remaining in the balancing accounts will continue to be amortized in the same manner as proposed in this testimony, subject to the cap on rate increases and the earnings test, until the balances are cleared.

## J. <u>Earnings Test</u>

**Q. Please describe the earnings test associated with the modified decoupling proposal.**

A. The modified proposal endorses an earnings test, where the Company is allowed to earn up to twenty-five (25) basis points above its overall rate of return on rate base before rebating to customers fifty (50) percent of the earnings in excess of this level. This test would be applied independently for PSE's electric and gas operations to mitigate potential risk of cross-subsidization between electric and gas customers from operation of the decoupling mechanisms.

**Q. Why is an earnings test being proposed as part of the modified proposal?**

A. The modified proposal, particularly with the more prominent K-factor, represents a change to the original proposal. To allay concerns that the Company will greatly exceed its rate of return, the earnings test provides an appropriate safeguard to customers.

**Q. What information source will be used to conduct the earnings test?**

A. The earnings test will be based on normalized and restated return on rate base in PSE's electric and gas Commission-basis reports.

**Q. Have you created an example of how this earnings test will be calculated?**

A. Yes. Please see the Fifth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-13), for an example of the earnings test calculation.

## K. Evaluation of Mechanism

**Q. Please describe the modifications made to the original proposal with respect to the evaluation of the decoupling mechanism.**

A. There are four minor modifications to the original proposal for the evaluation. First, due to the shortened duration of the proposed mechanisms, the evaluation will be submitted as part of the Company's next general rate case. Second, funding for this evaluation will be recovered through general rates, rather than through revenues received under PSE's Schedule 120 Conservation riders. Third, the cost of this evaluation will be limited to $150,000. Finally, the evaluation of whether the K-factor has been calculated correctly has been removed, as it will be predetermined as part of the approval of the mechanisms.

## IV. TREATMENT OF RATE PLAN CUSTOMERS

**Q. How does this rate plan proposal adjust rates for gas lighting and water heater customers?**

A. The proposal for gas lighting and water heaters is to increase their fixed monthly charges by the gas K-factor of 1.022 each time it is applied to the allowed revenues from other gas customers. The calculation of the rate surcharges for gas lighting and water heater service is provided in the Third Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-11).

**Q. How does this proposal adjust rates for electric lighting customers?**

A. Similar to the gas water heater customers, the fixed monthly electric rates of electric lighting customers are proposed to increase each time the electric K-factor is applied to the allowed revenues of other electric customers. Since these customers take power supply, as well as delivery service, the adjustment to their monthly rates is proposed to be the annual electric K-factor increase multiplied by the ratio of these customers' non-power cost revenue divided by their total pro forma revenue. The calculation of the rate surcharges for lighting service is provided in the Fourth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-12).

**Q. How does this proposal treat customers served under electric retail wheeling Schedules 449 and 459?**

A. To ensure that these customers also contribute to PSE's growing costs over the proposed general rate case stay-out period, the proposal is to surcharge the

Schedule 449 and 459 basic charge and Distribution Service rates by the electric K-factor increase each time it is applied to the allowed revenue of other electric customers. Along with electric lighting, these calculations are shown in the Fourth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-12).

## V. RESULTS OF MODIFIED PROPOSAL

### A. Proposed Allowed Volumetric Delivery Revenue Per Customer

**Q. Based on the approach described above, have you derived the proposed Annual Allowed Volumetric Delivery Revenue Per Customer over the years in which these mechanisms could operate?**

A. Yes. Table 3 below shows the results for electric customers between 2013 and 2017. Table 4 below shows the results for gas customers between 2013 and 2017.

**Table 3 – Annual Allowed Electric Volumetric Delivery RPC**

| Effective Date | Residential | Non-Residential |
|---|---|---|
| May 1, 2013 | $303.37 | $1,791.41 |
| January 1, 2014 | $315.38 | $1,852.79 |
| January 1, 2015 | $327.75 | $1,916.01 |
| January 1, 2016 | $340.49 | $1,981.13 |
| January 1, 2017 | $353.62 | $2,048.20 |

**Table 4 - Annual Allowed Gas Volumetric Delivery RPC**

| Effective Date | Residential | Non-Residential |
|---|---|---|
| May 1, 2013 | $298.56 | $1,638.73 |
| January 1, 2014 | $307.89 | $1,687.08 |
| January 1, 2015 | $317.43 | $1,736.50 |
| January 1, 2016 | $327.18 | $1,787.01 |
| January 1, 2017 | $337.14 | $1,838.63 |

Please see the Sixth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-14), for the derivation of these figures for each electric rate group. Please see the Seventh Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-15), for the derivation of these figures for each gas rate group.

**Q. How will Monthly Allowed Delivery Revenue Per Customer be calculated?**

A. The Annual Allowed Volumetric Delivery Revenue Per Customer will be shaped by month based on the weather-normalized electric and gas sales used in PSE's ERF proceeding for the period ending June 30, 2012. These calculations are shown in the Eighth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-16), for the electric mechanism and the Ninth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-17), for the gas mechanism.

**B. Proposed Schedule 139 Rate**

**Q. Have you calculated the initial rates for electric Schedule 139 that recover allowed delivery revenue beginning in 2013?**

A. Yes. Please see the Tenth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-18), at page 1, for this calculation. As shown on line 28, the initial Schedule 139 rate for electric customers will be $0.001631 per kWh. The initial Schedule 139 rate for non-residential customers will be $0.000338 per kWh.

**Q. Please describe the calculation of electric Schedule 139 rates.**

A. There are three primary steps in the calculation of electric Schedule 139 rates on page 1 of Exhibit No.___(JAP-18). First, the Test Year Delivery Revenue Per Unit ("RPU") is calculated by dividing Test Year Volumetric Delivery Revenue by Test Year Base Revenue. Next, Rate Year Delivery RPU is calculated by first projecting the allowed revenue in the rate year and adjusting for the prior year's deferrals. Schedule 139 rates are then calculated, subject to the three percent rate cap, as Rate Year Delivery RPU minus Test Year RPU. These calculations are performed separately for each rate group.

**Q. How are the proposed electric Schedule 139 rates tested against the three percent rate cap?**

A. This calculation is provided on page 2 of Exhibit No. ___(JAP-18). In simple terms, these calculations first determine an average rate per kWh for each rate group. This average rate includes the cost of energy supply and the then-current

Schedule 139 rates. The incremental change in rates due to proposed Schedule 139 rates are then divided by the previously-calculated average rate to determine the percentage change in rates. The proposed Schedule 139 rates for each rate group are revised downward to the extent that this test exceeds the three percent threshold. Otherwise, they remain as proposed.

**Q. What happens to the deferred balances that remain if the three-percent rate cap test limits the level of the proposed Schedule 139 rates?**

A. These balances will remain in the balancing accounts for recovery in a future rate period.

**Q. Have you calculated the initial rates for gas Schedule 139 in 2013?**

A. Yes. Please see the Eleventh Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-19), at page 1, for this calculation. As shown in line 28, the initial Schedule 139 rate is $0.02106 per therm for residential gas customers. Rates for non-residential customers are listed on page 3. On average, non-residential gas customers will see an initial average rate decrease of $0.00225 per therm as a result of Schedule 139. This is shown in column (d) of line 28 on page 1 of Exhibit No. ___(JAP-19).

**Q. Please describe the calculation of gas Schedule 139 rates.**

A. For residential gas customers, the calculation of gas Schedule 139 rates on page 1 of Exhibit No. ___(JAP-19) and the rate test on page 2 of Exhibit No. ___(JAP-19) are virtually identical to the calculations for residential electric customers. However, there are additional steps involved with spreading the rate change across non-residential gas customers. To calculate the Schedule 139 rates for non-residential gas customers, the change in the Delivery RPU between the rate year and test year is first multiplied by Rate Year Base Sales. This amount is then divided by Rate Year Volumetric Delivery Revenue to calculate the percentage change to the Rate Year Delivery RPU that should result from application of the Schedule 139 rates for non-residential gas customers. This percentage is then applied to the demand, delivery and procurement charges[20] listed in column (d) of page 3 of Exhibit No. ___(JAP-19) to determine the Schedule 139-related rate changes in column (g). The resulting Schedule 139 rates are shown in column (k).

**Q. Why was this more detailed approach used to calculate Schedule 139 rates for non-residential gas customers?**

A. Non-residential gas customers on several rate schedules face block rates which can have steeply declining slopes. The tail block rates in some non-residential gas rate schedules are so low that use of a blended Schedule 139 rate could produce more significant rate impacts to customers facing these rate structures. Therefore, to maintain a greater measure of equity among non-residential gas customers, this more detailed approach was used.

**Q. Have you prepared examples of the proposed Schedule 139 tariff sheets for electric and gas service based upon the approach you describe above?**

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[20] Volumetric delivery revenue for non-residential gas customers are derived from these three charges.

A. Yes. Please see the Twelfth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-20), for the proposed electric tariff Schedule 139. Please see the Thirteenth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-21), for the proposed gas tariff Schedule 139.

## C. Estimated Rate Impacts

**Q. Have you provided an illustration of how these mechanisms would work over time?**

A. Yes. Please see the Fourteenth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-22), for an illustration of how the mechanism would work for electric customers over time, and please see the Fifteenth Exhibit to the Prefiled Supplemental Direct Testimony of Mr. Jon A. Piliaris, Exhibit No. ___(JAP-23), for an illustration of how the mechanism would work for gas customers over time. On pages 1 and 2 of Exhibit No. ___(JAP-22), the monthly deferrals, associated interest expense, Schedule 139 rate revenue and associated rate impacts are projected for residential and non-residential electric customers, respectively, in 2013. Page 3 of Exhibit No. ___(JAP-22) provides an estimated calculation of the Schedule 139 rates for the next rate year beginning May 1, 2014 based on the same approach described above for Exhibit No. ___(JAP-18), but using PSE's current load and customer forecasts. Page 4 of Exhibit No.___(JAP-22) provides an example of the rate test for that rate year. Pages 5 and 6 of Exhibit No. ___(JAP-22) show information for 2014 similar to that provided for 2013 in pages 1 and 2 of Exhibit No. ___(JAP-22). Pages 7, 8, 9 and 10 of Exhibit No. ___(JAP-22) forecasts Schedule 139 rates, rate tests, deferrals and impacts an additional year into the future. Similar calculations are presented for gas customers in Exhibit No. ___(JAP-23), except that there are additional sheets showing the calculation of Schedule 139 rates for non-residential customers in future rate years.

**Q. Based on the assumptions used to derive the projected Schedule 139 rates, what are the initial revenue and rate impacts to electric customers?**

A. The initial average Schedule 139 revenue and rate impacts for electric customers are summarized in the table below.

**Table 5 – Summary of Average Schedule 139-Related Electric Revenue and Rate Impacts**

| Customer Class | Rate Schedule | Annual Schedule 139 Revenue ($M) | Average Rate Impact |
|---|---|---|---|
| Residential | 7 | $17.3 | 1.6% |
| General Service, < 51 kW | 24 | 0.9 | 0.3% |
| General Service, 51 – 350 kW | 25 | 1.0 | 0.4% |
| General Service, >350 kW | 26 | 0.7 | 0.4% |
| Primary Service | 31/35/43 | 0.5 | 0.4% |
| Campus Rate | 40 | 0.3 | 0.5% |
| High Voltage | 46/49 | 0.2 | 0.5% |
| Lighting Service | 51 - 59 | 0.4 | 2.1% |
| Choice/Retail Wheeling | 448/449 | 0.03 | 0.3% |
| **System Total / Average** | | **$21.2** | **1.0%** |

Based on this proposal, a residential electric customer using 1,000 kWh per month would experience an increase of $1.63 per month.

**Q. Based on the assumptions used to derive the projected Schedule 139 rates, what are the initial revenue and rate impacts to gas customers?**

A. The initial average Schedule 139 revenue and rate impacts for gas customers are summarized in the table below.

**Table 6 – Summary of Average Schedule 139-Related Gas Revenue and Rate Impacts**

| Customer Class | Rate Schedule | Annual Schedule 139 Revenue ($M) | Average Rate Impact |
|---|---|---|---|
| Residential | 16/23/53 | $11.8 | 1.8% |
| Commercial & Industrial | 31/31T | (0.8) | (0.4)% |
| Large Volume | 41/41T | (0.2) | (0.3)% |
| Interruptible | 85/85T | (0.1) | (0.5)% |
| Limited Interruptible | 86/86T | (0.03) | (0.3)% |
| Non-Exclusive Interruptible | 87/87T | (0.1) | (0.3)% |
| Rentals | 71/72/74 | 0.2 | 2.2% |
| **System Total / Average** | | **$10.8** | **1.1%** |

Based on this proposal, a residential gas customer using 68 therms per month would experience an increase of $1.43 per month.

## VI. ALIGNMENT OF MODIFIED DECOUPLING PROPOSAL WITH COMMISSION'S DECOUPLING POLICY STATEMENT

**Q. What were the requirements and criteria in the Decoupling Policy Statement upon which the Commission would consider a full decoupling mechanism?**

A. The Commission identified the following requirements and criteria in the Decoupling Policy Statement upon which the Commission would consider a full decoupling mechanism:

1. A description of the decoupling true-up mechanism;
2. The impact of the mechanism on rate of return;
3. The earnings test proposed in association with the mechanism;
4. The accounting of off-system sales and avoided costs in association with the mechanism;
5. The applicability of the mechanism to customer classes;
6. The effects of weather in the mechanism;
7. Evidence of incremental conservation associated with the mechanism;
8. Effect of mechanism on low-income customers;
9. The proposed duration of the mechanism;
10. An evaluation report on the mechanism; and
11. Other factors impacting the public interest.

**Q. Does the modified decoupling proposal address the criteria listed above?**

A. Yes. All of these criteria were addressed in PSE's prefiled direct testimony in this proceeding in the context of the original proposal.[21] The proposal outlined in this testimony simply modifies or expands on the original proposal.

**Q. Did PSE work with Commission Staff and the Coalition to ensure that the modified decoupling proposal continued to address these criteria?**

A. Yes. In fact, these discussions yielded several improvements for meeting these criteria relative to the original decoupling proposal.

[21] Exhibit No. ___(JAP-1T), pages 32-39.

**Q. How does the modified decoupling proposal better meet these criteria than the original proposal?**

A. There is more protection for low-income customers, potentially more gas conservation as a result of the modified proposal and the modified proposal better addresses the issue of throughput.

**Q. How are low-income customers better- protected by the modified decoupling proposals?**

A. To mitigate concerns about the impact of this modified decoupling proposal on low-income customers, PSE proposes that low-income bill assistance program funding be increased on August 31, 2013, and each August 31 thereafter, until the decoupling mechanism ceases operation. PSE also recommends that these increases in funding be tied to the percentage bill impacts to residential electric and gas customers that result from the Schedule 139 rate changes discussed earlier in this testimony.

**Q. How might the modified decoupling proposal promote additional gas conservation savings?**

A. NEEA has been soliciting interest for participation in a market transformation study for gas conservation within the region. As part of the modified decoupling proposal, PSE promises to be a participant in that study. While it is too early to tell what incremental gas conservation may result from this effort, it is further evidence of the Company's commitment to all forms of energy efficiency.

**Q. How does the modified decoupling proposal better address PSE's throughput incentive?**

A. As noted earlier in this testimony, the original decoupling proposal was criticized for not sufficiently eliminating the Company's throughput incentive. This was due to the fact that the "base" year for determining allowed revenue rolled forward each year so that throughput increases in one year would eventually result in an increase in allowed revenue to the Company in later years. Under the modified decoupling proposal, the "base" year is fixed at the test period used for PSE's ERF filing. Therefore, changes in throughput will have no effect on the base year used to determine allowed revenue.

## VII. CONCLUSION

**Q. Does this conclude your prefiled supplemental direct testimony?**

A. Yes.