Exh. DPK-1T
Dockets UE-240004,
UG-240005, UE-230810
Witness: Danny P. Kermode

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY,** **Respondent.**	**DOCKETS UE-240004, UG-240005 and UE-230810 (Consolidated)**

TESTIMONY OF

DANNY P. KERMODE

ON BEHALF OF STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Overall Revenue Requirement

August 6, 2024

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Danny Kermode, and my business address is 1850 Parkway Place, Suite 800, Marietta, GA 30067. My business email address is danny.kermode@gdsassociates.com.

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

A. I am employed by GDS Associates, a national consulting firm specializing in regulatory utility matters.

Q. Please state your qualifications to provide testimony in this proceeding.

A. I received my Bachelor of Science degree in accounting from Arizona State University in 1982 and was licensed as a Certified Public Accounting 1984. I have more than 40 years of regulatory accounting experience within both private practice and in government. A more detailed description of my qualifications is set forth in my Statement of Qualifications found at Exhibit DPK-2. I have appeared as an expert witness in numerous contested cases presenting financial, income tax and regulatory accounting issues. I last worked as the Assistant Director for Water and Transportation at the Washington Utilities and Transportation Commission (UTC or Commission). Prior to being appointed Assistant Director, I was UTC's Director of Policy and Legislation. I also was previously the Commissioners' chief accounting advisor and a senior energy policy advisor. I am a retired Certified Public Accountant.

I worked for the UTC for over 25 years. Prior to working at the UTC, I had accumulated over ten years of experience in private accounting practice specializing in public utility regulation and was a Certified Financial Planner, although that certification is now inactive.

I am a visiting faculty member and Senior Fellow at Michigan State University's Institute of Public Utilities, where I continue to teach advanced regulatory studies and basic ratemaking. Previously, I was on the faculty of the annual National Association of Regulatory Utility Commissioner (NARUC) Rate School in San Diego California. In 2014, I worked as an adjunct professor at St. Martin's University teaching business taxation.

In addition, I have written various articles on public utility regulation in nationally- recognized publications, including the Public Utility Fortnightly and the National Regulatory Research Institute Journal of Applied Regulation.

Q. Have you testified previously before a regulatory commission?

A. Yes. I have testified before the UTC at least 13 times covering various industries including electric, natural gas, telecom, marine pilotage, oil pipeline and water utility. For example, I filed testimony in two PacifiCorp d/b/a Pacific Power general rate cases, and two Avista Utilities general rate cases. I have also testified specifically on income tax issues in a rate case involving the Olympic Pipeline Company. Additionally, I have filed testimony in various investor-owned water company general rate cases.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. What is the purpose and scope of your testimony?

A. The purpose of my testimony is to present Staff's revenue requirement analysis for Puget Sound Energy's (PSE or Company) two-year multiyear rate plan (MYRP) with rate years beginning June 30, 2025, (Rate Year 1), and June 30, 2026, (Rate Year 2) for both its electric and gas operations. Staff conducted an independent, stand-alone analysis to determine the additional revenue required for the Company to have the opportunity to achieve a reasonable return on its investment in Washington using modified historical test year studies which include restating and known-and-measurable pro forma adjustments.

My testimony responds to the Company's Washington Results of Operations for Rate Year 1 and Rate Year 2 sponsored by Company witness Susan Free in Exhibit SEF-4 for Puget Sound Energy's electric operations and Exhibit SEF-8 for its natural gas operations.

Q. Please summarize the Company's rate increase request for its electric operations in Washington.

A. In January of this year, PSE filed its MYRP for the years 2025 and 2026 requesting the Commission approve rate increases for its electric operations of $584.3 million and $259.9 million, respectively. The Company is also requesting approval of three new trackers which, if approved, would collect an additional $101 million in revenue.

Q. Please summarize the Company's rate increase request for its natural gas operations in Washington.

A. At the same time which it filed for increased rates in its electric operations MYRP, PSE also filed for its natural gas operations. The Company filed for a rate increase of $247.6 million for Rate Year 1, reduced by $55.6 by tariffs resetting to zero; and as with its electric operations, the Company is also proposing a new tracker that would collect $4.0 million in additional revenue netting $196.0 million in additional revenue. For Rate Year 2 the Company is requesting $25.4 million.

PSE	Company	Company
Revenue Deficiency - Grossed Up	247,614,954	$ 25,350,286
Rate schedules set to zero	(55,609,679)	
Deficiencies for Trackers	4,035,116	
Total Revenue Rate Change	$ 196,040,391	$ 25,350,286

Q. Did Staff perform an analysis of the Company's request for increased rates.

A. Yes. Staff did a review of the Company's filing for both of its electric and gas operations.

Q. Summarize Staff's approach to its analysis of the revenue requirements for PSE's electric operations?

A. Staff is using revenue requirement models that reflect the Company's 2023 test year and the Company's proposed adjustments including adjustments to the 2024 GAP year and the two proposed Rate Years 2025 and 2026. The models compute, after adjustments, Staff's position regarding rate base and revenue requirement for each presented Rate

Year. In addition, PSEs MYRP for its electric operations contains a proposal to remove from base rates those costs associated with three new trackers the costs of which would normally be included in base rates. To better understand the impact of the proposed trackers on electric rates, Staff performed two revenue requirement analyses.

The two studies, as adjusted by Staff, show first, the impact of the Company's tracker associated costs and rate base impact on the overall revenue requirement for base rates as filed by the Company. I have identified this study as Exhibit DPK-3. In addition, a second study was performed to reflect the impact of the removal of trackers and the restoration of the costs on the overall revenue requirement for base rates. I have identified this study as Exhibit DPK-4.

Q. Please explain why you provided separate analyses for the Company's electric rate request showing the impact of restoring the trackers' costs to base rates?

A. As testified by Staff witness Chris McGuire, in Exhibit CRM-1T, Staff is recommending the Commission reject all three of the proposed trackers for electric and the single proposed tracker for gas. The rejection by Staff requires the Commission to have a clear understanding of the impact on revenue requirement of restoration of the embedded costs of the proposed trackers into base rates. To do so, it is necessary to provide an analysis reflecting the adjustments proposed by Staff not affected by the proposed trackers and an additional analysis showing the tracker costs returned to base rates.

Q. Please begin with a summary of your analysis of PSE's proposal for its electric operations with its proposed tracker costs removed from base rates.

A. As shown in Exhibit DPK-3 at page 4, line 49, for Rate Year 1, Staff's analysis shows PSE earning a 1.25 percent overall rate of return on its adjusted rate base. Whereas, for following Rate Year 2, our analysis shows PSE earnings drop to a negative 0.33 percent on its adjusted rate base at current rates.

As shown on DPK-3 at page 5, line 6, Staff's analysis, with the proposed trackers, including the impact of those rate schedules reset to zero in 2025, supports an increase in annual revenues of $110.3 million in 2025 (Rate Year 1) and a $275.5 million increase in annual revenues in 2026 (Rate Year 2).

Revenue Deficiency - Grossed Up	$	537,373,714	$	222,546,580
Rate schedules set to zero		(499,034,932)		-
Deficiencies for Trackers		71,926,822		52,918,205
Total Revenue Rate Change	$	110,265,603	$	275,464,785

Q. Staff is recommending the new trackers not be approved and that those costs should continue to be included in the Company's base rate costs. That being so, what is the revenue impact of restoring the trackers to base rates?

A. When the tracker costs are returned to base rates, the revenue requirement for base rates increases. As reflected in my Exhibit DPK-5 at Page 5, Staff's analysis computes the proposed increase without an offset for the costs associated with the proposed trackers and restores tracker costs into base rates. The impact of those rate schedules reset to zero in 2025 are still used. In total, the analysis supports an increase in annual revenues of $110.4 million in 2025 (Rate Year 1) and a $257.0 million increase in annual revenues in 2026 (Rate Year 2).

Revenue Deficiency - Grossed Up	$	609,504,748	$	257,077,956
Rate schedules set to zero		(499,034,932)		-
Deficiencies for Trackers				
Total Revenue Rate Change	$	110,469,816	$	257,077,956

Q. Did you perform an analysis of PSE proposal for its Natural Gas operations?

A. Yes, however for its natural gas operations, I did not create exhibits showing revenue with the proposed tracker and without. The Company requested only one natural gas tracker, which was not as material to the revenue requirement compared to the trackers proposed for the electric operations.

Q. Please summarize your analysis of the natural gas proposal, which includes the restoration of the proposed tracker costs back into base rates.

A. For Rate Year 1, Staff's analysis shows PSE natural gas operations earning an overall rate of return on its adjusted rate base of 1.57 percent; and for Rate Year 2, the analysis shows PSE would be earning a 1.18 percent return on its investment.[1] Staff's analysis on page 5, line 6, of Exhibit DPK-7 supports an increase in annual revenues of $164.4 million in Rate Year 1 and $15.0 million in Rate Year 2.

Revenue Deficiency - Grossed Up	$	220,104,658	$	15,018,807
Rete schedules set to zero		(55,609,679)		-
Deficiencies for Trackers				
Total Revenue Rate Change	$	164,494,979	$	15,018,807

[1] Kermode, Exh. DPK-7 at 4, line 49.

Q. Have you prepared any exhibits in support of your testimony?

A. Yes. I have prepared Exhibits DPK-2 through DPK-8.

- Exh. DPK-2 - Qualifications of Danny Kermode
- Exh. DPK-3 - Electric Summary Schedules Staff Results - Proposed Trackers included in analysis
- Exh. DPK-4 - Electric Operating Income with Staff Adjustments – Proposed Trackers included in analysis
- Exh. DPK-5 - Electric Summary Schedules Staff Results - Proposed Trackers removed with costs restored to base rates
- Exh. DPK-6 - Electric Operating Income with Staff Adjustments – Proposed Trackers removed with costs restored to base rates
- Exh. DPK-7 - Natural Gas Summary Schedules of Staff Results – Proposed Tracker removed with costs restored to base rates
- Exh. DPK-8 - Natural Gas Operating Income with Staff Adjustments – Proposed Tracker removed with costs restored to base rates

III. ELECTRIC RESULTS OF OPERATIONS AND REVENUE REQUIREMENT

Q. Please begin with a summary of your analysis of PSEs proposal for its electric operations with its proposed tracker costs removed from base rates shown in your Exhibit DPK-3 at page 1.

A. My analysis examines the results of operations for the Rate Years 1 and 2 under PSE's proposal to institute three new tracker mechanisms. In my Exhibit DPK-3 at page 1, line 12, for Rate Year 1, Staff's analysis shows a net revenue change in base rates of $537.3 million. However, this amount is reduced by $499.0 million by resetting and the zeroing out five tariff schedules.[2] In the same vein, the costs that the Company proposes to be recovered through trackers are added together to derive an increase in overall revenue requirement of $110.3 million, as shown on line 30, resulting in a total revenue requirement for Rate Year 1 of $285.1 million, or a 3.87 percent increase.

PSE				
		Company		Company
Revenue Deficiency - Grossed Up		584,376,758	$	259,901,924
Rate schedules set to zero		(499,034,932)		
Deficiencies for Trackers		106,876,213		25,266,288
Total Revenue Rate Change	$	192,218,039	$	285,168,212

In my Exhibit DPK-3 at page 1, line 12, Staff's analysis of the rate proposal for the 2026 Rate Year (year 2) shows a net revenue change in base rates of $222.5 million. With costs to be recovered by the trackers added back, the overall increase in revenue requirement is $275.5 million, resulting in a total revenue requirement of $3,066 million for Rate Year 2 or a 7.26 percent increase, as shown on line 30.

Revenue Deficiency - Grossed Up	$	537,373,714	$	222,546,580
Rate schedules set to zero		(499,034,932)		-
Deficiencies for Trackers		71,926,822		52,918,205
Total Revenue Rate Change	$	110,265,603	$	275,464,785

Q. Can you briefly discuss Staff's proposed Cost of Capital shown on page 2 of each of your Exhibits DPK-3, DPK-5 and DPK-7?

A. On page 2 of each of my Exhibits DPK-3, DPK-5, and DPK-7, I show Staff witness Parcell's cost of capital recommendation. Shown in each exhibit, is Parcell's

[2] Kermode, Exh. DPK-3 at 1, lines 17-21.

recommended costs of debt and equity and related capital structure for the Rate Years 1 and 2. For Rate Year 1, he recommends an overall weighted cost of capital of 7.36 percent whereas, for Rate Year 2, Mr. Parcell recommends a slightly higher overall cost of capital of 7.37 percent.

I reflect these returns on page 2 of my Exhibits DPK-3, DPK-5, and DPK-7, including the weighted cost of debt, which are used in Staff's recommended revenue requirement under the two scenarios for electric and for the single scenario of gas.

Q. Also, on page 3 of your Exhibits DPK-3, DPK-5 and DPK-7, you have a schedule labeled "Revenue Conversion Factor." Please discuss the purpose of this schedule and how it is used.

A. The revenue conversion factor is the result of a mathematical equation that is used to convert an expense or revenue into its related revenue requirement. For example, for the Company to recover in rates an additional expense of $100 will require more than $100 because of taxes or fees that are based on revenue or income. For example, if the Company receives revenue of $100 for the new expense, it must then pay the state utility tax and the UTC fee, reducing the amount received below the required $100.

The revenue conversion factor "grosses up" the amount to allow payment of the taxes and fees while still allowing recovery on the $100. Page 3 of each Exhibit DPK-3, DPK-5, and DPK-7 shows the derivation of the conversion factor which is used throughout the analysis.

Q. Returning to your Exhibit DPK-3, page 4, contains a schedule labeled "Electric Statement of Operating Income Including Proposed Trackers – 2024 General Rate Case." Could you please discuss the schedule?

A. Page 4 of Exhibit DPK-3 is a multicolumn portrayal of the development of the MYRP that summarizes the development of the costs and investments of PSE over the MYRP period ending in 2026. The unshaded columns (d, f, h, j, and l) are summations of detailed adjustments partially detailed in Exhibit DPK-4, and in the Excel model used in the analysis of the case.

The adjustments made in the columns labeled Restating Adjustments, Traditional Pro Forma Adjustments, and Gap Year Adjustments attempt to bring the Company's financial statements to the current period including changes in expenses and capital investment. Whereas, Rate Year 1 Adjustments and Rate Year 2 Adjustments project the future costs and revenues of the Company to allow rates to be set fairly.

Q. Does this schedule represent Staff's final recommendation?

A. No. It is important to keep in mind that Exhibit DPK-3 does not reflect Staff's final recommendation but is provided merely for clarity. Exhibit DPK-3 is Staff's analysis that recognizes the new proposed trackers as not being included in base rates. Staff, on the other hand, is recommending the restoration of the three proposed trackers back into base rates. This schedule focuses on the other non-tracker adjustments sponsored by staff witnesses allowing the Commission to better understand the impact of Staff's proposals to the overall revenue requirement before addressing the issue of trackers. Exhibit DPK-5 presents Staff's final recommendation.

Q. Please describe your Exhibit DPK-4 "Electric Operating Income with Staff Adjustments – Proposed Trackers Included in Analysis."

A. Exhibit DPK-4 includes the analysis of selected staff adjustments to the Company witness Susan Free, presented in Exhibit SEF-4. Exhibit DPK-4 details the changes and new adjustments Staff made to the Company filing. The intent is to allow the Commission and parties to clearly understand the changes recommended by Staff to the Company's proposed adjustments.

Q. Staff's recommendation is to deny and restore the proposed trackers to base rates. Please summarize the impact of the Company's three proposed trackers costs being <u>restored to base rates</u> as shown in your Exhibit DPK-6, pages 4 and 5.

A. Building onto the rate setting scenario presented in Exhibit DPK-4, Exhibit DPK-6 <u>restores</u> the costs of the proposed trackers through three Rate-Year Adjustments labeled S-6.49, S-6.50, and S-6.51 for Clean Generation Resources, Decarbonization, and Wildfire Prevention respectively. These adjustments impact both Rate Year 1 and Rate Year 2. Each adjustment detail is shown in Exhibit DPK-6 at pages 4 and 5. It should be noted that the tracker costs shown in Exhibit DPK-3 at page 1, lines 23 through 25, are zeroed out in Exhibit DPK-5, effectively restoring the tracker costs to base rates.

Q. Please summarize your analysis with the proposed tracker costs restored to base rates as shown in Exhibit DPK-5 at page 1.

A. As shown in Exhibit DPK-5 at page 1, line 12, for Rate Year 1, Staff's analysis shows a net revenue change in base rates of $609.5 million. However, this amount is once again reduced by $499.0 million by resetting and the zeroing out other tariff schedules,[3] resulting in a $110.5 million increased revenue requirement for Rate Year 1 and $257.0 million for Rate Year 2.[4]

Revenue Deficiency - Grossed Up	$	609,504,748	$	257,077,956
Rate schedules set to zero		(499,034,932)		-
Deficiencies for Trackers				
Total Revenue Rate Change	$	110,469,816	$	257,077,956

IV. NATURAL GAS RESULTS OF OPERATIONS AND REVENUE REQUIREMENT

Q. Please summarize PSE's rate increase request for its natural gas operations in Washington.

A. PSE filed for a rate increase of $196.0 million for 2025, made up of a general revenue deficiency of $247.6 million which is reduced by $55.6 by tariffs resetting to zero and by a new proposed tracker that would collect $4.0 million in additional revenue netting the requested $196.0 million. For Rate Year 2026 the Company is requesting $25.4 million of additional revenue.

PSE				
		Company		Company
Revenue Deficiency - Grossed Up		247,614,954	$	25,350,286
Rate schedules set to zero		(55,609,679)		
Deficiencies for Trackers		4,035,116		
Total Revenue Rate Change	$	196,040,391	$	25,350,286

[3] Kermode, Exh. DPK-5 at 1, line 28.
[4] Kermode, Exh. DPK-5 at 1, line 30.

Q. Can you please summarize your analysis of PSE's proposal for its natural gas operations with its proposed tracker costs <u>included in base rates</u> as shown in your Exhibit DPK-7, page 1.

A. My analysis of the results of operations for PSE's natural gas operations is a single analysis with includes Staff's recommendation to deny the new proposed tracker and includes the associated costs in base rates. This contrasts with the Electric segments analysis, in which two analyses were required to clearly show the effects of restoring the tracker costs. My analysis here simply restores the single proposed tracker into base rates because the amount being restored is relatively small, $3.8 million.

As shown in Exhibit DPK-7 at 1, for Rate Year 1, Staff's analysis shows a revenue deficiency of $220.1 million (line 12), reduced by $55.6 million by the zeroing out two tariff schedules (line 20), resulting in a net revenue increase of $165.4 million (line 22). This is in contrast with the $196.0 million requested by the Company for Rate Year 1.

In Exhibit DPK-1 at page 1, line 12, Staff's analysis for Rate Year 2 shows a net revenue change in base rates of $15.0 million. With no offsetting tariff, the resulting total revenue requirement for Rate Year 2026 is $15.0 million, whereas PSE is requesting $25.3 million.

Staff				
Revenue Deficiency - Grossed Up	$	220,104,658	$	15,018,807
Rate schedules set to zero		(55,609,679)		-
Deficiencies for Trackers		-		
Total Revenue Rate Change	$	164,494,979	$	15,018,807

Q. Exhibit DPK-7, page 4, is a schedule labeled "Gas Statement of Operating Income and Adjustments – 2024 General Rate Case." Could you please discuss the schedule?

A. Yes. Exhibit DPK-7, page 4, contains a multicolumn portrayal of the development of the MYRP that summarizes the development of the costs and investments of the Company's natural gas operations over the MYRP period ending in 2026.

The adjustments made in the columns labeled Restating Adjustments, Traditional Pro Forma Adjustments, and Gap Year Adjustments attempt to bring the Company's financial statements to the current period including changes in expenses and capital investment. The columns "2025 Rate Year 1 Adjustments" and "2026 Rate Year 2 Adjustments" attempt to project the future costs and revenues.

V. CONTESTED ADJUSTMENTS

Q. Please describe Staff's adjustment to PSE's cost of capital.

A. In his testimony for Staff, witness Parcell reduces PSE's requested cost of capital for Rate Year 1 from the requested 7.65 percent to 7.36 percent, or 29 basis points. Parcell also recommends lowering the requested cost of equity from 9.95 percent to 9.50 percent.

For Rate Year 2, Mr. Parcell recommends reducing the Company requested overall cost of capital from 7.99 percent to 7.37 percent, resulting primarily from a 100-basis point reduction in PSE's requested return on equity of 10.50 percent to 9.50 percent. In addition to the equity adjustments, the weighed cost of debt was adjusted slightly upward in Rate Years 1 and 2.

Q. Please discuss Staff witness Watkins's proposal to adjust *Gas Common Adjustment 11.01 Revenues and Expenses* and the impact on the gas rates.

A. Mr. Watkins disputes the Company's proposed expected decrease in therms demanded by residential customers during both Rate Years. He instead proposes a lesser decrease, resulting in in a projected decrease of revenues of $3.6 million rather than the $8.4 million offered by the Company for Rate Year 1. The impact on revenues for Rate Year 2 drops to $486,743.

Q. Focusing on PSE's electric operations, Staff witness McGuire is contesting the Company adjustment 6.47 related to CETA DR PPA Deferrals. Please address the revenue requirement impact of his proposed adjustment.

A. Staff witness McGuire is sponsoring an adjustment addressing the PSE's request for (a) for recognition of an accrued deferred return after the PPAs were included in rates and (b) a return at the overall weighed cost of capital. His adjustment reduces the amount of PPA that a return can be applied to and also provides the weighted cost of debt, rather than the overall cost of capital.

For Rate Year 1 Mr. McGuire's adjustment increases net operating income by $329,037 over the Company proposal, reducing the proposed revenue requirement by $438,000. For Rate Year 2, the adjustment increases net operating income by $25,128, which reduces the electric revenue requirement by $33,446.

Q. Adjustment S-6.49 is an adjustment by Staff witness McGuire contesting PSE's adjustment 6.47 related to the Clean Generation Resources Tracker, Schedule

141CGR. Please discuss the revenue requirement impact of his proposed adjustment.

A. Staff witness McGuire is opposing the PSE's proposal to include CWIP in rate base and of the use of a tracker to do so. The Beaver Creek Project is the only project associated with the tracker currently. Staff includes revenue requirements for Beaver Creek of $43.2 million in 2025 and $89.4 million in 2026. Relative to PSE's request of $71.6 million in 2025 and $90.1 million in 2026, Staff's recommendation to deny PSE's request to include CWIP in rate base for the Beaver Creek Project reduces electric revenue requirement in Rate Year 1 by $28.4 million and *increases* electric revenue requirement in Rate Year 2 by $0.7 million.

Q. The proposed wildfire tracker is also being opposed by Staff. Please discuss its impact on the PSE's revenue requirement and net operating income.

A. Staff is opposing the tracker since, as Staff witness McGuire correctly asserts, the issue is still before the Commission, has not been ruled upon, and therefore, the issue is simply not ripe for regulatory action. The impact of restoring the costs associated with the tracker into base rates, Staff adjustment S-6.51, reduces the Company's net operating income by $16.0 million in Rate Year 1 and by $5.3 million in Rate Year 2, while increasing the Company's revenue requirement by $21.3 million in Rate Year 1 and by $7.1 million in Rate Year 2.

Q. Finally, Staff witness McGuire adjusts PSE's O&M adjustments in both the electric operations and gas operations. Please discuss impact on the Company's revenue requirement and net operating income for both adjustments.

A. Staff witness McGuire's electric O&M Adjustment 6.22 produces incremental revenue requirements of $13.3 million in Rate Year 1 and another $3.3 million in Rate Year 2. When compared to PSE's as-filed electric operations Adjustment 6.22, McGuire's Adjustment 6.22 is an $18.7 million reduction to revenue requirement in Rate Year 1 and an $18.5 million reduction to revenue requirement in Rate Year 2.

Mr. McGuire's natural gas O&M Adjustment 11.22 produces incremental revenue requirements of $4.4 million in Rate Year 1 and an additional $8.1 million in Rate Year 2. When compared to PSE's as-filed natural gas O&M Adjustment 11.22, Mr. McGuire's Adjustment is a $3.7 million reduction to revenue requirement in Rate Year 1 and a $2.2 million reduction to revenue requirement in Rate Year 2.

Q. Does this conclude your testimony?

A. Yes.