EXH. SEF-1T
DOCKETS UE-18___/UG-18___
PSE EXPEDITED RATE FILING
WITNESS: SUSAN E. FREE

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of: **PUGET SOUND ENERGY** **Expedited Rate Filing**	**Docket UE-18____** **Docket UG-18____**

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF

SUSAN E. FREE

ON BEHALF OF PUGET SOUND ENERGY

JUNE 15, 2018

PUGET SOUND ENERGY

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF SUSAN E. FREE

CONTENTS

LIST OF EXHIBITS

PUGET SOUND ENERGY

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF SUSAN E. FREE

I. INTRODUCTION

Q. Please state your name, business address, and position with Puget Sound Energy.

A. My name is Susan E. Free. My business address is 10885 N.E. Fourth Street Bellevue, WA 98004. I am the Manger of Revenue Requirement for Puget Sound Energy ("PSE" or the "Company").

Q. Have you prepared an exhibit describing your education, relevant employment experience, and other professional qualifications?

A. Yes. It is Exh. SEF-2.

Q. What is the purpose of your testimony?

A. My testimony sets forth the electric and natural gas revenue requirement for this expedited rate filing ("ERF"). My testimony updates PSE's electric and natural gas costs consistent with the ERF methodology utilized in 2013 in Dockets UE-130137 and UG-130138, and consistent with the methodology outlined in the Multiparty Settlement Stipulation and Agreement in PSE's 2017 general rate case[1] ("2017 Settlement Agreement"). Additionally, my testimony provides an update related to the efforts by PSE and Commission Staff to develop a methodology to allocate insurance and third-party proceeds for environmental

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[1] *WUTC v. PSE*, Dockets UE-170033 & UG-170034 ("2017 general rate case").

remediation projects. Engagement in the process to develop such a methodology was a requirement of the 2017 Settlement Agreement.

II. OVERALL REVENUE REQUIREMENT

Q. Please explain how this filing was prepared.

A. In preparing this expedited rate filing, PSE followed the procedures used in the 2013 expedited rate filing and the principles set forth in the 2017 Settlement Agreement. First, PSE prepared a commission basis report ("CBR") for the twelve months ended March 31, 2018, consistent with the approach defined in WAC 480-90-257 and WAC 480-100-257. Second, PSE segregated those costs into two categories: 1) power costs that are set in a power cost only rate case and purchased gas and gas cost recovery mechanism related costs; and 2) all other costs. Costs included in the "all other" category are the costs that will be used to determine the electric and natural gas revenue requirement associated with this expedited rate filing. Third, PSE included the necessary adjustments to annualize the revenues and underlying costs resulting from the 2017 general rate case to the extent they were not already included in the CBR results. Fourth, PSE based its revenue deficiency on the approved rate of return from the 2017 general rate case, but has updated the rate of return to reflect the lower cost of debt, as discussed in the Prefiled Direct Testimony of Katherine J. Barnard, Exh. KJB-1T. Finally, as discussed in the Prefiled Direct Testimony of Jon A. Piliaris, Exh. JAP-1T, PSE allocated the revenue deficiency utilizing an equal percent methodology rather than the rate spread and rate design from the 2017 general rate case.

Q. Please explain Exh. SEF-3.

A. Exh. SEF-3 presents the calculation of the electric revenue deficiency based on the restated ERF test period. Page 1 of Exh. SEF-3 shows the restated ERF test period rate base (line 1) and net operating income (line 6). Based on a rate base of $3,145,294,476, a rate of return of 7.49 percent, and an adjusted net operating income of $204,466,406, PSE would have an overall revenue deficiency of $41,386,720.

Q. What rate of return is used to determine the revenue deficiency?

A. As discussed in more detail by Ms. Barnard, PSE used 7.49 percent to determine the revenue deficiency. The 7.49 percent is based on the authorized rate of return of 7.60 percent as determined in PSE's 2017 general rate case in Order 08 in Dockets UE-170033 and UG-170034, updated for a lower cost of debt. The rate of return is presented on page 2 of Exh. SEF-3. Both the capital structure and the return on equity components are unchanged from the levels approved in the 2017 general rate case.

Q. What conversion factor is used to determine the revenue deficiency?

A. As I discuss below, this expedited rate filing includes revenues and federal income taxes that incorporate the effects of the Tax Cuts & Jobs Act ("TCJA"), which lowered the corporate tax rate from 35 percent to 21 percent. Dockets UE-180282 and UG-180283 incorporated some of the effects of this change into PSE's base rates. As this rate filing is based on the current 21 percent statutory tax rate, the conversion factor that is used to gross up PSE's revenue requirement in this filing must also include the statutory tax rate of 21 percent. Therefore, PSE has taken the conversion factor from the March 2018 commission basis report[2] and updated it for the 21 percent statutory tax rate. This ERF conversion factor is presented on page 3 of Exh. SEF-3.

Q. Please continue explaining Exh. SEF-3.

A. Page 4 of Exh. SEF-3 presents the Expedited Rate Filing Related Adjusted Results for electric operations. Column A represents the per books results of electric operations for the twelve months ended March 31, 2018. Column B summarizes the restating adjustments that are standard adjustments as allowed under WAC 480-100-257 to bring the balances to a Commission basis. Exh. SEF-5, which is described in more detail later in this testimony, supports each of these columns. Column D then segregates the balances from column C between non-ERF costs which are costs that are recoverable in a power cost only rate case and all other costs to be recovered in the expedited rate filing. The amount of revenues reflected in column D are the amounts associated with power costs. These revenues were determined by using the revenue per kWh for power costs included in rates during the twelve months ended March 31, 2018, multiplied by the weather normalized load for the same period. The amount of expenses included in column D are the actual expenses included in column C for the same categories. Column E pro forms the revenues to reflect the change in revenues

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[2] From page 15 of Exh. SEF-5, which is presented later in my testimony.

authorized in Docket UE-180282[3], which are supported by Mr. Piliaris in Exh. JAP-3. In order to maintain a proper matching of the annualized revenues and expenses, Column E also includes adjustments that are necessary to annualize the underlying costs associated with those revenues to the extent they were not fully included in the test year. Each of these adjustments is discussed in more detail below.

With these adjustments to the commission basis report results, the rate of return on line 38 changes from 8.24 percent in column E to 6.50 percent in column G. This is 99 basis points below the 7.49 percent adjusted authorized rate of return discussed above. Therefore, page 1 of Exh. SEF-3 calculates the expedited rate filing increase of $41.4 million that would be necessary to allow PSE the opportunity to earn its authorized rate of return, bringing rate base, revenues and expenses in alignment for the current period.

Q. Please describe the purpose of Exhibit SEF-4.

A. Exh. SEF-4 presents the calculation of the natural gas revenue deficiency based on the restated test period. Page 1 of Exh. SEF-4 shows the restated test period rate base (line 1) and net operating income (line 6). Based on a rate base of $1,837,067,097, a rate of return of 7.49 percent and an adjusted net operating income of $112,393,510, PSE would have an overall natural gas revenue

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[3] In Dockets UE-180282 & UG-180283, PSE updated its 2017 GRC compliance filings from Dockets UE-170033 & UG-170034 to reflect the changes resulting from the Tax Cuts & Jobs Act ("TCJA"), which lowered the corporate tax rate from 35 percent to 21 percent. The revenues and tax expenses in the current filing reflect this lower corporate tax rate.

deficiency of $33,423,002. The rate of return and conversion factor used were determined as discussed above and are presented on pages 2 and 3 of Exh. SEF-4.

Q. Please continue explaining Exh. SEF-4.

A. Page 4 of Exh. SEF-4 presents the Expedited Rate Filing Related Adjusted Results for natural gas operations. Column A represents the per books results of operations for natural gas for the twelve months ended March 31, 2018. Column B summarizes the restating adjustments that are standard adjustments as allowed under WAC 480-90-257 to bring the balances to a Commission basis, which are represented in Column C. Exh. SEF-6, which is described in more detail later in this testimony, supports each of these columns. Column D then segregates the balances from column C between (i) non-ERF costs, which are PGA and Gas Cost Recovery Mechanism ("CRM") costs, as these costs have a separate method of recovery; and (ii) all other costs to be recovered in the expedited rate filing. The amount of revenues reflected in column D are the revenues recovered in PGA Schedule 101[4] and Gas CRM Schedule 149. The amount of expenses included in column D are the actual amounts included in Column C for gas costs associated with the PGA and depreciation and rate base associated with the Gas CRM. Column F pro forms the revenues to reflect the change in revenues authorized in Docket UG-180283[5], which are supported by

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[4] Schedule 106 revenues and gas costs are removed in the CBR adjustment presented on page 18 of Exh. SEF-6.

[5] In Dockets UE-180282 & UG-180283 PSE updated its GRC Compliance filings from Dockets UE-170033 & UG-170034 to reflect the changes resulting from the Tax Cuts & Jobs Act

Mr. Piliaris in Exh. JAP-4. In order to maintain a proper matching of the annualized revenues and expenses, Column F also includes adjustments that are necessary to annualize the underlying costs associated with those revenues to the extent they were not fully included in the test year. Each of these adjustments are discussed in more detail below.

With these adjustments to the commission basis report results, the rate of return on line 36 changes from 6.54 percent in column E to 6.12 percent in column G. This is below the 7.49 percent adjusted authorized rate of return discussed above. Therefore, page 1 of Exh. SEF-4 calculates the expedited rate filing increase of $33.4 million that would be necessary to allow PSE the opportunity to earn its authorized rate of return, bringing rate base, revenues and expenses in alignment for the current period.

Q. Please describe the purpose of Exh. SEF-5 and Exh. SEF-6.

A. Exh. SEF-5 and Exh. SEF-6 present balances for the twelve months ended March 31, 2018, for electric and natural gas operations respectively in a format consistent with the CBR filings. These exhibits provide the basis and support for page 2 of Exhs. SEF-3 and Exh. SEF-4.

Q. Please describe the filing requirements associated with commission basis reports.

A. Electric and natural gas utilities operating in Washington must file an annual CBR pursuant to WAC 480-100-257 for electric companies and WAC 480-90-257 for

("TCJA"), which lowered the corporate tax rate from 35 percent to 21 percent. The revenues and tax expenses in the current filing reflect this lower corporate tax rate.

gas companies. The two codes are identical except for the specific references to electric or gas operations and read as follows;

> (1) Commission basis reports are due within four months of the end of a utility's fiscal year.
>
> (2) The intent of the commission basis report is to depict the electric [gas] operations of an electric [gas] utility under normal temperature and power supply conditions during the reporting period. The commission basis report must include:
>
> > (a) Booked results of electric [gas] operations and rate base, and all the necessary adjustments as accepted by the commission in the utility's most recent general rate case or subsequent orders;
> >
> > (b) Results of operations adjusted for any material out-of-period, nonoperating, nonrecurring, and extraordinary items or any other item that materially distorts reporting period earnings and rate base; and
> >
> > (c) Booked revenues and power supply expenses adjusted to reflect operations under normal temperature and power supply conditions before the achieved return on rate base is calculated.
>
> (3) Commission basis reports should not include adjustments that annualize price, wage, or other cost changes during a reporting period, nor new theories or approaches that have not been previously addressed and resolved by the commission.
>
> (4) Each utility must submit the basis of any cost allocations and the allocation factors necessary to develop the commission basis results of electric [gas] operations for the state of Washington.

Q. In Exh. SEF-5 and SEF-6, did you perform all adjustments that are typically included in the CBR report?

A. No. For purposes of this filing, adjustments relating to power costs were not performed since all power costs are ultimately removed from the results of operations prior to calculating the expedited rate filing revenue requirement, and adjusting them would only complicate the removal of all production related costs. For natural gas operations, all CBR adjustments were included. The following table shows the adjustments PSE makes in a commission basis report and their reference numbers in this filing.

Ref. No. Electric	Ref. No. Gas	Description	Ref. No. Electric	Ref. No. Gas	Description
5.01	6.01	CBR Summary Pages	5.15	6.15	Bad Debt Expense
5.02	6.02	Cost of Capital	5.16	6.16	Incentive Pay
5.03	6.03	Test Year Income Statement	5.17	6.17	Excise Tax and Filing Fee
5.04	6.04	Test Year Balance Sheet	5.18	6.18	D&O Insurance
5.05	6.05	Test Year Rate Base	5.19	6.19	Interest on Customer Deposits
5.06	6.06	Test Year Working Capital	5.20	6.20	Pension Plan
5.07	6.07	Allocation Methods	5.21	6.21	Injuries and Damages
5.08	6.08	Conversion Factor	5.22	6.22	Miscellaneous Adjustments
5.09	6.09	Temperature Normalization	5.23	N/A	ASC 815
5.10	6.10	Revenues and Expenses	5.24	N/A	Storm Damage
5.11	6.11	Federal Income Taxes	(Note 1)	N/A	Power Costs
5.12	6.12	Tax Benefit of Interest	(Note 1)	N/A	Montana Electric Energy Tax
5.13	6.13	Pass-Through Revenue and Expenses	(Note 1)	N/A	Wild Horse Solar
5.14	6.14	Rate Case Expenses			

(Note 1) Not performed as production related

Q. Please provide an overview of the adjustments made in PSE's March 31, 2018 electric and natural gas CBRs.

A. The CBRs are presented in a similar manner as the accounting exhibits filed in a general rate case. Page 1 of Exh. SEF-5 and Exh. SEF-6, titled Results of Operations, presents the unadjusted operating income statement and end of period rate base for electric and natural gas respectively as of March 31, 2018, in the column labeled “Actual Results of Operation”[6]. This presentation is consistent with the manner in which PSE presented its CBR in the 2013 ERF. The various line items are then adjusted for the summarized restating adjustments, to arrive at the “Restated Results of Operations”. These restated results of operations are then used to determine the rate of return experienced during the period on a commission basis.

Q. Have you presented the supporting schedules to the Actual Results of Operations?

A. Yes. Pages 5 through 15 (reference numbers 5.02 through 5.08) of Exh. SEF-5 for electric and pages 4 through 13 (reference numbers 6.02 through 6.08) of Exh. SEF-6 for natural gas present the supporting schedules to the Actual Results of Operations. Included in these schedules are: the test period income statements, balance sheets, rate base, working capital, allocation methods and conversion factors.

CBR Adjustment Nos. 5.08E & 6.08G – Conversion Factor

Page 15 of Exh. SEF-5 and page 13 of Exh. SEF-6 present the electric and natural gas development of the conversion factors that are used in the various CBR adjustments that impact revenues. The revenue sensitive items are the Washington State utility tax, Washington Utilities and Transportation

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[6] These statements are included in pages 5 through 15 (reference numbers 5.02 through 5.08) of Exh. SEF-5 for electric and pages 4 through 13 (reference numbers 6.02 through 6.08) of Exh. SEF-6 for natural gas.

Commission ("WUTC") annual filing fee, and bad debts. The conversion factor used for commission basis reporting is 0.951695 for electric operations and 0.954501 for gas operations.

CBR Adjustment Nos. 5.07E & 6.07G – Allocation Factors

WAC 480-100-257(4) and WAC 480-90-257(4) require that allocation factors necessary to develop the commission basis results be provided. The allocation factors developed for the reporting period are presented on page 14 of Exh. SEF-5 and page 12 of SEF-6 (reference number 5.07E & 6.07G) and are used to allocate common expenditures between electric and natural gas operations. The methodologies used to develop the allocation factors are consistent with those used in commission basis reports and general rate cases.

Q. Is rate base reflected at the end of the test period values in the March 31, 2018 report?

A. Yes. As part of the 2017 Settlement Agreement, the settling parties agreed that rate base may be reflected at end of period values in the 2018 ERF. The use of end of period rate base is explained in more detail in Ms. Barnard's testimony.

Q. Please explain the remaining pages in Exh. SEF-5 and Exh. SEF-6.

A. Pages 2 and 3 for natural gas and pages 2 through 4 for electric present a summary schedule of all the restating adjustments for electric and natural gas operations. The first column of numbers on page 2 is the unadjusted net operating income for the year ended March 31, 2018 and the unadjusted end of period rate base for the same period. Each column to the right of the first column represents the restating adjustment to net operating income or rate base that is necessary to reflect the results of operations on a commission basis. Each of these adjustments has a supporting schedule, which is indicated by the reference number shown in each column title. The last column, shown on the summary schedule on page 3 for natural gas and page 4 for electric, summarizes all the adjustments. The remaining pages of these exhibits contain the supporting schedules showing the calculations of each of the adjustments summarized on pages 2 and 3 for natural gas and pages 2 through 4 for electric. The following section of testimony provides an overview of each of the adjustments.

CBR Adjustment Nos. 5.09E & 6.09G Temperature Normalization

This adjustment restates test period delivered load and revenue to a level that would have been expected to occur had the temperatures during the reporting period been "normal". The weather normalization methodology is performed in the same manner as in PSE's 2017 general rate case.

For electric operations, because PSE's decoupling mechanism effectively removes the impact of temperature from PSE's recorded revenues during the reporting period, only the portion of PSE's revenues not included in its decoupling mechanism require a temperature normalization adjustment.

For electric operations, the difference between the actual reporting period Generated, Purchased and Interchange ("GPI") load and the temperature normalized GPI load in megawatt hours ("MWh") is adjusted for system losses. The result of this calculation is then allocated to the rate classes. The revenue impact based on the applicable end step production only energy rate in effect each month during the reporting period for each rate class is then calculated. The adjustment to load for temperature decreases actual GPI by 45,190 MWh, or 41,901 MWh when adjusted for line losses. After allocation to the different customer classes, this adjustment decreases net operating income for electric operations by $2,067,691.

This adjustment calculates the impact on revenue sensitive items in the same manner as PSE's general rate cases and commission basis reports. For purposes of calculating the impact on federal income tax, the statutory rate for natural gas for the test year is 35 percent for April to December 2017 and 21 percent for January through March 2018, which yields a prorated statutory tax rate of 31.5 percent. Therefore, PSE has used this prorated statutory tax rate of 31.5 percent to adjust income tax expense on all of PSE's commission basis report adjustments.

For gas operations, there are only a few schedules that are not decoupled, which results in a minor adjustment for temperature. To determine the amount of the adjustment, the system-level temperature adjustment was calculated in total and allocated to each of the applicable classes by month based on the same gas temperature adjustment methodology used in PSE's 2017 general rate case.

The adjustment is an addition of 819,211 therms. When priced by rate schedule at the rates in effect each month of the reporting period, the adjustment yields an increase to test year revenue of $17,119 and increases net operating income for natural gas operations by $11,193.

Q. Please continue describing the adjustments.

A. The next adjustments are as follows:

CBR Adjustment Nos. 5.10E & 6.10G Revenue & Expense

Consistent with PSE's general rate case and CBR treatment, for both electric and natural gas, this adjustment removes merger rate credit revenues passed back in Schedule 132 as well as removes PSE's earnings sharing accruals booked during the period. Additionally, for electric, this adjustment removes the impacts of amounts included in Schedule 95a, which provides pass back of PSE's wind related Treasury grants. The associated amortization of Schedule 95a revenues is also removed on this adjustment. Finally, for electric, this adjustment removes the expense associated with creating the regulatory liability associated with production tax credits ("PTCs") that was recorded during the test year. Any related tax effects of these Treasury grants or PTCs would be removed in the federal income tax adjustment (reference number 5.11).

CBR Adjustment Nos. 5.11E & 6.11G Federal Tax

This restating adjustment, which is applied in the same manner as in a commission basis report and general rate case, calculates the federal income tax expense applicable to the test year for electric and natural gas operations respectively. Because annualizing adjustments are not allowed in a CBR,[7] PSE uses the statutory federal income tax rates that were in effect for each month of the reporting period to calculate the income tax expense for electric and natural

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[7] WAC 480-90-257(3) & WAC 480-100-257(3).

gas operations. The statutory rate during the test year is 35 percent for April to December 2017 and 21 percent for January through March 2018, which yields a prorated statutory tax rate of 31.5 percent. This adjustment reflects the impact of flow-through taxes; it allows the turnaround of the excess deferred taxes through the Average Rate Assumption Method ("ARAM") of $5.8 million for electric and $2.0 million for natural gas, which occurred in the first quarter of 2018, to remain in the Commission basis results. Based on Commission rules, these are the only adjustments PSE is allowed to make in its CBR. Therefore, additional adjustments will be made to income taxes in PSE's ERF Adjustment No. 3.07E & 4.07G, which are discussed later in this testimony. This CBR adjustment decreases net operating income for electric operations by $13,381,486 and natural gas operations by $ 9,904,784.

CBR Adjustment Nos. 5.12E & 6.12G Tax Benefit of Interest

During the reporting period, the tax benefit of PSE's interest deduction is recognized below the line. Therefore, this adjustment, which is applied in the same manner as in a commission basis report and general rate case, recognizes the tax benefit of PSE's regulated interest by multiplying the weighted average cost of debt during the reporting period of 2.94 percent[8] by the electric and natural gas rate base to derive the regulated interest during the reporting period. Then it applies the prorated statutory federal tax rate of 31.5 percent to derive the reduction to tax expense. The result is an increase to net operating income of

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[8] *See* page 15 (reference number 5.08) of Exh. SEF-5 and page 13 (reference number 6.08) of Exh. SEF-6.

$48,356,629 for electric operations and an increase to net operating income of $17,620,748 for natural gas operations.

CBR Adjustment Nos. 5.13E & 6.13G Pass-Through Revenue & Expense

This restating adjustment, which is applied in the same manner as in a commission basis report and general rate case, removes from operating revenues all rate schedules that are a direct pass through of specifically identified costs or credits to customers, such as the conservation rider, municipal taxes and the low-income program. The associated expense recorded in the reporting period for these direct pass-through tariffs are also removed in this adjustment.

The net impact of this adjustment is to decrease net operating income for electric operations by $374,060 and natural gas operations by $963,273.

CBR Adjustment Nos. 5.14E & 6.14G Rate Case Expense

This restating adjustment, which is applied in the same manner as in a commission basis report and general rate case, adjusts the test year rate case expense to equal the average cost of the prior two general rate cases and increases net operating income for electric operations by $261,776 and decreases net operating income for natural gas operations by $13,079.

CBR Adjustment Nos. 5.15E & 6.15G Bad Debt Expense

This restating adjustment, which is applied in the same manner as in a commission basis report and general rate case, calculates the bad debt rate for Commission reporting by using the average bad debt percentage for three of the last five years after removing the high and low years. The net reporting period revenues are multiplied by the calculated average bad debt percentage to determine the amount of restated bad debt expense. This amount is compared to the actual reporting period level of bad debt expense to determine the effect on income. This bad debt percentage is also used in the conversion factor shown on page 15 for electric and page 13 for gas used in the various CBR adjustments that impact revenues.

This adjustment decreases net operating income for electric operations by $770,394 and for natural gas operations by $770,820.

CBR Adjustment Nos. 5.16E & 6.16G Incentive Pay

This restating adjustment, which is applied in the same manner as in a commission basis report and general rate case, uses a four-year average of incentive compensation paid to employees and is allocated between electric and natural gas operations.

For this calculation, PSE used the payouts which occurred in March for the years 2015 through 2018, which related to calendar years 2014 through 2017. The incentive payment is allocated to operations and maintenance ("O&M") expense based on the distribution of wages during the test year. The four-year average of the payouts is allocated between electric and natural gas O&M expense using the direct labor allocator.

This adjustment increases net operating income for electric operations by $1,252,544 and natural gas operations by $901,133.

CBR Adjustment Nos. 5.17E & 6.17G Excise Tax and Filing Fee

This restating adjustment, which is applied in the same manner as in a commission basis report and general rate case, adjusts the Washington State excise tax and WUTC filing fee to the amount that should be recorded for these costs based on the level of applicable revenue recorded in the test year. This adjustment decreases net operating income by $35,348 for electric operations and $8,073 for natural gas operations.

CBR Adjustment Nos. 5.18E & 6.18G Directors and Officers ("D&O") Insurance

This restating adjustment is applied in the same manner as in a commission basis report. In a general rate case, this is a pro forma and restating adjustment that annualizes the premiums based on the most recent policy. Because WAC 480-100-257(3) and WAC 480-90-257(3) do not allow annualizing adjustments, the CBR adjustment does not annualize the most recent premiums and only removes the portion of D&O insurance that should be allocated to non-utility activity based on the applicable ratios specific to the test year.

The total amount is then allocated to O&M expense in the same manner as the test year D&O insurance, which is based on where direct labor is charged. To allocate the restated insurance expense between utility and non-utility activity, PSE uses an allocation methodology evenly weighted between the 1) allocation of directors' fees and 2) allocation of covered employees' salaries. The restated D&O insurance applicable to O&M is then allocated between electric and natural gas operations based on the average number of customers allocator.

This adjustment increases net operating income for electric operations by $4,993 and natural gas operations by $3,605.

CBR Adjustment Nos. 5.19E & 6.19G Interest on Customer Deposits

This restating adjustment reflects the impact of interest associated with using customer deposits as a reduction to rate base. Since this interest is originally recorded below the line in the test period, this restating adjustment adds to operating expense the amount of interest that was recorded below the line during the reporting period. The adjustment is applied in the same manner as in a commission basis report. In a general rate case, this is a pro forma and restating adjustment that annualizes the interest expense based on the most recent interest rate. Because WAC 480-100-257(3) and 480-90-257(3) do not allow annualizing adjustments, the CBR adjustment does not annualize the most recent interest rate and only brings the actual interest cost for the reporting period above the line. The impact of this restating adjustment decreases net operating income for electric operations by $308,786 and natural gas operations by $89,978.

CBR Adjustment Nos. 5.20E & 6.20G Pension Plan

This restating adjustment, which is applied in the same manner as in a commission basis report and general rate case, calculates pension expense based on a four-year average of cash contributions to PSE's qualified retirement fund.

As determined by the plan actuary, PSE made the following tax deductible cash contributions during each of the twelve-month periods ending in March: $22.5 million in 2015, $18.0 million in 2016, $28.5 million in 2017 and $13.5 million in 2018. These total $82.5 million for the four-year period ending with the CBR reporting period. The four-year average of these cash contributions is allocated to O&M based on the distribution of wages and then allocated between electric and natural gas based on the employee benefit assessment allocator.

This adjustment decreases net operating income for electric operations by $2,058,762 and natural gas operations by $1,046,928.

CBR Adjustment Nos. 5.21E & 6.21G Injuries and Damages

This restating adjustment, which is applied in the same manner as in a commission basis report and general rate case, is prepared in accordance with the 2009 general rate case order in Dockets UE-090704 and UG-090705. This adjustment restates injuries and damages by adjusting actual test year accruals and payments of injuries and damages to the three-year average of the most recent accruals and payments. This adjustment increases net operating income for electric operations by $626,367 and natural gas operations by $205,678.

CBR Adjustment Nos. 5.22E & 6.22G Miscellaneous Adjustments

This restating adjustment removes from the reporting period costs that should have been recorded below the line. This adjustment increases net operating income by $2,366 for electric operations and $416,934 for natural gas operations.

CBR Adjustment No. 5.23E Accounting Standards Codification 815

This restating adjustment, which is applied in the same manner as in a commission basis report and general rate case, removes the effect of ASC 815 (previously SFAS 133), that represents mark-to-market gains or losses recognized for derivative transactions. This accounting pronouncement is not considered for rate making purposes. This adjustment increases net operating income for electric operations by $7,197,139.

CBR Adjustment No. 5.24E Storm Normalization

This restating adjustment which is applied in the same manner as in a commission basis report and general rate case reflects adjustment of the test year expense level of storm damage expense to the normal level of storm damage expense, which is based on the average of the most recent six years. In a general rate case, this adjustment would also pro form the deferred storm balances, however, this part of the adjustment is not allowed under the CBR WAC. Accordingly, PSE is making the pro forma portion of the storm adjustment in its ERF Adjustment No. 3.11E which is reflected on page 13 of Exh. SEF-3. This adjustment increases net operating income for electric operations by $2,392,136.

Q. Please explain how PSE adjusted its commission basis report results for ERF purposes in Exh. SEF-3 and Exh SEF-4.

A. As discussed previously, the first step after completing the commission basis report is to remove from the adjusted results revenues, expenses and rate base for items that are not to be recovered in an ERF. For electric operations, the non-ERF items are power cost related revenues and expenses that are recovered in a power cost only rate case. These amounts are removed from the commission basis report in Column D on page four of Exh. SEF-3. For natural gas operations, these non-ERF items include (i) the Purchased Gas Adjustment revenues and gas costs recovered under gas rate schedule 106; and (ii) cost recovery mechanism revenues, depreciation and rate base recovered under gas rate schedule 149.

These amounts are removed from the commission basis report adjusted results in Column D on page four of Exh. SEF-4.

As the commission basis report adjusted results contain a prorated statutory tax rate of 31.5 percent as discussed above, the income tax impacts of removing the non-ERF amounts were also determined using 31.5 percent. The amounts included in Column D are subtracted from Column C to arrive at the ERF-only restated commission basis report results.

Q. Do the ERF-only commission basis report adjusted results require adjustment prior to being used to calculate the revenue requirement in this proceeding?

A. Yes. Because WAC 480-100-257(3) and 480-90-257(3) do not allow adjustments that annualize price, wage, or other cost changes during a reporting period, the revenues in the adjusted results do not reflect the most recent rates PSE established in Dockets UE-180282 and UG-180283 ("Tax Reform Revenues"). Therefore, to reflect the most current revenues for ERF purposes requires adjustment of the CBR adjusted results to annualize the Tax Reform Revenues. Additionally, with annualization of these revenues, PSE must annualize the costs that underlie these revenues to the extent these costs are not fully reflected in the reporting period. This approach was agreed to in the 2017 Settlement Agreement which is shown in Exh. KJB-3.

Q. When annualizing the expenses associated with the annualized general rate case revenues, is it necessary to make all of the same adjustments as were made in the 2017 general rate case?

A. No. There are many adjustments that were made in the 2017 general rate case where similar adjustments to the current test period are not needed because the current test period contains a representative level of costs for which the general rate case adjustment was made. I have included Exh. SEF-7 which presents all of the adjustments that potentially could have been made in this filing starting from the standard commission basis report adjustments and including all of the 2017 general rate case adjustments that were made. It then provides an explanation as to whether or not the adjustment is needed for this filing.

Q. Please explain the ERF adjustments in Exh. SEF-3 and SEF-4.

A. PSE made the following ERF adjustments to the electric and gas CBR results which are summarized on page 6 of Exhs. SEF-3 and SEF-4 to determine the ERF deficiencies for electric and gas:

ERF Adjustment Nos. 3.05E and 4.05G Annualize Revenues

In order to reflect a full amount of revenue from PSE's most recent rates established in Dockets UE-180282 and UG-180283, PSE first removed the decoupling deferrals that still exist in the ERF-only CBR adjusted results in order to establish volumetric revenues to be adjusted to amounts from Dockets UE-180282 and UG-180283. This removal is performed on line 8 for electric and line 7 for gas of page 7 and removes $974,923 and $8,015,164 of revenue respectively. Additionally, before repricing the revenues at the rates from Dockets UE-180282 and UG-180283, PSE removed the deferrals for tax reform that were booked as proposed in PSE's accounting petition filed under Dockets UE-171225 and UG-171226. This adjustment is performed on line 9 for electric and line 8 for gas and removes $18,931,683 and $8,475,167 of negative revenues respectively. Once these adjustments were made, PSE then repriced the weather adjusted volumes and billing determinants for all electric and natural gas customer classes at the rates from Docket UE-180282 and UG-180283. These adjustments are reflected on lines 2 and 3 for electric and lines 2 and 5 for gas. As I discuss below, the federal income tax rate for ERF purposes will be reflected at the most current statutory tax rate, which is 21 percent. ERF Adjustments 3.07E and 4.07G make this adjustment to annualize the federal income taxes for ERF purposes. Accordingly, the impact of all ERF adjustments on federal income taxes is calculated at 21 percent as shown on line 24 for electric and line 23 for gas. The impact of all these adjustments on net operating income is a reduction of $65,456,863 for electric operations and $23,291,691 for natural gas operations.

ERF Adjustment Nos. 3.06E and 4.06G Depreciation Study

In order to match the annualized revenues, this annualizing adjustment calculates the impact of implementing the depreciation study over the test year as approved in the 2017 general rate case. The new depreciation rates went into effect December 19, 2017, and this adjustment recalculates the depreciation expense as if the rates were in effect for the entire test year. The new depreciation rates were applied against the depreciable balance for ERF related plant from April 2017 through December 2017 and compared to the actual test year amounts for those months to determine the adjustment for the test period. This adjustment shown on page eight resulted in an increase to depreciation expense for electric on line 5 of $8,894,287and a decrease to depreciation expense for gas on line 5 of

$14,963,763. Additionally, to recognize the impact of the increase in depreciation expense on accumulated depreciation, on line 13 for electric and line 14 for gas, PSE increased (electric) or reduced (gas) the balance of accumulated depreciation by the increase or decrease in depreciation expense. The impact on deferred federal income taxes at 21 percent for the change to book depreciation was also taken on line 14 for electric and line 15 for gas.

The impact of these adjustments is a decrease to net operating income of $7,026,487 for electric and an increase to net operating income for gas of $11,821,373. Additionally, electric rate base is decreased by $7,026,487 and gas rate base is increased by $11,821,373.

ERF Adjustment Nos. 3.07E and 4.07G Annualize Federal Income Tax

In order to match the income tax expense to the annualized revenues that were adjusted in ERF Adjustment Nos. 3.05E and 4.05G, an adjustment is required to annualize the statutory tax rate in the ERF-only CBR adjusted results from 31.5 percent to 21 percent. This adjustment was performed to adjust the federal income tax expense in the ERF to the expected effective tax rate of 19.96 percent for electric and 19.61 percent for natural gas. The expected effective tax rate is largely based on the following adjustments:

1) use of 21 percent statutory rate for all months;

2) reversal of ERF-only plant related (FERC 282) excess deferred taxes using the Average Rate Assumption Method ("ARAM"), which reduced deferred tax expense by $2.8 million for electric and $1.9 million for gas.

The difference between the ERF ARAM and the CBR ARAM mentioned earlier in my testimony is the ARAM associated with production plant that is not included in the ERF. The gas ARAM for CBR and ERF are close because there is very little ARAM on plant recovered through the gas CRM as the assets being replaced are fully depreciated for book purposes and the CRM replacement assets are too new to be in turnaround.

3) reversal of prior flow-through tax benefits; and

4) meals and entertainment permanent differences.

Given this, the effective tax rates of less than 21 percent are reasonable considering the annualized statutory tax rate of 21 percent and the ARAM turnaround which reduces the effective tax rate below the statutory tax rate.

These adjustments result in an increase to net operating income of $25,330,036 for electric operations and $9,202,836 for natural gas operations.

ERF Adjustment Nos. 3.08E and 4.08G Deferred Property Gains and Losses

In order to match the annualized revenues, this annualizing adjustment calculates the impact of including a full year of amortization for the deferred gains and losses over the test year as approved in the 2017 general rate case. The new amortization for deferred gains and losses went into effect December 19, 2017, and this adjustment recalculates the amortization expense as if the amortization were in effect for the entire test year. These annualized amounts were compared to the actual test year amounts to determine the adjustment for the test period.

The impact of this annualizing adjustment increases net operating income by $148,784 for electric operations and decreases net operating income by $91,330 for natural gas operations.

ERF Adjustment Nos. 3.09E and 4.09G Environmental Remediation

In order to match the annualized revenues, this annualizing adjustment calculates the impact of implementing the environmental remediation amortization for deferred proceeds and costs over the test year as approved in the 2017 general rate case. The new amortization for environmental remediation went into effect December 19, 2017, and this adjustment recalculates the amortization expense as if the amortization were in effect for the entire test year. These annualized amounts were compared to the actual test year amounts to determine the adjustment for the test period.

The impact of this annualizing adjustment decreases net operating income by $804,286 for electric operations and $4,859,924 for natural gas operations.

ERF Adjustment Nos. 3.10E and 4.10G Payment Processing Costs

The payment processing adjustment in the general rate case addressed three items associated with changes in payment processing costs: 1) it established a three-year amortization for the previously deferred costs associated with customers' use of debit and credit cards to pay their bills; 2) it included an estimate of the ongoing costs PSE would incur for January 2018 through December 2018 once those fees were no longer deferred; and 3) it incorporated the effect of the new service agreement PSE negotiated with its payment processing vendor that went into effect in October 2016.

In order to match the annualized revenues, this adjustment annualizes costs in the earlier part of the test year that were being deferred prior to rates becoming effective on December 19, 2017. The adjustment is captured on line 2 and takes the credit card transaction assumptions for the annual period of December 2017 to November 2018 that were used in Dockets UE-180282 and UG-180283, less actual costs reflected in the ERF test year (December 19, 2017 through March 31, 2018), for a total increase to operating expense of $1,946,751 for electric operations and $1,259,508 for natural gas operations. Next, on line 3, the amortization of the deferrals, which commenced on December 19, 2017, was annualized for an additional increase to operating expense of $592,550 for electric operations and $427,153 for natural gas operations. The effect of the new service agreement with the payment processing vendor was fully reflected in the test year; this item from the GRC is not reflected on this page as no adjustment to the test period is necessary. The overall impact of this annualizing adjustment on net operating income is a decrease of $2,006,048 for electric operations and $1,332,462 for natural gas operations.

ERF Adjustment No. 3.11E Storm Damage

In order to match the annualized revenues, this electric only annualizing adjustment calculates the impact of implementing the storm damage amortizations over the test year as approved in the 2017 general rate case. The new amortization for storm damage went into effect December 19, 2017, and this adjustment recalculates the amortization expense as if the amortization were in effect for the entire test year. These annualized amounts were compared to the actual test year amounts to determine the adjustment for the test period.

In this case PSE is not proposing amortization of deferred storm costs that occurred between the date of the 2017 Settlement Agreement and December 31, 2017. Paragraph 77 of the 2017 Settlement Agreement provides that PSE shall propose amortization of these deferred storm costs, for recovery in its next general rate case or any ERF. PSE believes proposing amortization and recovery of these storm costs, which would increase the revenue requirement, would complicate this ERF, and PSE intends to propose amortization of these deferred storm costs in its next general rate case.

The impact of this annualizing adjustment on electric operations is a decrease to net operating income of $5,561,664.

<u>Base Rates Revenue Requirement Deficiency</u>

Q. Please provide an overview of the electric and gas revenue requirement that results after all the above adjustments are incorporated.

A. The overall electric base rates revenue requirement deficiency is shown on page one of Exh. SEF-3. The schedule shows the test period restated rate base on line 1, rate of return on line 2, operating income requirement on line 4 and base rates revenue requirement deficiency on line 10.

Based on $3,145,294,476 invested in rate base, a 7.49 percent rate of return and $204,466,406 of restated base rates operating income, PSE has an overall base rates revenue requirement deficiency for electric revenues of $41,386,720.

The overall natural gas base rate revenue requirement deficiency is shown on page one of Exh. SEF-4. The schedule shows the test period restated rate base on line 1, rate of return on line 2, operating income requirement on line 4 and base rates revenue requirement deficiency on line 10.

Based on $1,837,067,097 invested in rate base, a 7.49 percent rate of return and $112,393,510 of restated base rates operating income, PSE has an overall base rates revenue requirement deficiency for gas revenues of $33,423,002.

III. ENVIRONMENTAL REMEDIATION ALLOCATION METHODOLOGY

Q. Please provide an update on the process that PSE and Commission Staff have been engaged in to develop a methodology for allocating third party and insurance proceeds for environmental remediation accounts.

A. Per paragraph 54 of the 2017 Settlement Agreement, PSE and Commission Staff were to commence a process to determine a methodology for assigning third party and insurance recoveries (“proceeds”) for environmental remediation received by PSE, and this process was to commence by March 15, 2018. PSE and Commission Staff fulfilled this requirement with their first meeting on the environmental remediation assignment methodology, which was held on February 13, 2018. Additionally, in the 2017 Settlement Agreement, PSE agreed to update the Commission on the process in this expedited rate filing. Although Staff and

PSE are continuing to work together on a process, PSE provides the following update on the progress made to date. PSE and Commission Staff have a working draft of the agreement on how proceeds should be treated, which bases the treatment of proceeds on the type of proceeds received and the type of deferral being offset. It segregates deferrals into three categories:

- Additional costs associated with projects previously reviewed and approved for amortization in Dockets UE-170033 and UG-170034;
- New projects whose costs would have been covered by legacy policies that comprised the unassigned recoveries that existed and were reviewed in in Dockets UE-170033 and UG-170034; and
- New projects that cannot be tied to prior recoveries that may or may not have new recoveries specific to the project.

The draft methodology also indicates that treatment of any other unassigned recoveries that were not assessed in the 2017 general rate case and that are not connected to a specific site will be determined in a future proceeding.

PSE intends to continue working with Commission Staff to finalize the methodology and once finalized, to work with interested parties to ensure understanding. PSE plans to file its next rate case using the final agreed upon methodology and will seek approval of the final agreed upon methodology at that time.

IV. CONCLUSION

Q. Does this conclude your testimony?

A. Yes, it does.