

EXHIBIT NO. ____ (MRM-1T)
DOCKET NO. UE-13 ____
WITNESS: MATTHEW R. MARCELIA

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**In the Matter of the Petition of
PUGET SOUND ENERGY, INC.
For an Accounting Order Approving the
Allocation of Proceeds of the Sale of
Certain Assets to Public Utility District #1
of Jefferson County.**

Docket No. UE-13 ____

**PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
MATTHEW R. MARCELIA
ON BEHALF OF PUGET SOUND ENERGY, INC.**

OCTOBER 31, 2013

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PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF

MATTHEW R. MARCELIA

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1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF**

3
4 **MATTHEW R. MARCELIA**

5 **I. INTRODUCTION**

6 **Q. Please state your name and business address.**

7 A. My name is Matthew R. Marcellia. I am employed as Director of Tax for Puget
8 Sound Energy, Inc. (“PSE” or “the Company”). My business address is 10885
9 NE Fourth Street, Bellevue, WA 98009-9734.

10 **Q. Have you prepared an exhibit describing your professional qualifications?**

11 A. Yes, I have. It is Exhibit No. ____ (MRM-2).

12 **Q. What is the purpose of your testimony?**

13 A. My testimony will address the calculation and allocation of gain resulting from
14 the involuntary liquidation of PSE's assets and future business opportunities in
15 Jefferson County, Washington.

16 **II. THE GAIN CALCULATION**

17 **Q. Please explain the components of the gain calculation.**

18 A. In Exhibit No. ____ (MRM-3), I summarize the financial results relevant to the gain
19 calculation associated with the forced sale of PSE's Jefferson County assets
20 (“Assets”) to Public Utility District No. 1 of Jefferson County (“JPUD”). For
21 purposes of this discussion, I will divide the transaction into three parts: (a) the

1 transfer of Assets, (b) transaction costs, and (c) ancillary items. The combined
2 effect of these elements of the transaction results in the gain to be allocated in this
3 proceeding.

4 **Q. Please explain the “Assets Transferred” section of Exhibit No. ___(MRM-3)**
5 **and the proceeds that are reported in the Exhibit.**

6 A. The Assets in question are the transmission and distribution facilities, and
7 associated real property, specifically described in an Asset Purchase Agreement,
8 dated June 11, 2010 (“APA”). This list of Assets is set forth in Exhibit A to the
9 APA. No Assets other than those specifically identified on Exhibit A (as
10 amended) were included in the sale. The APA and a Customer Transition
11 Agreement, dated as of February 4, 2013 (“CTA”), provided PSE compensation
12 for various costs incurred in connection with the transactions, but when I refer to
13 the “Assets” I am only referring to the Assets that are specifically described in
14 Exhibit A (as amended) of the APA.

15 Exhibit No. ___(MRM-3) refers to “Assets Owned as of June 11, 2010” and
16 “Assets from June 12, 2010 - March 31, 2013.” This distinction is derived from
17 the APA. The APA included a list of Assets in service as of June 11, 2010 and
18 established a purchase price for those Assets of \$103,000,000. These Assets are
19 referred to in Exhibit No. ___(MRM-3) as the “Assets Owned as of June 11,
20 2010” and the proceeds of the sale of these Assets can be seen on line 1 of the
21 Exhibit.

1 At the time the APA was executed, JPUD lacked the resources it needed to close
2 the transaction. However, the APA contained a three-year contingency period to
3 enable JPUD sufficient time to acquire these resources. After the APA was
4 negotiated, PSE placed additions and improvements to the Assets in service
5 commensurate to the needs of the service area. Anticipating these needs, section
6 2.4 of the APA required a “true-up” to the Asset list and the purchase price as of
7 the cutover date (i.e. March 31, 2013). Exhibit No. ____ (MRM-3) refers to these
8 Assets as “Assets from June 12, 2010 - March 31, 2013.”

9 **Q. How was the amount of proceeds determined for the sale of the Assets owned**
10 **as of June 11, 2010?**

11 A. This amount was determined through a negotiated settlement under JPUD's threat
12 of condemnation. The analyses supporting this settlement are fully described in
13 the Testimony of Karl R. Karzmar, former Director of Regulatory Relations for
14 PSE, filed in the Commission in Docket No. U-101217, *In the Matter of the*
15 *Petition of Puget Sound Energy, Inc., For a Declaratory Order Regarding the*
16 *Transfer of Assets to Jefferson County Public Utility District.*

17 **Q. How was the amount of proceeds determined for the sale of the Assets placed**
18 **in service between June 12, 2010 and March 31, 2013?**

19 A. Section 2.4 of the APA provides that Assets placed in service between June 12,
20 2010 and the cutover date (i.e. March 31, 2013) were to be charged to JPUD at
21 their net book value. As a result, there is no gain or loss associated with the
22 transfer of these Assets to JPUD. They were transferred at their net book value.

1 **Q. Please explain what the “Original Cost” line (row two of Exhibit**
2 **No. ___(MRM-3)) represents.**

3 A. The “Original Cost” on line two of Exhibit No. ___(MRM-3) represents the
4 original, historical cost of the Assets. It is the original amount of invested capital
5 associated with the Assets.

6 **Q. What was the source of the “invested capital”?**

7 A. The source of invested capital comes from investors. Investors provided this
8 capital to the Company in the form of debt and equity.

9 **Q. Please explain the Accumulated Depreciation line (row three of Exhibit**
10 **No. ___(MRM-3)) and what it represents.**

11 A. The “Accumulated Depreciation” on line three of Exhibit No. ___(MRM-3)
12 represents the accumulated depreciation of the Assets. When utility property is
13 placed in service, it begins to be depreciated. In general, the annual amount of
14 depreciation expense is determined by taking the original cost of the utility
15 property and dividing that amount by the service life of such property.
16 Depreciation accounts for the wear or consumption of the property. Each month,
17 another layer of depreciation expense is added to the depreciation reserve, also
18 referred to as accumulated depreciation. The reserve for accumulated
19 depreciation represents the accumulation of all of the years of depreciation
20 expense that have been applied to the Assets.

21 **Q. Please explain the Net Book Value line (row four Exhibit No. ___(MRM-3)).**

1 A. The “Net Book Value” on line four of Exhibit No. ____ (MRM-3) represents the
2 unrecovered portion of the investors' investment in the Assets. It is the amount of
3 capital that has not yet been returned to the investors. It represents the amount of
4 the Assets that has not yet been consumed in providing service to customers.

5 **Q. How is the Total Gain on line six of MRM-3 calculated?**

6 A. The “Total Gain” on line six of Exhibit No. ____ (MRM-3) is calculated by
7 subtracting the net book value from the proceeds of the sale of the Assets, then
8 removing the transaction and other costs.

9 **Q. What transaction costs were incurred in the transaction?**

10 A. PSE incurred \$2.5 million in transaction costs. Transaction costs include costs
11 incurred in connection with the transfer of the Assets (e.g., legal, consulting,
12 escrow, labor, and other costs and expenses typically incurred in connection with
13 transactions of this nature). In this category, I also include various transition costs
14 incurred by PSE in connection with the transition of the Jefferson service territory
15 from PSE to JPUD.

16 As summarized in Exhibit No. ____ (MRM-4), the main components of the
17 transaction costs were labor costs, legal costs, costs to sever customer billing data,
18 and overheads. Pursuant to the APA, the parties initially agreed to each be
19 responsible for their own transaction costs. However, due to the unique nature of
20 some of the transition costs incurred by PSE pursuant to the CTA, PSE required
21 an \$800,000 “Transition Payment” from JPUD to reimburse PSE for these

1 expenses. Therefore, Exhibit No. ____ (MRM-4), reflects this \$800,000 Transition
2 Payment as a reduction to transaction costs.

3 **Q. What overheads were included in the transaction costs?**

4 A. The retirement orders for the transaction incurred the Company's standard
5 overhead charges just like any other retirement order incurs.

6 **Q. Please explain the "Other Ancillary Items" category of the gain calculation.**

7 A. The "Other Ancillary Items" category in Exhibit No. ____ (MRM-3) contains a
8 handful of ancillary items which were necessary to the transaction. They are
9 briefly discussed below.

10 **Q. Please explain the payment for property taxes.**

11 A. Pursuant to the APA, JPUD paid its pro-rata share of 2013 property taxes. Since
12 cut-over occurred on March 31, 2013, PSE will bear the property taxes for the
13 first three months of the year and JPUD will bear the cost for the final nine
14 months of the year. In order to effectuate this arrangement, JPUD paid its share
15 of the estimated property tax at closing.

1 **Q. Please explain the payment for inventory.**

2 A. JPUD paid PSE for inventory items, referred to as “Stores” in the APA, which
3 included a relatively small amount of consumables and supplies PSE elected to
4 leave behind at its former Jefferson county service center. Per section 2.2 of the
5 APA, these items were transferred to JPUD at a price determined by PSE to be
6 equal to the actual cost of these items. There was a minor difference between the
7 book value of the Stores and the cash received from JPUD for the Stores.

8 **Q. What was the final amount of the gain?**

9 A. The gain was \$59,964,313

10 **III. PSE’S PROPOSED GAIN ALLOCATION**

11 **Q. How does PSE propose to allocate the gain?**

12 A. PSE is proposing to allocate 75% of the gain to investors and 25% to the
13 remaining customers. This allocation would result in \$44,973,235 to investors
14 and \$14,991,078 to customers.

15 **Q. How did you arrive at this allocation?**

16 A. I arrived at this allocation as a means to fairly distribute the gain to our investors
17 and to our remaining customers. This allocation is reflective of the unusual and
18 extraordinary circumstances surrounding this transaction. The APA is a
19 settlement agreement entered into under threat of condemnation. This transaction
20 was not a voluntary sale. There is unique harm associated with taking a utility's
21 service area. In addition to the loss of property--the Assets in this case--the utility

1 also loses its ability to earn on these assets. The utility loses a revenue source in
2 addition to the loss of its assets.

3 **Q. What unusual and extraordinary circumstances did you consider?**

4 A. Many of these circumstances are covered in greater detail by the testimony of
5 other witnesses in this proceeding, but I would summarize these unusual and
6 extraordinary circumstances as follows:

- 7 • This transaction involved the forced sale of the Assets to a public utility
8 district, which is a municipal corporation under the laws of the State of
9 Washington, under threat of condemnation. PSE was not a willing seller and
10 the decision to enter into the transaction was based upon an assessment of
11 litigation risk. The forced liquidation of a portion of our service area is both
12 an unusual and extraordinary circumstance.
- 13 • The Assets in question comprised the entirety of PSE's utility operating
14 system in Jefferson County. The involuntary conversion of all of the
15 Company's assets in an area where investments were made by the Company,
16 for approximately 96 years, with a reasonable expectation to be able to
17 continue to serve its customers, is both an unusual and extraordinary
18 circumstance.
- 19 • The liquidated Assets were included in the rate base of the utility, such that
20 the investors lost the ability to earn on this investment in the future. The risk
21 of losing the return on this investment by reason of a forced liquidation of the
22 Assets is both an unusual and extraordinary circumstance.

- 1 • The sale of the Assets was concurrent with PSE being relieved of, and JPUD
2 assuming, the public utility obligations to the customers within the area. As a
3 result, PSE lost its ability to conduct its business in an established market.

4 In addition to these circumstances I considered the consequences to PSE's
5 remaining customers associated with the forced sale of Assets to JPUD. These
6 consequences are addressed in detail in the testimony of Mr. Jon A. Piliaris. Mr.
7 Piliaris has assessed the impact of the transaction on the Company's remaining
8 customers and concludes that these customers were not adversely affected by the
9 sale.

10 **Q. Is your proposed allocation consistent with direction the Washington Utilities**
11 **and Transportation Commission (“Commission”) has provided the Company**
12 **in connection with prior transactions?**

13 A Yes. However, I do not believe that the Commission has addressed the facts
14 presented in this case in a prior decision. In the very different case of voluntary
15 sales, the Commission has looked carefully at the context of the sale and allocated
16 gain on the basis of the relative equities, by application of the principles that the
17 rewards of a transaction should follow the relative risk assumed by the parties and
18 that the benefits of the transaction should follow burdens of prior ownership. I
19 applied these equitable principles in determining my proposed allocation of gain.
20 Many of the consequences of the transaction that I considered in making this
21 determination are addressed, in detail, in the testimony of Jon A. Piliaris, Exhibit
22 No. ___(JAP-1T).

1 By operation of the terms and conditions of the APA and the CTA, the Company
2 was successful in placing the majority of transactional risk on the departing
3 customers. The investors, however, primarily bear the risk of reinvestment, while
4 the remaining customers bear little or no transactional risk. The burden of prior
5 ownership was carried by the investors, who paid for the assets, and the departing
6 customers who paid their fair share of the cost of the service that they received.
7 Under these facts and taking guidance from the precedent that the Commission
8 has applied under the very different circumstances presented by voluntary
9 transactions, I arrived at an allocation of 75% of the gain to investors and 25% to
10 the remaining customers.

11 IV. ACCOUNTING FOR THE GAIN

12 **Q. Please explain the specific accounting that would be required to account for**
13 **the gain as you have discussed it here, beginning with the gain allocated to**
14 **the Company.**

15 A. The gain is currently sitting on the balance sheet in FERC Account 25300061,
16 Deferred Credits – Jefferson County, as a credit balance. The gain allocated to
17 the Company will be moved from FERC Account 25300061 and credited to
18 FERC Account 421.1, Gain on Disposition of Property, on the income statement.

19 **Q. What is the accounting for the portion of the gain allocated to remaining**
20 **customers who weren't harmed by the transaction?**

21 A. The portion of the gain allocated to remaining customers will be amortized from
22 FERC Account 25300061 to FERC Account 407 over 48 months.

V. CONCLUSION

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2 Q. Does this conclude your testimony?

3 A. Yes.