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EXHIBIT: SEF-1T
ADMIT ☑ W/D ☐ REJECT ☐

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of **PUGET SOUND ENERGY** **For Approval of its April 2019 Power Cost Adjustment Mechanism Report**	**Docket UE-19____**

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF

SUSAN E. FREE

ON BEHALF OF PUGET SOUND ENERGY

APRIL 30, 2019

PUGET SOUND ENERGY

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF SUSAN E. FREE

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PUGET SOUND ENERGY

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF SUSAN E. FREE

I. INTRODUCTION

Q. Please state your name, business address and present position.

A. My name is Susan E. Free. My business address is 355 110th Ave. NE, Bellevue, Washington 98009-9734. I am the Manager of Revenue Requirement for Puget Sound Energy ("PSE").

Q. What is your educational and professional experience?

A. The First Exhibit to my testimony, Exh. SEF-2 describes my educational and professional experience.

Q. What are your duties as Manager of Revenue Requirement for PSE?

A. My present responsibilities include overseeing general and power cost only rate case filings, tariff rate change filings, and accounting petitions. Additionally, I am responsible for issuing internal accounting instructions that are used to ensure adherence to the regulatory approvals obtained through PSE's various filings and petitions.

Q. What is the purpose of this filing?

A. As explained below in Section II, "Background Regarding the PCA Mechanism", PSE is filing the PCA 17 annual true-up for calendar year 2018 by April 2019. Through its Petition, PSE is requesting approval of its PCA Mechanism Report ("PCA Annual Report") for the Twelve Months Ended December 31, 2018 ("PCA Period 17"). The PCA Annual Report is provided in this filing as the Second Exhibit to my Prefiled Direct Testimony, Exh. SEF-3.

II. BACKGROUND REGARDING THE PCA MECHANISM

Q. Please provide a brief summary of the Power Cost Adjustment Mechanism.

A. At inception, as authorized by the Commission, PSE's PCA Mechanism accounted for differences in PSE's modified actual power costs relative to a power cost baseline. The calculation was performed using the methodology shown in Exhibit B to the Settlement Stipulation approved in the Commission's Twelfth Supplemental Order in Docket UE-011570 ("2002 PCA Settlement"). That mechanism accounted for a sharing of costs and benefits that were graduated over four levels of power cost variances. The 2002 PCA Settlement defined the specific sharing levels and conditions.

A PCA collaborative was initiated as part of the settlement terms from PSE's 2013 power cost only rate case, Docket UE-130617 ("2013 PCORC"). After fourteen months of collaboration, PSE, WUTC Staff, and Public Counsel

("Settling Parties") reached a settlement stipulation involving modifications to PSE's PCA mechanism ("2015 PCA Settlement").[1] The Commission approved the 2015 PCA Settlement in Order 11 of PSE's 2013 PCORC ("Order 11"). As a result, beginning January 2017, the power cost baseline rate is comprised of both variable power costs, which will continue to be tracked in the PCA mechanism, and fixed production and delivery costs, which are now included in the decoupling mechanism approved in PSE's most recent general rate case, Docket UE-170033. Accordingly, as of January 1, 2017, PSE reports only the variable portion of the power cost baseline rate. PCA Period 15 for the twelve months ended December 31, 2016 was the last compliance filing submitted pursuant to the 2002 PCA Settlement.

Additional modifications to PSE's PCA mechanism approved in Order 11 are discussed further below.

Q. Please describe the scope of the 2015 PCA Settlement and its principal aspects.

A. The 2015 PCA Settlement changed PSE's PCA mechanism from the one established in the 2002 PCA Settlement. which was effective through the twelve months ended December 31, 2016. The 2015 PCA Settlement is the product of the year-long collaborative process to address concerns of various parties

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[1] The Alliance of Western Energy Consumers (then known as the Industrial Customers of Northwest Utilities) was a party to the 2013 PCORC but opposed the 2015 PCA Settlement.

regarding the mechanics of the original PCA mechanism. The key modifications included:

- Removal of fixed production costs from the PCA imbalance calculation.
- Adjustment of the dead-bands and sharing bands for under- and over-recovery of allowed costs to:
  - Narrow the deadband from $20 million to $17 million to provide earlier sharing of both costs and benefits;
  - Adjust the first sharing band from $17 million to $40 million so that customers will receive 65 percent of the benefits of power cost over-recoveries rather than the 50/50 sharing that previously occurred in the first sharing band, and
  - Eliminate the third sharing band, thus limiting customers' sharing of under- or over-recoveries over $40 million to 90 percent.
- The threshold for determining the timing of rate refunds or surcharges was reduced to $20 million from the previous $30 million cumulative deferred balances.
- Continuation of the existing PCORC filing provisions, which allow for a full update to power costs (both variable and fixed production costs) in a PCORC.
- A streamlining and clarification of the exhibits required for power costs in a PCORC or GRC filing and those required in the annual PCA compliance filings.

Q. Are there additional components of the 2015 PCA Settlement?

A. Yes. There were several additional key components to this settlement, which are described briefly below.

- **Five-year moratorium for changes to the PCA mechanism:** The Settling Parties agreed to a five-year moratorium on further changes to the PCA mechanism, effective from the start of the modified PCA mechanism, January 1, 2017. During the moratorium the requirement to file a GRC following a PCORC filing will be removed. I discuss further below an agreed-upon change to the mechanism that resulted from PSE's 2017 general rate case in Docket UE-170033 ("2017 GRC").

- **PCORC filing moratorium:** During the five-year moratorium discussed above, the settlement provides for a limited stay-out period by PSE of six months following the rate effective date of any PCORC filing. This is not considered to be a permanent change to the PCA mechanism, but PSE agreed to such stay out during the five-year moratorium period discussed above.

- **Cost categories:** The settlement recognizes that certain costs will no longer be included in the PCA imbalance calculation, but they will still be updated through a PCORC filing. To continue with the PCORC updates without unduly burdening others and the Commission, the Settling Parties agreed to separately identify costs using three categories: 1) variable production costs (recovered and tracked through the PCA imbalance calculation), 2) fixed production-related costs (that are included in the electric decoupling mechanism, and 3) delivery costs (all other costs including those currently in the decoupling mechanism).

- **Fixed Production Costs:** Fixed production costs were removed from the mechanism effective January 1, 2017. They were included in the decoupling mechanism pursuant to PSE's 2017 GRC, effective on December 19, 2017. During the interim period between January 1 and December 19, 2017, PSE deferred the revenue variances associated with recovery of its fixed production costs pursuant to an accounting petition approved in Docket UE-161112. Accordingly, fixed production costs are not a subject of this compliance filing.

- **Variable Costs:** PCA variable costs include actual monthly amounts recorded in FERC Accounts 501 – Steam generation fuel, 547 – Other power generation fuel, 555 – Purchased power, 447 – Sales for resale, 565 – Transmission of electricity by others. Costs related to the hedging line of credit have been removed from the PCA imbalance calculation and are now included in PSE's cost of capital. The 2015 PCA Settlement also modified the PCA imbalance calculation to no longer include Colstrip major maintenance amortization, variable costs and credits for sales of non-core gas, transmission revenue for specifically identified transmission lines and the return on regulatory assets and liabilities associated with items formerly approved to be recovered through the PCA mechanism.

- **Adjustments to Variable Costs:** The following adjustments to variable costs are part of the PCA mechanism:

Adjustments reflected on Exhibit B:[2]

1) PPA Equity Adjustment – An adjustment to variable costs is required for the equity component of the Transalta Centralia Coal Transition Power Purchase Agreement ("PPA") approved by the Commission in Docket UE-121373. Consistent with Order 03 in Docket UE-121373, paragraph 125, PSE accounts for the cost associated with the equity return component on Schedule B of the PCA mechanism. By including the costs associated with the equity return component on the lines designated in the Adjustments section of Schedule B, the PCA mechanism will account for the total costs associated with the Coal Transition PPA. This type of adjustment is necessary to make actual booked expenses, which do not include regulatory adjustments, match the recovery built into rates. The equity component of PSE's authorized rate of return for the Coal Transition PPA is earned by PSE and recovered in an amount equal to $1.49/MWh for each MWh of energy paid for by PSE under the Coal Transition PPA.[3] During calendar year 2017, PSE purchased 3,328,180 MWh through the Coal Transition PPA resulting in an adjustment of $4,958,989 under Exhibit B.

2) Energy Imbalance Market ("EIM") Costs Adjustment – As part of the settlement stipulation in PSE's 2017 GRC, which became effective December 19, 2017, a line item for all costs related to the California Independent System Operator ("CAISO") EIM is to be included as actual costs in the annual PCA filing. For purposes of calculating the PCA imbalance in the PCA mechanism, the amount for capital items (depreciation and return on) and labor related to the CAISO EIM as included in Exhibit D to the 2017 GRC settlement, or a monthly amount of $616,827 – which is the original $704,939 approved amount adjusted for tax reform – is included as a line-item in actual allowed power costs in Schedule B. The 2017 GRC settlement requires these costs to be included in Schedule B in a manner similar to the equity adder for the Coal Transition PPA, in that they will be included in the Adjustments section of Schedule B. The 2017 GRC settlement recognized that

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[2] Exhibits F - Colstrip Availability and G - New Resource Adjustment were removed from the PCA mechanism pursuant to Order 11.

[3] *See In the Matter of Puget Sound Energy, Inc. For Apprvoal of a Power Purchase Agreement for Aquisition of Coal Transition Power, as Defined in RCW 80.80.010, and the Recovery of Related Acquisition Costs,* Docket UE-121373, Order 03, ¶123 (Jan. 9, 2013).

the moratorium on changes to the PCA mechanism remained in effect but for this limited change approved in the 2017 GRC settlement agreement.

Adjustments related to prior period:

1) Variable costs incurred may be adjusted for items pursuant to the Methodology for Adjustments of Costs Outside of the PCA Period ("Restatement Methodology").[4]

2) Adjustments to variable costs for items from prior periods that do not meet the requirements for prior period restatement under the Restatement Methodology are flowed through the current month PCA calculation.

III. PCA PERIOD 17 ACCOUNTING

Q. Please explain how PSE tracked its PCA Period 17 power costs.

A. Each month PSE calculates the power costs that are subject to PCA sharing. Allowed power costs include the variable costs, net of the adjustments discussed above. These total allowable costs are then compared to the approved baseline power cost rate, multiplied by the actual delivered load, and any difference is allocated to PSE or customers based on the different levels of sharing defined in the PCA mechanism. Any difference allocated to customers is recorded in FERC Account 182.3, Other regulatory assets.

Under the PCA mechanism the deferred amount at the time of the next PCA annual true-up filing, along with the projected variable costs through the next

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[4] *See* Section 11 of Attachment A to the 2015 PCA Settlement.

proposed rate year, could be considered in the determination of any rate change for the subsequent PCA period. Amounts deferred, when authorized, would be amortized to FERC Account 407.3, Regulatory debits or 407.4, Regulatory credits as they are recovered from or refunded to customers. PSE accrues interest monthly on any deferred balance (debit or credit) at the interest rate calculated in accordance with WAC 480-90-233(4). At this time, PSE is not requesting recovery of the amounts deferred under the PCA mechanism.

Q. Did the baseline power cost rate change during PCA Period 17?

A. Yes. On December 5, 2017 the Commission issued Order 08 in PSE's 2017 GRC, approving and adopting a multi-party settlement agreement and resolving all disputed issues in the proceeding. The variable component of the updated baseline rate of $32.895, found on page eight of Exh. SEF-3, was approved in Order 08 and went into effect on December 19, 2017.

On May 1, 2018, in Docket UE-180282, PSE filed a change to its baseline rate to recognize changes related to the Tax Cuts and Jobs Act. These changes impacted only the fixed costs shown on the baseline rate. Therefore, the variable component of the baseline rate found on page ten of Exh. SEF-3 remains $32.895.

Q. What is the actual average power cost rate experienced for PCA Period 17?

A. As shown on page five of Exh SEF-3, the calculated average variable power cost rate experienced for PCA Period 17 is $33.064 per MWh.

Q. Why did the total allowable costs on line 27 of Exh. SEF-3, page five, differ from the total allowable costs in effect during PCA Period 17 presented on line 27 on pages eight and ten of Exh. SEF-3?

A. The total variable allowable costs differed from the baseline power costs in effect during PCA Period 17 due to changes in the variable components of the PCA mechanism, which are discussed in the prefiled direct testimony of Paul K. Wetherbee, Exh. PKW-1CT.

Q. How did the actual power costs compare to the average baseline power cost rates in effect during PCA Period 17?

A. Actual power costs were higher than the average baseline power cost in rates effect during PCA Period 17 by $3,491,161 (after adjustment for Firm Wholesale). PSE's share of this under-recovery of power costs is $3,491,161. The customers' share of this under-recovery of power costs is $0. See page six of Exh. SEF-3.

Q. What is the distribution of the resulting cumulative imbalance for sharing at the end of PCA Period 17?

A. Considering the activity that occurred in PCA Period 17, the cumulative imbalance for sharing at the end of PCA Period 17 for PCA Periods 1 through 17 was an under-collection of $29,359,893. PSE's share of this imbalance is $25,905,548 with the remaining $3,454,344 assigned to the customer: See page four of Exh. SEF-3. As stated above, PSE is not requesting recovery of the PCA customer deferral at this time.

IV. ADJUSTMENT OF COSTS MADE UNDER THE RESTATEMENT METHODOLOGY

Q. Were there any adjustments made under the Restatement Methodology for power costs in PCA Period 17?

A. Yes. There was one adjustment made to SAP variable costs during PCA Period 17. The adjustment did not meet the requirements for restatement of prior periods, and thus was flowed through the PCA calculation in the PCA Period 17 months in which it was identified, pursuant to Section 11. a. i. of Attachment A to the 2015 PCA Settlement. The adjustment occurred in January 2018, and PSE recorded a credit of $1,063,362 in FERC order 547 to record the reversal for the December 2017 adjustment to the gas for power inventory at Jackson Prairie to lower of cost or market. This credit was excluded from the PCA 17 total allowable costs via a credit adjustment because an inventory write-down is considered a non-cash financial adjustment to costs so should not impact the PCA.

V. CONCLUSION

Q. Does this conclude your testimony?

A. Yes, it does.