

Exhibit No. ____ (EJK-1T)
Docket U-101217
Witness: Edward J. Keating
REDACTED VERSION

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION**

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

DOCKET U-101217

For a Declaratory Order Regarding the
Transfer of Assets to Jefferson County
Public Utility District.

TESTIMONY OF

Edward J. Keating

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

December 21, 2010

**CONFIDENTIAL PER PROTECTIVE ORDER
REDACTED VERSION**

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1 **I. INTRODUCTION AND SCOPE OF TESTIMONY**

2

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

4 A. My name is Edward J. Keating. My business address is the Richard Hemstad
5 Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia,
6 Washington, 98504. My e-mail address is ekeating@utc.wa.gov.

7

8 **Q. By whom are you employed and in what capacity?**

9 A. I am employed by the Washington Utilities and Transportation Commission
10 ("Commission") as a Regulatory Analyst.

11

12 **Q. Would you please state your educational and professional background?**

13 A. In May 2006, I graduated from Saint Martin's University in Lacey, Washington with
14 a Bachelor of Arts degree in Accounting.

15 I began my employment at the Commission in February 2009. During my
16 employment at the Commission, I have performed accounting and financial analysis
17 of regulated utility companies and presented Staff recommendations at open
18 meetings.

19 My experience prior to joining the Commission consisted of 10 years in
20 management, accounting, auditing and banking.

1 **Q. What is the purpose of your testimony in this proceeding?**

2 A. My testimony supports the multi-party Settlement Stipulation, filed December 15,
3 2010, by Puget Sound Energy, Inc. (“PSE” or “Company”), Staff and Public Utility
4 District #1 of Jefferson County (“JPUD”). That Settlement Stipulation requests that
5 the Commission issue an order declaring that:

- 6 1. The transfer of Assets from Puget Sound Energy, Inc. to Public Utility
7 District #1 of Jefferson County is authorized by RCW 80.12.020(2) and no
8 further action is required by the Commission to approve the transfer of the
9 Assets for purposes of RCW 80.12.020;
- 10
- 11 2. The purchase price of \$103 million is fair, reasonable and sufficient; and
12
- 13 3. The provisions of the Asset Purchase Agreement regarding transition of
14 PSE’s responsibilities to provide electrical service to its customers in the
15 Service Territory are sufficient and consistent with PSE’s public service
16 obligations.

17
18 Items 1 and 3 are primarily legal issues and will be addressed separately by Staff
19 Counsel in a Memorandum of Commission Staff in Support of Settlement
20 Stipulation. My testimony focuses on item 2 and explains why, under the particular
21 circumstances of this case, Staff recommends that the Commission issue this
22 requested declaration. I also confirm testimony from Company witness Karl
23 Karzmar that the assets being sold are necessary only to serve PSE’s existing
24 customers within Jefferson County.

25

26 **II. DISCUSSION**

27

28 **Q. Please summarize the factual events underlying the sale of PSE’s assets in**
29 **Jefferson County to JPUD.**

1 A. In November 2008, the citizens of Jefferson County voted to approve Proposition 1,
2 authorizing JPUD to construct or acquire electrical facilities for the generation,
3 transmission or distribution of electric power in Jefferson County. Prior to the
4 approval of Proposition 1, outside consultants were hired by both PSE and JPUD to
5 conduct feasibility studies to determine the potential costs and risks associated with
6 JPUD acquiring the assets of PSE in Jefferson County (“Jefferson County Assets”)
7 and providing electric service to the residents of East Jefferson County (“Service
8 Territory”). These consultants derived a wide range of values for the Jefferson
9 County Assets using a variety of analytical approaches.

10 In June 2009, outside counsel was retained by JPUD to assist in the
11 acquisition, by purchase or by condemnation, of the Jefferson County Assets. In
12 July 2009, settlement negotiations commenced between PSE and JPUD and
13 additional appraisals were performed. PSE entered these settlement negotiations as
14 an “unwilling seller” under the threat of condemnation by JPUD.¹

15 On April 30, 2010 a tentative agreement was reached for the sale of the
16 Jefferson County Assets and a Letter of Intent (“LOI”) was signed. On June 11,
17 2010 an Asset Purchase Agreement (“APA”) was entered by PSE and JPUD. The
18 purchase price for the Jefferson County Assets is \$103 million. PSE states that this
19 purchase price constituted JPUD’s last and best offer.²

20 The APA contains provisions related to the provision of electrical service
21 from PSE to JPUD prior to closing. The sale of the Jefferson County Assets must
22 close within 18 and 36 months from the date the APA was entered.

¹ Exh. No. KRK-1CT at 3:19-20.

² Exh. No. KRK-1CT at 5:10-11.

1 Finally, as a condition precedent to closing, the APA requires an order from
2 the Commission confirming that: (a) the purchase price is sufficient to fully
3 compensate PSE's customers for the sale of the Assets, (b) the provisions of the APA
4 pertaining to PSE's transition of its responsibilities to provide electrical service to its
5 customers in the Service Territory are sufficient and consistent with PSE's public
6 service obligations; and (c) the transfer of the assets is authorized by RCW
7 80.12.020(2).³ The Company sought to acquire these declarations on July 15, 2010
8 by filing with the Commission a Petition for Declaratory Order Regarding the
9 Transfer of Assets to Jefferson County Public Utility District.

10
11 **A. The Purchase Price of \$103 Million for the Sale of the Jefferson County Assets**
12 **is Fair, Reasonable, and Sufficient**

13
14
15 **Q. The Settlement Stipulation asks the Commission to issue an order declaring that**
16 **the \$103 million purchase price for the Jefferson County Assets is fair,**
17 **reasonable and sufficient. Please explain what is meant by a “fair, reasonable**
18 **and sufficient” purchase price.**

19 A. For the purposes of the Settlement Stipulation, \$103 million is a “fair” and
20 “reasonable” purchase price because it is a price that might be reasonably expected
21 to result between a willing buyer and a willing seller, *i.e.*, a fair market value. \$103
22 million is a “sufficient” price because it appears to be the maximum PSE was able to
23 obtain in this transaction under the threat of condemnation by JPUD. Thus, \$103
24 million is the maximum amount that could be recovered for ratepayers after the

³ PSE clarified at hearing that this final declaration means the transfer of assets from PSE to JPUD does not require Commission approval under RCW 80.12.020(1). Tr. 8:23-25.

1 transaction closes. The term “sufficient” does not address whether or not the \$103
2 million purchase price fully recovers PSE’s investment in the Jefferson County
3 Assets.

4
5 **Q. Please summarize why the \$103 million purchase price for Jefferson County**
6 **Assets is fair, reasonable and sufficient.**

7 A. Staff reviewed a number of appraisals prepared by PSE and JPUD for the Jefferson
8 County Assets, as described in Mr. Karzmar’s direct testimony. These appraisals
9 ranged from [REDACTED] million at the low end to [REDACTED] million at the high end. Staff
10 does not necessarily agree with any one of these appraisals. However, taken
11 together, they lend support for the \$103 million purchase price.

12 Staff also independently analyzed the transaction using the following
13 approaches:

- 14 • **Comparable Forced Sales:** Staff compared recent “takeovers” in the
15 Northwest to the sale of the Jefferson County Assets. While not a direct
16 match, the 2001 purchase of PacifiCorp assets by the City of Hermiston,
17 Oregon was examined. There, PacifiCorp was an unwilling seller, yet
18 eventually agreed to a final price, just as PSE has done. Measuring nominal
19 purchase prices between the two transactions is not a valid comparison.
20 Staff, therefore, used price to book multiples as a basis of comparison.

21 The City of Hermiston’s purchase of PacifiCorp’s assets realized an
22 amount in excess of two times PacifiCorp’s net book value of the purchased

1 assets.⁴ The price to book multiple for the purchase of PSE's Jefferson
2 County Assets exceeds two times (approximately 2.14) using the net book
3 value of the assets at the time the APA was entered (\$48.2 million) and the
4 purchase price of \$103 million.

- 5 • **Market Sales:** Staff also examined the price to book multiple that
6 Macquarie paid for PSE in the recent acquisition, along with the stock prices
7 of a select group of publicly traded utilities in the Northwest, including
8 Avista Corporation, MDU Resources Group, Inc., Northwest Natural Gas,
9 IdaCorp, Inc., and Portland General Electric Company. Although none of
10 these companies are identical to PSE in size or composition of assets, their
11 stock prices indicate what investors are willing to pay for a Northwest utility
12 in daily market transactions. Staff calculated a high and low price to book
13 multiple for each company, along with an average for the group over a one
14 year period beginning September 30, 2009 and ending September 30, 2010.
15 The average price to book multiple for all of the companies throughout the
16 year was 1.25. Macquarie paid 1.5 times book to acquire PSE. In
17 comparison, PSE is expected to receive approximately 2.14 times book value
18 for the sale of the Jefferson County Assets. That is reasonable given the
19 premiums generally paid for mergers or acquisitions and the improvements in
20 the financial markets over the last two years.

21 As with the comparable forced sales described above, the market sales
22 approach is not the perfect methodology for valuing the Jefferson County

⁴ *In the Matter of the Application of PacifiCorp for Approval of the Sale and Transfer of Electric Properties and Transfer of Service Territory to the City of Hermiston*, 2001 WL 1335742 (Or.P.U.C.).

1 Assets. However, observations of market transactions within a select
2 industry group can be used in conjunction with other inputs in determining
3 whether a fair, reasonable and sufficient market price was achieved by PSE
4 for the sale of its Jefferson County Assets.

- 5 • **Tax Assessed Value:** This methodology was the final approach Staff
6 reviewed. The latest assessed valuation by the Washington State Department
7 of Revenue (“DOR”) for the Jefferson County Assets was approximately \$23
8 million for the Service Territory for 2009. 2010 valuations are not yet
9 available.

10 The tax assessed value was derived by DOR using three approaches:
11 cost, income and market. The cost and income approaches look at total costs
12 and total income of the Company as a whole and then allocate to each
13 individual district. The market-based approach looks at stock prices and debt
14 to equity. The three numbers are then reconciled to arrive at the final tax
15 assessed value.

16 The tax assessed value does not likely represent a fair market price for
17 the Jefferson County Assets. Nevertheless, it is substantially below the price
18 agreed upon by PSE and JPUD. It would also be presented to a jury in a
19 condemnation proceeding. Because of this, failure to execute the transaction
20 with JPUD may put PSE at risk of receiving much less than the \$103 million
21 it did achieve without condemnation.

22

1 **B. The Jefferson County Assets Are Not Used to Provide Electric Service Outside**
2 **of Jefferson County**
3

4 **Q. PSE states that the transmission and distribution facilities being sold are**
5 **necessary only to serve PSE's existing customers within the Service Territory.**

6 **Did Staff confirm this testimony?**

7 **A. Yes. According to Mr. Karzmar:**

8 The assets in question are all located within the Service Territory. There are
9 no assets being sold that are located outside of Jefferson County. . . . None of
10 the assets being sold are used to provide service outside of Jefferson County.
11 Unique characteristics of the configuration of PSE's system in Jefferson
12 County provide for a "clean break" from the remainder of our system. . . .
13 There are no generation assets involved in or affected by this transaction.
14 The assets in question serve no function or purpose outside of the Service
15 Territory. No electrical facilities of any significance are stranded or rendered
16 uneconomic by reason of this acquisition. There are no severance damages
17 (or stranded assets) to be accounted for in this transaction.⁵
18

19 Staff reviewed a map of the Service Territory and surrounding areas and confirmed
20 Mr. Karzmar's statements. There are no transmission lines, generating facilities or
21 distribution substations outside of the Service Territory that would be negatively
22 affected by the sale. Moreover, none of the assets being sold will affect continuing
23 service outside of Jefferson County.
24

25 **C. The Settlement Stipulation Satisfies the Staff and Public Interest**

26

27 **Q. Please summarize your testimony in support of the Settlement Agreement?**

⁵ Exh. No. KRK-1CT at 6:6-17.

1 A. The \$103 million is a fair and reasonable purchase price for the Jefferson County
2 Assets because it is a price PSE could reasonably expect to receive in a market
3 transaction. Because PSE is an unwilling seller that negotiated in good faith to
4 receive the best offer under JPUD's threat of condemnation, the purchase price is
5 sufficient and represents the maximum amount that could be expected in the
6 appropriate rate proceeding.

7 Moreover, because the Jefferson County Assets are not used to provide
8 electrical service outside Jefferson County, sale of the assets will not impact the
9 Company's service to customers outside the Service Territory.

10
11 **Q Please explain why the Settlement Stipulation satisfies the interests of Staff.**

12 A. The Settlement Stipulation satisfies the requirements of the APA and allows PSE and
13 JPUD to move forward with the transfer of the Jefferson County Assets. The
14 purchase price is fair, reasonable and sufficient and removes any risk associated with
15 a condemnation proceeding.

16
17 **Q Please explain why the Settlement Stipulation satisfies the public interest.**

18 A. The Settlement Stipulation removes the potential for additional costly and time
19 consuming negotiations and/or civil litigation that are not in the best interest of the
20 public. The Settlement Stipulation removes uncertainty and allows the APA to be
21 implemented for continued reliable service during the transition period.

22

1 Q. Does this conclude your testimony?

2 A. Yes it does.