EXH. SEF-1T
DOCKETS UE-18___/UG-18___
2018 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

NOVEMBER 7, 2018

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 position with Puget Sound Energy.

A. My name is Susan E. Free. My business address is 355 110th Ave. NE, Bellevue, WA 98004. I am the Manager 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 in a manner that is consistent with the ERF methodology utilized in 2013 in Dockets UE-130137 and UG-130138 and the methodology outlined in the Multiparty Settlement Stipulation and Agreement in PSE's 2017 general rate case[1] ("2017 Settlement Agreement") while also adapting those methodologies to incorporate feedback that Commission Staff provided in response to PSE's ERF

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

filing in Dockets UE-180532 and UG-180533[2]. 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 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. PSE used the following steps to determine the revenue requirement for this proceeding:

1. **<u>Commission Basis Report</u>** – PSE prepared a commission basis report ("CBR") for the twelve months ended June 30, 2018, consistent with the approach defined in WAC 480-90-257 and WAC 480-100-257.

2. **<u>End of Period CBR</u>** – Following treatment in its most recent general rate case, PSE's CBR must be prepared with rate base valued on the average-of-monthly-averages basis ("AMA"). In this proceeding, PSE is requesting recovery of its rate base on an end-of-period basis ("EOP") as supported by Ms. Katherine J. Barnard in her Prefiled Direct Testimony, Exh. KJB-1T. Therefore, to adapt the CBR results for purposes of this filing, the results from

[2] PSE filed an Expedited Rate Filing on June 15, 2018 that was subsequently withdrawn in response to concerns expressed by Commission Staff.

No. 1, above, were adjusted to be presented on an end-of-period basis for rate base and associated depreciation and amortization expense[3].

3. **<u>EOP Annualized</u>** – The EOP CBR results from Step 2, above, were further adjusted to be reflected on an annualized basis. Specifically, PSE annualized the authorized revenue from its May 1, 2018 tariff filing in Dockets UE-180282 and UG-180283, which set new base rates to reflect changes in tax law ("Tax Reform Update").[4] Due to the annualization of revenue and to ensure proper matching, the EOP CBR results were also adjusted to annualize any underlying amortizations that were the basis for determining the annualized revenues.

4. **<u>Removal of Non-ERF Items</u>** – The items for which PSE is not requesting recovery in this filing need to be removed from the EOP annualized results prior to determining the revenue requirement for this proceeding. Therefore, PSE removed the power costs that are addressed in PSE's power cost adjustment mechanism ("PCA") from the electric annualized results, and PSE removed the purchased gas costs and the gas cost recovery mechanism related costs recovered in gas Schedule 149 from the natural gas annualized results.

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[3] The Prefiled Direct Testimony of Matthew R. Marcelia, Exh. MRM-1T, discusses the IRS requirements to treat rate base, depreciation expense and deferred taxes on a consistent basis.

[4] In Dockets UE-180282 & UG-180283, PSE updated its rates using the 2017 general rate case compliance filings from Dockets UE-170033 and UG-170034 ("2017 general rate case"), updated to reflect the changes resulting from the Tax Cuts and Jobs Act ("TCJA"), which became effective January 1, 2018, and lowered the corporate tax rate from 35 percent to 21 percent. Therefore, throughout this testimony I will refer to approved treatment from the 2017 general rate case, which is interchangeable with rates approved in Dockets UE-180282 and UG-180283.

All remaining costs were used to determine the electric and natural gas revenue requirement associated with this expedited rate filing.

5. **<u>Determination of the Deficiency</u>** – PSE calculated the revenue deficiency using a 7.49 percent rate of return which represents the approved rate of return from the 2017 general rate case that has been updated to reflect the lower cost of debt, as discussed in the Prefiled Direct Testimony of Katherine J. Barnard, Exh. KJB-1T. Mr. Jon A. Piliaris discusses how the revenue requirement is allocated in his Prefiled Direct Testimony, Exh. JAP-1T.

Q. Please explain Exh. SEF-3.

A. Exh. SEF-3[5] presents the calculation of the electric revenue deficiency based on the EOP annualized ERF results. 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 $5,101,822,356, a rate of return of 7.49 percent, and an adjusted net operating income of $367,953,662, PSE has an overall revenue deficiency of $18,853,621, or $18,850,552 after removing the portion of the deficiency associated with firm resale customers.

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[5] Exhs. SEF-3 through SEF-12, and SEF-15, are filed in MS Excel format. For convenience, these exhibits have also been provided in PDF format in Exh. SEF-16.

Q. Why did PSE use a rate of return of 7.49 percent to determine the revenue deficiency?

A. As discussed in more detail by Ms. Barnard, the 7.49 percent rate of return is based on the rate of return of 7.60 percent that was authorized in the final order in PSE's 2017 general rate case, 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 of the rate of return 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 TCJA, which lowered the corporate tax rate from 35 percent to 21 percent. PSE's Tax Reform Update 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 June 2018 CBR[6] 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 summary of the steps taken (as discussed above) to develop the electric revenue requirement in this proceeding. Exhs. SEF-

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

5, 7 and 9, which are described in more detail later in this testimony, support each of the following columns.

- Column A represents the per books results of electric operations for the twelve months ended June 30, 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[7].
- Column C combines Columns A and B to show the AMA restated results of operations.
- Column D brings balances to end-of-period status.
- Column E combines Columns C and D together to show the end-of-period restated results of operations.
- Column F pro forms the revenues to reflect the change in revenues authorized in the Tax Reform Update, which are supported by Mr. Piliaris in Exh. JAP-3. 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 is discussed in more detail later in my testimony.
- Column G adds together Column E and F to present end-of- period, annualized results of operations.

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[7] Exh SEF-14 contains an overview of procedures in place at PSE on which PSE relies for adherence to WAC 480-100-257(2)(b).

- Column H removes the costs and revenues that are subject to PSE's PCA mechanism.
- Column I includes all other costs to be recovered in this expedited rate filing. This is the column on which the revenue requirement and deficiency is calculated on page 1 of Exh. SEF-3.

Q. Please explain the rate of return shown in SEF-3.

A. Exh. SEF-3 begins with a rate of return of 7.81 percent, shown in column C on line 38. This does not reflect the actual return PSE is currently earning for several reasons.

First, it has not been adjusted to reflect end-of-period. In Exh. KJB-1T, Ms. Barnard discusses the reasons PSE is seeking recovery of end-of-period rate base in this proceeding. When PSE reflects its CBR on an end-of-period basis the rate of return falls to 7.59 percent, which is 9 basis points below the authorized rate of return of 7.68 for the period.[8]

Second, it does not include the current annualized revenues based on PSE's Tax Reform Update filing. When the adjustments to annualize the effects of PSE's Tax Reform Update are incorporated in Columns F and G, PSE's rate of return falls an additional 23 basis points to 7.36 percent.

Finally, PSE must remove the PCA-related revenues and costs before determining the revenue requirement and deficiency. Ms. Barnard discusses the reasons that

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[8] The 7.68 percent rate of return is based on a 7.77 percent rate of return authorized in Docket UE-130137 for 171 days (July 1-December 18, 2017) and a 7.60 percent rate of return authorized in Docket UE-170033 for 194 days (December 19, 2017 through June 30, 2018).

the PCA-related revenues and costs should not be included in this proceeding in Exh. KJB-1T. Once the PCA-related revenues and costs are removed, the ERF related rate of return decreases an additional 15 basis points to 7.21 percent, as shown in column I. This is 28 basis points below the 7.49 percent authorized rate of return, adjusted for lower debt costs, requested in this proceeding.

Page 1 of Exh. SEF-3 calculates the expedited rate filing increase of $18.9 million that would be necessary to allow PSE the opportunity to earn its authorized rate of return, adjusted for lower cost of debt, while also 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 in the same format that was just described for Exh. SEF-3. Page 1 of Exh. SEF-4 shows in the first column the restated test period rate base (line 1) and net operating income (line 6). Based on a rate base of $1,863,536,608 a rate of return of 7.49 percent and an adjusted net operating income of $ 111,326,695, PSE would have an overall natural gas revenue deficiency of $37,470,801. 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. Is this the natural gas revenue requirement and deficiency that PSE is requesting in this proceeding?

A. No. WAC 480-07-505(1)(b) indicates that if a company's tariffs would be restructured such that the gross revenue provided by any customer class would increase by three percent or more, then by definition, the proceeding is considered a general rate case. Because the current filing is an expedited rate filing and not a general rate case, PSE has held each customer class to less than a three percent increase when developing the rates for this proceeding. This reduces the requested revenue requirement and resulting deficiency by $15.8 million, which is reflected in the second column on page 1 of Exh. SEF-4. This limitation will essentially only allow PSE the opportunity to earn a rate of return of 6.85 percent which is well below[9] PSE's 7.49 percent requested rate of return against which PSE will be benchmarked.

Q. Please continue explaining Exh. SEF-4.

A. Page 4 of Exh. SEF-4 presents the summary of the steps taken to develop the natural gas revenue requirement in this proceeding and follows the same methodology as laid out above for Exh. SEF-3[10]. The non-ERF costs removed in Column H are for PSE's PGA and Gas Costs Recovery mechanism. Column I is the column on which the revenue requirement and deficiency is calculated on page 1 of Exh. SEF-4.

On a commission basis, the rate of return in column C on line 38 is 6.61 percent which lags PSE's authorized rate of return of 7.68 percent for the period. And when PSE reflects its CBR on an end of period basis, the rate of return decreases 54 basis points to 6.07 percent. When the adjustments to annualize the effects of

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[9] 64 basis points below as reflected in the last column of page 1 of Exh. SEF-4.

[10] The calculation by Mr. Piliaris for natural gas annualized revenues is presented in his Exh. JAP-4.

PSE's Tax Reform Update are incorporated in Columns F and G, PSE's rate of return increases an additional 9 basis points to 6.16 percent. Finally, when the PGA and Gas Cost Recovery mechanism revenues and costs are removed, the rate of return decreases to 5.97 percent in column I. This is 152 basis points below the authorized rate of return, adjusted for lower debt costs, of 7.49 percent. Therefore, page 1 of Exh. SEF-4 calculates the expedited rate filing increase of $37.5 million that would be necessary to allow PSE the opportunity to earn its requested rate of return, bringing rate base, revenues and expenses in alignment for the current period. However, as noted above, PSE is not requesting the full $37.5 million, but rather has limited its request to $21.7 million to keep the rate increases below three percent for customer groups, which would represent only a 6.85 percent rate of return.

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 June 30, 2018, for electric and natural gas operations respectively in a format consistent with PSE's annual CBR filings. These exhibits provide the basis and support for page 4 of Exh. SEF-3 and Exh. SEF-4.

Q. Please describe the filing requirements associated with CBRs.

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 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. Yes. Adjustments relating to all aspects of PSE's operations, including those related to items recovered in PSE's PCA and PGA mechanisms were made. The following table shows the adjustments PSE makes in a CBR and their reference numbers in this filing.

Table 1 – List of Commission Basis Report Adjustments

Ref. No. Electric	Gas	Description	Ref. No. Electric	Gas	Description
5.01	6.01	CBR Summary Pages	5.14	6.14	Rate Case Expenses
5.02	6.02	Cost of Capital	5.15	6.15	Bad Debt Expense
5.03	6.03	Test Year Income Statement	5.16	6.16	Incentive Pay
5.04	6.04	Test Year Balance Sheet	5.17	6.17	Excise Tax and Filing Fee
5.05	6.05	Test Year Rate Base	5.18	6.18	D&O Insurance
5.06	6.06	Test Year Working Capital	5.19	6.19	Interest on Customer Deposits
5.07	6.07	Allocation Methods	5.20	6.20	Pension Plan
5.08	6.08	Conversion Factor	5.21	6.21	Injuries and Damages
5.09	6.09	Temperature Normalization	5.22	6.22	Miscellaneous Adjustments
5.10	6.10	Revenues and Expenses	5.23	N/A	ASC 815
5.11	6.11	Federal Income Taxes	5.24	N/A	Storm Damage
5.12	6.12	Tax Benefit of Restated Interest	5.25	N/A	Power Costs
5.13	6.13	Pass-Through Revenue and Expens	5.26	N/A	Montana Electric Energy Tax
			5.27	N/A	Wild Horse Solar

Q. Please provide an overview of the adjustments made in PSE's June 30, 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, present the unadjusted operating income statement and AMA rate base for electric and natural gas respectively as of June 30, 2018, in the column labeled "Actual Results of Operation." 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 presents 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.

Q. On what basis is rate base and working capital presented?

A. WACs 480-90-257(2)(a) and 480-100-257(2)(a) require PSE's results of operations and rate base to be reported as accepted by the Commission in PSE's most recent general rate case or subsequent order. Therefore, PSE has presented its rate base and working capital in this filing for CBR purposes consistent with its 2017 general rate case. In that proceeding, rate base and working capital were accepted on an AMA basis. Additionally, the working capital calculation follows the methodology agreed to in PSE's settlement in that proceeding, including the inclusion of CWIP in the determination of the working capital ratio. Further, below I explain how rate base and working capital are adjusted to an end-of-period basis for purposes of determining the ERF revenue requirement.

Q. Please continue describing the adjustments.

A. The next adjustments are as follows:

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 for electric, and on page 12 of Exh. SEF-6 for natural gas (reference numbers 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 PSE's CBRs and general rate cases.

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

Page 15 of Exh. SEF-5 (electric) and page 13 of Exh. SEF-6 (natural gas) present the development of the electric and natural gas 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 Commission ("WUTC") annual filing fee, and bad debts. The conversion factor used for commission basis reporting is 0.951557 for electric operations and 0.954404 for gas operations. The federal income tax rate used in the CBR conversion factors is 28 percent, the basis for which is discussed further below under CBR Adjustment Nos. 5.11E & 6.11G.

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

A. Pages 2 and 3 of Exh. SEF-6 for natural gas and pages 2 through 4 of Exh. SEF-5 for electric present a summary schedule of all the CBR restating adjustments for electric and natural gas operations. The first column of numbers on page 2 is the unadjusted net operating income and the unadjusted AMA rate base for the year ended June 30, 2018. Each column to the right of the first column represents the restating adjustments to net operating income or rate base that are 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 of Exh. SEF-6 for natural gas and page 4 of Exh. SEF-5 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 of Exh. SEF-6 for natural gas and pages 2 through 4 of SEF-5 for electric. The following section of testimony provides an overview of each of the adjustments:

CBR Adjustment Nos. 5.09E & 6.09G Temperature Normalization

The adjustment to electric and natural gas revenues for the normalization to load for temperature is discussed in the Prefiled Direct Testimony of Jon A. Piliaris, Exh. JAP-1T. The impact on electric and gas net operating income is a decrease for electric of $1,942,304 and an increase for natural gas of $15,999.

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 in 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 are removed in the federal income tax adjustment (reference number 5.11). This CBR adjustment decreases net operating income for electric operations by $25,673,714 and natural gas operations by $247,785.

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 before the deduction for interest applicable to the test year for electric and natural gas operations respectively. Because annualizing adjustments are not allowed in a CBR,[11] 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 gas operations. The statutory rate during the test year is 35 percent for July to December 2017 and 21 percent for January through June 2018, which yields a prorated statutory tax rate of 28 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 $7.6 million for electric and $2.6 million for natural gas, which occurred in the first two quarters of 2018 to remain in the commission basis results. Additionally, this adjustment includes permanent differences at test year levels consistent with PSE's established commission basis reporting. 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 Nos. 9.04E & 10.04G, which are discussed later in this testimony. This CBR adjustment

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

increases net operating income for electric operations by $3,963,382 and decreases net operating income for natural gas operations by $9,354,928.

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 and the Federal Tax Adjustment Nos. 5.11E and 6.11G do not include the tax benefit for PSE's interest deduction. 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 2.89 percent[12] 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 28 percent to derive the reduction to tax expense. The result is an increase to net operating income of $41,850,058 for electric operations and an increase to net operating income of $15,056,153 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.

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[12] See pages 4 and 5 of Exhs. SEF-3 and SEF-4, respectively.

The net impact of this adjustment is to decrease net operating income for electric operations by $345,862 and natural gas operations by $1,068,142.

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

This restating adjustment, which is applied in the same manner as in a CBR and general rate case, adjusts the test year rate case expense to equal the average cost of the prior two general rate cases normalized over two years. Additionally, for electric, the adjustment includes the average cost of the prior two power cost only rate cases normalized over four years. This adjustment increases in net operating income for electric operations by $63,732, and decreases net operating income for natural gas operations by $126,865.

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 gas used in the various CBR adjustments that impact revenues.

This adjustment decreases net operating income for electric operations by $237,608 and for natural gas operations by $752,137.

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 each of the payout years. The four-year average of the payouts is allocated between electric and natural gas O&M expense using the direct labor allocator during each of the payout years.

This adjustment increases net operating income for electric operations by $1,563,444 and natural gas operations by $889,242.

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 CBR 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 $117,304 for electric operations and increases net operating income by $83,723 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. It 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.

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 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. 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 $5,269 and natural gas operations by $3,806.

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 $395,844 and natural gas operations by $101,802.

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 June 2018: $21.0 million in 2015, $18.0 million in 2016, $33.0 million in 2017 and $9.0 million in 2018. These total $81.0 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 $2,172,871 and natural gas operations by $1,038,585.

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

This restating adjustment is applied in the same manner as in a CBR and general rate case. This adjustment restates injuries and damages by adjusting actual test year accruals and payments in excess of accruals for injuries and damages to the most recent three-year average. When necessary, amounts are allocated to O&M based on the distribution of wages and then allocated between electric and natural gas based on the average number of customers allocator. This adjustment increases net operating income for electric operations by $707,511 and natural gas operations by $581,180.

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 $2,632 for electric operations and $369,390 for natural gas operations.

CBR Adjustment No. 5.23E Accounting Standards Codification 815

This electric-only restating adjustment, which is applied in the same manner as in a CBR 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 decreases net operating income for electric operations by $171,187.

CBR Adjustment No. 5.24E Storm Normalization

This electric-only 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, 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 rule. Accordingly, PSE is making the pro forma portion[13] of the storm adjustment in its ERF Adjustment No. 9.09E. This adjustment decreases net operating income for electric operations by $2,576,960.

CBR Adjustment No. 5.25E Power Costs

This electric-only restating adjustment is applied in the same manner as in a commission basis report and is intended to depict power costs under normal temperature and power supply conditions. Test year power costs are adjusted to recognize the changes in load and generation from test year levels summarized below. The following changes in load and generation are priced at the mid-C flat dollar per MWh embedded in rates that were in effect for the month being repriced.

1) the change in load used in the weather normalization adjustment (Adjustment No. 5.09E) for retail revenues, and

[13] The pro forma portion is limited to annualizing the amortizations established in the 2017 general rate case.

2) the adjustment to reflect hydro and wind volumes at normal levels based on levels assumed in the most recent general rate case as they are also impacted by weather.

Additionally, the following non-weather adjustments to power costs were made consistent with PSE's established commission basis reporting:

1) An adjustment is required for the equity component of the TransAlta Centralia Coal Transition Power Purchase Agreement ("PPA") approved by the Commission in Docket UE-121373. This adjustment is necessary to make actual booked expenses, which do not include regulatory adjustments, match the recovery built into rates.

2) A GAAP only non-settled fuel valuation for gas for power storage is removed as the true amount recorded as power costs for fuel is valued at the time the inventory is used and is not valued at the financial statement date.

3) The one-time fixed production cost deferral, which was in place July through December 18, 2017 of the test year, was adjusted a) to reflect the revised methodology proposed by Commission Staff and authorized in Docket UE-180280 and b) to reflect weather normalized loads.

Overall, this restating adjustment decreases net operating income for electric operations by $1,579,359.

CBR Adjustment No. 5.26E Montana Electric Energy Tax

This electric-only restating adjustment, which is applied in the same manner as in a commission basis report and general rate case, adjusts the Montana Electric

Energy tax and Montana Wholesale Energy Transaction tax related to Colstrip Units 1 through 4, to the amount that should be recorded for these costs based on the level of actual kilowatt hour generation of Colstrip Units 1 through 4, recorded in the test year. This adjustment increases net operating income by $35,851 for electric operations.

CBR Adjustment No. 5.27E Wild Horse Solar

This is the last adjustment made for CBR purposes. This adjustment is a restating adjustment that removes the effects of the solar project at PSE's Wild Horse wind facility. This power project is a demonstration project, and PSE has not included this project for rate recovery in prior proceedings. This restating adjustment increases net operating income for electric operations by $144,679 and decreases rate base by $1,756,001.

Q. Please explain how PSE adjusted its CBR results to arrive at end of period results in Exh. SEF-7 and Exh SEF-8.

A. As discussed previously, the first step after completing the commission basis report is to show EOP restated results of operations. These adjustments are summarized in Column D of Exh. SEF-3 and Exh. SEF-4 and on page 1 of Exh. SEF-7 and Exh. SEF-8.

Q. Please explain the end-of-period adjustments in Exh. SEF-7 and Exh. SEF-8.

A. The following EOP adjustments are included in Exh. SEF-7 and Exh. SEF-8:

EOP Adjustment No. 7.02E & 8.02G Rate Base to End of Period

The adjustments to reflect rate base and working capital from an AMA basis in the CBR results to an EOP basis are included on page 2 of Exh. SEF-7 and Exh. SEF-8. The EOP amounts were determined utilizing the same account treatment as was used in Adjustments 5.05E/6.05G, 5.06E/6.06G and 5.27E with the only difference being the amounts used for the calculation were June 30, 2018 EOP balances instead of AMA. The resulting adjustments are a decrease to electric rate base of $36 million and an increase to natural gas rate base of $72.6 million.

EOP Adjustment No. 7.03E & 8.03G Depreciation Expense to End of Period

This end-of-period adjustment restates depreciable balances from an AMA basis to an EOP basis. This adjustment restates depreciation expense as if the end of period balances from Adj. 7.02E and 8.02G were in effect for the entire test period[14]. There are three categories of depreciable assets that are included in this adjustment; 1) Standard, 2) Not Studied, and 3) End of Life. Each of these categories is described in Table 2 below along with the methodologies used to calculate the adjustment to depreciation expense for purposes of determining EOP and Annualized depreciation expense.

[14] Adjs. 7.03E and 8.03G do not adjust depreciation expense for the new depreciation rates that were approved in UE-170033 and UG-170034 as PSE considers that to be an annualizing adjustment and that adjustment is made in Exh. SEF-9 and Exh. SEF-10.

Table 2 – Summary of Methodologies Used to Adjust Depreciation Expense

Type	End of Period	Annualizing	Justification
Standard	June 2018 balance x depreciation rate in effect each month of the CBR period	June 2018 balance x June 2018 depreciation rate (would be from 2017 GRC approved depreciation study) for each month of the CBR period	These accounts were studied and so standard treatment can be used when determining end of period or annualized depreciation expense.
Not Studied (includes ARO Accretion)	June 2018 depreciation expense is used for each month of the CBR period	No annualizing adjustment is made for this category of depreciation	An end of period adjustment recognizes the change in the depreciable balance over the CBR period. But since this category of assets was not studied, no change in their depreciation rates occurred and so an Annualizing adjustment is not warranted.
End of Life	No EOP adjustment is made for this category of depreciation	June 2018 depreciation expense is used for each month of the CBR period	The depreciation for this class of assets is based on the NBV of the assets amortized to a set termination date. The NBV is based on a static gross plant value. Therefore, an EOP adjustment is not warranted. However, a change to the end of life assumption as a result of the depreciation study requires an annualizing adjustment of this category of assets.

The adjustment results in increases to depreciation expense of $20,424,403 for electric and $8,951,742 for natural gas. Additionally, to recognize the full impact of the increases in depreciation expense on the EOP accumulated depreciation, PSE increased the balance of accumulated depreciation by the respective increases in depreciation expense. Also, the change to book depreciation expense necessitates a change to deferred taxes which are decreased by 28 percent[15] of the change to accumulated depreciation. Finally, PSE records its deferred tax balances during the test year based on an estimate of its plant additions for the 2018 calendar year. Accordingly, in order to maintain the consistency provisions

[15] The statutory tax rate remains at 28 percent for purposes of the EOP adjustments as is it not annualized until Adj. 9.04E and 10.04G.

of the IRS normalization rules[16], a final adjustment is made to PSE's deferred taxes to value them based on actual plant additions through June 2018. For electric operations, the impact of this adjustment is a decrease of $14,705,570 to net operating income and a decrease to rate base of $11,805,954. For natural gas operations, the impact of this adjustment is a decrease of $6,445,254 to net operating income and a decrease to rate base of $5,427,526.

EOP Adjustment No. 7.04E & 8.04G Tax Benefit of Interest

The final EOP adjustment is required to adjust the tax benefit of interest for the change in rate base from the other EOP adjustments. This impact to the tax benefit of interest is determined using the weighted average cost of debt of 2.89 percent from the test year and 28 percent as these amounts have not yet been annualized. This adjustment reduces net operating income for electric by $387,080 and increases net operating income for natural gas by $543,678.

Q. Please explain the ERF annualizing adjustments in Exhs. SEF-9 and SEF-10.

A. The adjustments I describe below are the ERF annualizing adjustments made to the electric and gas end of period restated results of operations. These adjustments are summarized in column F on page 4 of Exh. SEF-3 and Exh. SEF-4, and on page 1 of Exh. SEF-9 and Exh. SEF-10. All of the adjustments in these exhibits are tax affected at 21 percent as the statutory tax rate is annualized in Adj. 9.04E and 10.04G as discussed below.

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[16] This is discussed in the Prefiled Direct Testimony of Matthew R. Marcelia, Exh. MRM-1T.

Q. When annualizing the expenses associated with the annualized Tax Reform Update 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-13 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 describe the annualizing adjustments made in Exhs. SEF-9 and SEF-10.

A. Following are the explanations for each adjustment made in Exh. SEF-9 and Exh. SEF-10.

ERF Annualizing Adjustment Nos. 9.02E and 10.02G Annualize Tax Reform Revenues

The following items are being adjusted:

1) Because WACs 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 EOP restated results do not reflect the most recent rates PSE established in the Tax Reform Update. Therefore, to reflect the most current

revenues for ERF purposes requires adjustment to annualize the revenues approved in the Tax Reform Update. These amounts were determined by Mr. Piliaris based on test year normalized billing determinants in his Exh. JAP-3 for electric and Exh. JAP-4 for natural gas. These are presented in lines 3 and 4 of Adjustment No. 9.02E and lines 2 and 5 of Adjustment No. 10.02G.

2) Because the amounts adjusted in No. 1, above, are based on current rates at weather normalized loads, the deferrals recorded during the test year for tax reform[17] and decoupling are removed. These are presented in lines 12 and 13 of Adjustment No. 9.02E and lines 7 and 8 of Adjustment No. 10.02G.

3) Because fixed production costs are recovered volumetrically, the resulting revenue determined by Mr. Piliaris based on weather normalized load is higher than that allowed by PSE's current tariffs for fixed production revenues. Therefore, an offsetting adjustment is made to bring the level of fixed production revenues in No. 1, above, to the level allowed by the tariff. This is presented in line 6 of Adjustment No. 9.02E.

4) An adjustment is made to purchased gas costs that corresponds with the adjustment to purchased gas revenues in No. 1 above, and this adjustment is also determined by Mr. Piliaris. This is presented in line 15 of Adjustment No. 10.02G.

[17] Dockets UE-171225 and UG-171226.

These adjustments result in a decrease to net operating income of $11,497,412 for electric operations and a decrease to net operating income of $11,402,259 for natural gas operations.

ERF Annualizing Adjustment Nos. 9.03E and 10.03G Depreciation Expense

In order to match the revenues that were annualized in Adj. Nos. 9.02E and 10.02G this adjustment calculates the impact of implementing the depreciation rates as approved in the 2017 general rate case that went into effect on December 19, 2017 as if they had been in place at the beginning of the test year. The methodology for adjusting each category of depreciable assets was reflected in Table 2 above. This annualizing adjustment results in an increase to depreciation expense for electric operations of $25,808,344 and a decrease to depreciation expense for natural gas depreciation of $11,068,116. Additionally, to recognize the full impact of the change in depreciation expense on the EOP accumulated depreciation, PSE changed the balance of accumulated depreciation by the respective changes in depreciation expense. Finally, the change to book depreciation expense necessitates a change to deferred taxes which are decreased by 21 percent of the change to accumulated depreciation. For electric operations the impact of this adjustment is a decrease to both net operating income and rate base of $20,388,591. For natural gas operations the impact of this adjustment is an increase to both net operating income and rate base of $8,743,811.

ERF Annualizing Adjustment Nos. 9.04E and 10.04G Adjust FIT Expense for the Tax Cuts and Jobs Act

In order to match the income tax expense to the annualized revenues that were adjusted in ERF Adjustment Nos. 9.02E and 10.02G, an adjustment is required to annualize the statutory tax rate in the EOP restated results from 28 percent to 21 percent. Additionally, to ensure the proper handling of the tax benefit of interest, this adjustment removes the tax benefit of interest that is included in the EOP restated results as it is recalculated and included in this filing in Adjustment Nos. 9.05E and 10.05G. Finally, this adjustment incorporates a full twelve months of the plant related excess deferred taxes that PSE recognizes on the ARAM methodology, which brings the total plant related reversals included in this filing to $18.5 million for electric and $5.8 million for natural gas.

These adjustments result in an increase to net operating income of $2,602,970 for electric operations and a decrease to net operating income of $2,706,915 for natural gas operations.

ERF Annualizing Adjustment Nos. 9.05E and 10.05G Annualize Tax Benefit of Pro Forma Interest

Because the tax benefit of interest in the EOP restated amounts were removed in Adjustments Nos. 9.04E and 10.05G, this adjustment is required to reflect the appropriate level of tax benefit based on PSE’s final rate base ($5.1 billion for electric and $1.9 billion for natural gas), requested rate of return (7.49 percent) and annualized statutory tax rate (21 percent). This adjustment increases net operating income for electric and natural gas by $30.8 million and $11.7 million, respectively.

ERF Annualizing Adjustment Nos. 9.06E and 10.06G Deferred Property Gains and Losses

In order to match the annualized revenues included in Adjustment Nos. 9.02E and 10.02G, 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 EOP restated results, which are the same as the actual test year amounts, to determine the adjustment for the test period.

This adjustment increases electric net operating income by $96,765 and decreases net operating income by $59,399 for natural gas operations.

ERF Annualizing Adjustment Nos. 9.07E and 10.07G Environmental Remediation

In order to match the annualized revenues included in Adjustment Nos. 9.02E and 10.02G, 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 EOP restated results, which are the same as the actual test year amounts, to determine the adjustment for the test period.

The impact of this annualizing adjustment decreases net operating income by $523,088 for electric operations and $3,160,778 for natural gas operations.

ERF Annualizing Adjustment Nos. 9.08E and 10.08G Payment Processing Costs

The payment processing adjustment in the general rate case was a pro forma adjustment that 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 included in Adjustment Nos. 9.02E and 10.02G, 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 with the EOP annualized amount determined by taking the actual costs from December 1, 2017 through June 30, 2018[18] plus the level of costs included in the 2017 general rate case for the equivalent months (July through November). This treatment is similar to the way power costs in Adjustment No. 9.10 are handled, which is the other pro forma adjustment from the general rate case that is addressed in this filing. This level of annualized costs, when compared to the amount recorded in the EOP restated results, which is the same as the test year, results in a total increase to operating expense of $1,143,604 for electric operations and $826,089 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 $385,382 for electric operations and $277,810 for natural gas operations. The effect of the new service agreement with the payment processing vendor was fully reflected in the test year. Therefore, no adjustment for this item is necessary. The overall impact of this annualizing adjustment on net operating income is a decrease of $1,207,899 for electric operations and $872,080 for natural gas operations.

ERF Annualizing Adjustment No. 9.09E Storm Damage

In order to match the annualized revenues included in Adjustment No. 9.02E, 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

[18] As reported through April 2018 in UE-160203 and UG-160204 and as calculated on an equivalent basis for May and June 2018.

amortization were in effect for the entire test year in order to match the annualized revenues that are recovering this amortization. These annualized amounts were compared to the EOP restated amounts, which are the same as 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 or another appropriate proceeding.

The impact of this annualizing adjustment on electric operations is a decrease to net operating income of $3,617,174.

ERF Annualizing Adjustment No. 9.10E Power Costs

Power costs were set in PSE's 2017 general rate case on a pro forma basis for calendar year 2018. Accordingly, in order to match annualized revenues included in Adjustment No. 9.02E, an adjustment needs to be made to power costs to reflect them on an equivalent basis as the revenue recovering power costs. This adjustment is not necessary in order to determine the ERF deficiency (since variable power costs are not a subject of PSE's request). It is performed in order to not distort the rate of return on a total company basis that is presented in column G on page 4 of Exh. SEF-3, which is prior to the removal of variable power costs. As this is an expedited rate filing and not a full general rate case, and power costs are not a subject of this proceeding, PSE cannot prepare power costs in the same manner that it would in a general rate case. Therefore, in order to annualize this electric only adjustment, PSE is using the actual power costs included in the EOP restated results for the period January through June 2018 and the level of power costs included in the 2017 general rate case for the remaining equivalent months (July through December). It is necessary to adjust the power costs used for July through December for the difference in the load used in the 2017 general rate case to determine the power costs and the load from the ERF test year. Also included in this adjustment is the removal of the fixed production cost deferral that is no longer needed since revenues were annualized to the appropriate level in Adjustment No. 9.02E. This adjustment decreases net operating income for electric operations by $7.1 million.

ERF Annualizing Adjustment No. 9.11E Montana Electric Energy Tax

This electric-only annualizing adjustment calculates the Montana Electric Energy tax and Montana Wholesale Energy Transaction tax related to Colstrip Units 1 through 4, to the amount that should be recorded for these costs based on the level of kilowatt hour generation of Colstrip Units 1 through 4 that results from Adjustment No. 9.10E. This adjustment increases net operating income by $135,389 for electric operations.

ERF Annualizing Adjustment No. 9.12E Regulatory Assets and Liabilities

In order to match annualized revenues included in Adjustment No. 9.02E, this adjustment brings the test year level of rate base and amortization expense for

PSE's production regulatory assets to the level set in rates in the 2017 general rate case. This adjustment increases rate base by $143,006 and increases net operating income by $135,279 for electric operations.

ERF Annualizing Adjustment No. 9.13E White River

In order to match annualized revenues included in Adjustment No. 9.02E, this adjustment brings the test year level of rate base and amortization expense for the White River regulatory asset to the level set in rates in the 2017 general rate case. This adjustment decreases net operating income for electric operations by $1,878,945 and decreases rate base by $1,878,945.

ERF Annualizing Adjustment No. 9.14E Re-class of Hydro Treasury Grant

In order to match annualized revenues included in Adjustment No. 9.02E, this adjustment removes the amortization of the Hydro Treasury grants which was set to zero in the 2017 general rate case. No adjustment to rate base is required because these items were already adjusted to zero in adjustment 7.02E. This final electric only annualizing adjustment decreases net operating income by $1.2 million.

Energy Imbalance Market

As indicated in Exh. SEF-13, the technology costs related to participation in the Energy Imbalance Market ("EIM") were placed in service in October 2016 and were therefore fully included in the test period and so require no adjustment. Additionally, the additional required employees needed for participation in the EIM were fully included in the test year and also require no further adjustment. In

PSE's 2017 general rate case, parties agreed to exclude the EIM benefits and the related EIM fixed costs from the settled revenue requirement and that both would be included in PSE's PCA mechanism imbalance calculation. As the fixed costs are now fully included in this test year and are included in fixed production costs in this proceeding, PSE will discontinue including the fixed costs in the PCA imbalance calculation coincident with the date that rates go into effect in this proceeding.

Q. Please explain the adjustment in Exh. SEF-11 and Exh. SEF-12.

A. As stated at the beginning of this testimony, before calculating the revenue requirement and deficiencies in this ERF, the non-ERF amounts included in the EOP annualized results need to be removed. The below adjustments are performed for this purpose.

Adjustment No. 11.01E Remove Non-ERF Summary (PCA)

As discussed by Ms. Barnard, variable power costs are not a subject of this proceeding. Therefore, this adjustment removes the level of variable power cost revenues and expenses that are subject to PSE's PCA mechanism that are included in the EOP annualized results. This adjustment reduces net operating income for electric operations by $7.4 million.

Adjustment No. 12.01G Summary of Natural Gas Non-ERF Amounts

Page 1 of Exh. SEF-12 summarizes the four adjustments to natural gas for non-ERF amounts.

Adjustment No. 12.02G Remove Non-ERF (PGA)

Similar to Adjustment No. 11.01E, purchased gas costs are not a subject of this proceeding. Therefore, this adjustment removes the level of purchased gas revenues and costs included in the EOP annualized results. This adjustment reduces net operating income for natural gas by $708,685.

ERF Annualizing Adjustment No. 12.03G Remove Non-ERF (CRM)

PSE recovers the plant return and depreciation for the investments made under its pipe replacement program plan through a cost recovery mechanism ("CRM") approved by the Commission and recovered in Gas Schedule 149. Because this investment is subject to recovery in a separate mechanism, PSE is not including CRM investment in this proceeding. This adjustment removes the level of CRM rate base and depreciation included in the EOP annualized results. This adjustment reduces net operating income for gas operations by $6.8 million and rate base by $73.0 million.

ERF Annualizing Adjustment No. 12.04G Tax Benefit of Interest

This adjustment removes from the EOP annualized results the portion of the tax benefit of interest associated with the CRM investment that was removed in Adjustment No. 12.03G at the requested rate of return (7.49 percent) and annualized statutory tax rate (21 percent) and reduces net operating income for gas operations by $441,603.

III. UPDATE TO PCA EXHIBIT A-1

Q. Does PSE's Exhibit A-1 Baseline Rate require updating as a result of this filing?

A. Yes. Because PSE's Exhibit A-1 reflects fixed production costs, an updated Exhibit A-1 has been submitted on page one of Exh. SEF-15 for approval with this filing. Fixed production costs are included on the Exhibit A-1:

1. as support for the fixed production costs included in PSE's decoupling mechanism, and
2. in order to determine the deficiency in any future PCORC filings that include fixed production costs.

Because this filing does not update variable power costs, the variable amount of $32.895 per MWh shown on in column (VI) line 32 that is used on PSE's baseline rate for PCA tracking purposes has not changed since its most recent filing in Docket UE-180282. However, because fixed production costs are reflected on PSE's Exhibit A-1, this updated Exhibit A-1 is being presented in this filing for approval so that all amounts shown on the approved Exhibit A-1 are the most current. Additionally, a second version of PSE's Exhibit A-1 that will go into effect once Microsoft takes retail wheeling services under a special contract pursuant to Docket UE-161123 was also approved in Docket UE-180282. The second version, which was referred to as the Contingent PCA Baseline Rate, included the impacts that will occur once Microsoft takes retail wheeling service pursuant to a special contract as was approved in Docket UE-161123. The intention of gaining approval of the second version of the Exhibit A-1 was to facilitate the updates to PSE's rates and amounts that will be used for PCA tracking that will need to occur once Microsoft takes retail wheeling service pursuant to a special contract[19]. Accordingly, the updated Contingent PCA Baseline Rate and its impact on PSE's existing revenue requirement are also being updated and presented in this proceeding for approval on pages 2 and 3 of Exh. SEF-15. Similar to the Exhibit A-1 on page one, only the fixed costs have changed on the Contingent PCA Baseline Rate which has no bearing on the impacts that will occur once Microsoft takes retail wheeling service under a special contract. However, it is important to have this updated Contingent PCA Baseline Rate approved so that all amounts presented on the approved Exhibit A-1 are the most current.

IV. 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. In paragraph 54 of the 2017 Settlement Agreement, PSE and Commission Staff agreed 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

[19] See the Supplemental Testimony of Jon A. Piliaris, Exh. JAP-34T, Dockets UE-170033 and UG-170034, for a discussion of the process to update PSE's rates once Microsoft takes retail wheeling service pursuant to a special contract.

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.

V. CONCLUSION

Q. Does this conclude your testimony?

A. Yes, it does.