

**EXHIBIT NO. JHS-21
DOCKET NOS. UE-090704/UG-090705
2009 PSE GENERAL RATE CASE
WITNESS: JOHN H. STORY**

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

**Docket No. UE-090704
Docket No. UG-090705**

**SEVENTH EXHIBIT (NONCONFIDENTIAL) TO THE
PREFILED REBUTTAL TESTIMONY OF
JOHN H. STORY
ON BEHALF OF PUGET SOUND ENERGY, INC.**

DECEMBER 17, 2009

Exhibit No. __ T (MPP-2T)
Dockets UE-072300/
UG-072301/UG-080064
Witness: Michael P. Parvinen

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

DOCKET UE-072300
DOCKET UG-072301
(Consolidated)

DOCKET UG-080064

CROSS ANSWERING TESTIMONY OF

MICHAEL P. PARVINEN

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Recommending Rejection of Various Public Counsel Ratemaking Adjustments

July 3, 2008

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I. INTRODUCTION

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Q. Please state your name and business address.

A. My name is Michael P. Parvinen. My business address is The Richard Hemstad Building, 1300 S. Evergreen Park Dr. S.W., P.O. Box 47250, Olympia, Washington 98504-7250. My e-mail address is mparvine@utc.wa.gov.

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

A. I am employed by the Washington Utilities and Transportation Commission (“UTC”) as the Assistant Director of Energy. In that capacity I supervise the members of the Energy Section that analyze electricity and natural gas filings and issues. Before my current position, I was a Regulatory Analyst and later the Deputy Assistant Director in the Energy Section.

Q. Did you previously file testimony in this proceeding?

A. Yes.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. Please describe the scope of your testimony.

A. I present Staff’s response to Public Counsel witnesses Michael Majoros and Charles King regarding their Reverse Whitehorn, Storm Damages, Federal Income Tax, and King Depreciation adjustments.

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Q. Please summarize your position and recommendation on those issues.

A. The adjustments proposed by Public Counsel should be rejected because they violate the matching principle of ratemaking and/or they set bad ratemaking precedent. The matching principle is described in my response testimony, Exhibit No. __ T (MPP-1T), beginning on page 7, line 18. Rejecting these adjustments increases the recommended revenue requirement of Public Counsel by approximately \$106 million for the Company’s electric operations and \$20 million for the natural gas operations.

III. REVERSE WHITEHORN ADJUSTMENT

Q. Please explain why the Commission should reject Public Counsel’s Reverse Whitehorn adjustment.

A. At Exhibit No. __ (MJM-4), page 3, column 3, Mr. Majoros reverses the Company’s proposed Whitehorn Generating Station adjustment essentially on the basis that the adjustment violates the matching principal and is not a proper pro forma adjustment. On the surface, Mr. Majoros is correct in that rate base items are typically not pro formed due to the difficulties of identifying all associated revenues and expenses.

However, in recent years the Commission has allowed specific pro forma rate base adjustments. Resource acquisitions are a primary example. It has been much more common to allow resource acquisitions that are placed into service after the test period primarily because the models utilized to produce the expected power supply

1 costs for the rate year are based on the availability of the asset. In other words, the
2 cost of fuel, and availability, displacement and other factors, are all considered in the
3 pro forma power supply calculation. Therefore, in order to properly match all the
4 costs and benefits, a pro forma rate base adjustment is necessary. I note that the
5 actual in-service date is important. An asset should be in-service prior to being
6 allowed into rates.

7

8 **Q. Are the costs and benefits associated with the Whitehorn generating facility**
9 **included in the power supply expense calculation in this case?**

10 A. Yes. They are in both the Company and Staff power supply calculations. Public
11 Counsel did not propose an adjustment to the Company's power supply calculation.

12

13 **Q. Does that mean that by accepting Public Counsel's recommended adjustment**
14 **the matching principal would be violated?**

15 A. That is correct.

16

17 **Q. What is the revenue requirement associated with Public Counsel's Reverse**
18 **Whitehorn adjustment?**

19 A. Exhibit No. __ (MJM-4), page 3, column 3, removes from the Company's filed case
20 a revenue requirement amount of \$4,196,266.

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IV. STORM DAMAGE ADJUSTMENT

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Q. Please explain why you disagree with the Storm Damage adjustment proposed by Mr. Majoros.

A. I disagree with his proposal to use the cost of removal portion of accumulated depreciation, which he proposes to treat as a regulatory asset in a separate adjustment to offset the catastrophic storm damage costs charged to rate payers. Mr. Majoros is correct that PSE has collected from ratepayers amounts to pay for the future cost of removal. However, he ignores the fact that these funds are specifically collected for the future cost of removal. Mr. Majoros does not state where the actual cost of removal funds will come from when it is time to pay removal costs if the funds have, instead, been used to offset storm damage costs, as he proposes in his adjustment. This is very much like robbing Peter to pay Paul. It just does not make intuitive sense and sets a bad precedent by asking future rate payers to pay for yesterday's costs.

Q. Is the problem with Mr. Majoros' approach compounded if the Commission were to accept Mr. King's recommendation to use a present value on future removal costs?

A. Absolutely. Not only will future rate payers be asked to pay the increased cost of removal associated with present value method Mr. King proposes (described later in my testimony), they will also be asked to pay for the cost of removal funds that were used to offset storm damage costs.

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Q. What is the revenue requirement associated with Public Counsel’s Storm Damage adjustment?

A. Exhibit No. __ (MJM-4), page 3, column 6, removes from the Company’s filed case a revenue requirement amount of \$15,854,297.

V. FEDERAL INCOME TAX ADJUSTMENT

Q. Turning now to Mr. Majoros’ proposed Federal Income Tax adjustment, please explain why you disagree with this adjustment.

A. Mr. Majoros proposes to flow-thru the tax effect of the deferred storm damage costs in the first year rates are in effect, as opposed to normalizing the tax effect. Again, his proposal violates the matching principal of rate making. If the Commission rejects Mr. Majoros’ Storm Damage adjustment and deems it appropriate to amortize the catastrophic storm damage expenses, as proposed by the Company and Staff, it is appropriate to match the tax effects with the expenses. Normalization creates the proper match.

Normalization takes an extraordinary event or cost, like storm damages, and spreads or “levelizes” the costs over a rational recovery period. The Company and Staff propose to amortize the full expense amount of the extraordinary event over a 6 year period, thus, creating a levelized amount over that period. This is consistent with the matching principal in that the revenues, that are set based on a levelized expense, will match the expense for the duration of the chosen period. It is important

1 to match the tax effects of the amortization level for each year for a proper leveling
2 effect.

3

4 **Q. How does Mr. Majoros’ proposal create a mismatch between the leveled
5 amount of expenses and the federal income tax?**

6 A. Please refer to the chart below. The chart on the left side under “Normalized” shows
7 the net income effect of leveling the catastrophic storm damage over six years and
8 normalizing the FIT effects (assuming an FIT rate of 35%). The chart on the right
9 side under “Flow-Thru” shows the net income effects of the methodology proposed
10 by Mr. Majoros.

11

| 12/31/06 Wind Storm \$83,574,249 (Amortization = \$13,929,042/year for six years) | | | | | | |
|---|---------------------|------------|--------------|---------------------|------------|----------------|
| | <u>Normalized</u> | | | <u>Flow-Thru</u> | | |
| | Amortization (a) | Tax (b) | NOI (a-b) | Amortization (a) | Tax (b) | NOI (a-b) |
| Year 1 | \$13,929,042 | 4,875,165 | \$9,053,877 | \$13,929,042 | 29,250,987 | (\$15,321,945) |
| Year 2 | \$13,929,042 | 4,875,165 | \$9,053,877 | \$13,929,042 | 0 | \$13,929,042 |
| Year 3 | \$13,929,042 | 4,875,165 | \$9,053,877 | \$13,929,042 | 0 | \$13,929,042 |
| Year 4 | \$13,929,042 | 4,875,165 | \$9,053,877 | \$13,929,042 | 0 | \$13,929,042 |
| Year 5 | \$13,929,042 | 4,875,165 | \$9,053,877 | \$13,929,042 | 0 | \$13,929,042 |
| Year 6 | \$13,929,042 | 4,875,165 | \$9,053,877 | \$13,929,042 | 0 | \$13,929,042 |

12

13 **Q. What do you surmise from this chart?**

14 A. The Year 1 effect under “Flow-Thru” demonstrates Public Counsel’s approach in
15 this case. The next five years reflect the effect on rate payers from taking the tax
16 benefits in the first year. If rates are set per the first year, as Public Counsel
17 proposes, the second year creates a significant mismatch. The chart on the left under

1 “Normalized” demonstrates a rational approach that matches the tax effects with the
2 treatment of the costs.

3

4 **Q. What is the revenue requirement associated with Public Counsel’s FIT
5 adjustment?**

6 A. Exhibit No. __ (MJM-4), page 3, column 7, removes from the Company’s filed case
7 a revenue requirement amount of \$64,249,225.

8

9 **VI. KING DEPRECIATION ADJUSTMENT**

10

11 **Q. Please turn to Public Counsel’s King Depreciation adjustment and explain why
12 you disagree with the proposal.**

13 A. Again, it basically comes down to the matching principal. The Commission has
14 historically accepted the straight-line, remaining life method for determining
15 depreciation expense as the preferred approach to recover from rate payers the net
16 cost of an asset over its useful service life. The net cost of the asset is the original
17 purchase price, less salvage, plus the cost of removal. The beauty of the remaining
18 life methodology is that, as the estimated service life, salvage value, or cost of
19 removal change over time, those changes are reflected going forward over the
20 remaining life of the asset. This levelizes the effects of the changes so that at the end
21 of the service life (retirement date) all costs have been recovered from rate payers. It
22 is, therefore, appropriate to match the dollars collected with the dollars spent.
23 Performing a present value calculation, as Public Counsel proposes, creates a

1 mismatch in timing of the actual dollars collected. The mismatch occurs because,
2 under Public Counsel's proposal, fewer dollars are collected in the early years and
3 more dollars will have to be collected in the later years.

4

5 **Q. Do you have any other concerns with regards to Mr. King's approach?**

6 A. Yes. Referring to Mr. King's response testimony the second bullet on page 4,
7 beginning on line 3, he recommends use of the present value of the future removal
8 costs or the actual net removal cost of the last five years, whichever is higher. His
9 approach is virtually a pay-as-you-go approach, as opposed to actually building the
10 reserve to meet the costs when they occur in the future.

11

12 **Q. What are the consequences of a pay-as-you-go approach as you have described?**

13 A. As Mr. King expresses in his response testimony, the Company is collecting more in
14 the cost of removal than it is spending for most accounts. This is due to the heavy
15 amount of removal costs that are yet to take place. If not enough funds are collected
16 now much more burden is placed on future rate payers who have not received the
17 same level of service or performance from the asset. This again leads back to the
18 matching principal that is met by the straight-line approach on both the depreciation
19 expense and the net removal costs. An equal nominal recovery component over the
20 service life consistently matches the use of the asset, the revenues collected from
21 customers, and the systematic recovery of the net cost of the asset.

22

1 **Q. What happens if at some point the cost of removal actually experienced**
2 **indicates that the Company has indeed collected more than is needed to remove**
3 **an asset?**

4 A. The remaining life methodology will adjust the depreciation rate going forward to
5 correct the balance over the remaining life. Customers in the meantime will get the
6 benefit of a reduced rate base by virtue of an overstated accumulated depreciation
7 reserve. The customer does only get the benefit of the Company's authorized rate of
8 return versus what Mr. King describes as the customer's value of money. However,
9 since the cost of removal is essentially an estimate of future costs based on what we
10 know now, it is assumed that some accounts may be over-accruing and others may
11 be under-accruing. Over time the remaining life approach will levelize these
12 imbalances.

13
14 **Q. What is the revenue requirement associated with Public Counsel's King**
15 **Depreciation adjustment?**

16 A. Exhibit No. __ (MJM-4), page 3, column 9, removes from the Company's filed
17 electric case a revenue requirement amount of \$21,566,030. Exhibit No. ____ (MJM-
18 4), page 5, column 4, removes from the Company's filed natural gas case a revenue
19 requirement amount of \$20,093,123.

20
21 **Q. Is all of Mr. King's electric operations adjustment associated with the present**
22 **value also associated with cost of removal?**

23 A. No. Some of his proposed electric operations adjustment is associated with changing

1 service lives, which I do not address. However, I was not able to distinguish which
2 part of his proposed adjustment was associated with service life changes and which
3 part was associated with the present value of cost of removal.

4

5 **Q. Does this conclude your cross-answering testimony?**

6 A. Yes it does.

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