BEFORE THE WASHINGTON

UTILITIES & TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

DOCKETS UE-240004 and UG-240005 (*Consolidated*)

RESPONSE TESTIMONY OF GREG R. MEYER
ON BEHALF OF THE
WASHINGTON STATE OFFICE OF THE ATTORNEY GENERAL
PUBLIC COUNSEL UNIT

EXHIBIT GRM-1CT

August 6, 2024

Public Version

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DOCKET(S) UE-240004 and UG-240005

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EXHIBITS LIST

I. INTRODUCTION/SUMMARY

Q. Please state your name and business address.

A. Greg R. Meyer. My business address is 16690 Swingley Ridge Road, Suite 140, Chesterfield, Missouri, 63017.

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

A. I am a consultant in the field of public utility regulation and a Senior Principal with the firm of Brubaker & Associates, Inc. (BAI), energy, economic and regulatory consultants.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Public Counsel Unit of the Washington Attorney General's Office ("Public Counsel").

Q. Please describe your professional qualifications.

A. This information is included in Exhibit GRM-2.

Q. What exhibits are you sponsoring in this proceeding?

A. I am sponsoring the following exhibits:

- Exhibit GRM-2 Qualification of Greg R. Meyer;
- Exhibit GRM-3 Electric Revenue Requirement;
- Exhibit GRM-4 Gas Revenue Requirement
- Exhibit GRM-5C PSE's Response to Public Counsel Data Request No. 87, Attachment A;
- Exhibit GRM-6 PSE's Response to Staff Data Request No. 150;
- Exhibit GRM-7 PSE's Response to Public Counsel Data Request No. 216;

- Exhibit GRM-8 PSE's Response to Public Counsel Data Request No. 92;
- Exhibit GRM-9 PSE's Response to Staff Data Request No. 105, Attachment A;
- Exhibit GRM-10 PSE's Response to Public Counsel Data Request No. 72; and
- Exhibit GRM-11 PSE's Response to Public Counsel Data Request No. 209.

Q. Please summarize your testimony.

A. My testimony addresses certain revenue requirement issues that affect the revenue requirement requested by Puget Sound Corporation ("PSE" or "Company") in this rate case.

A. Case Overview

Q. Please provide a case overview as it pertains to the PSE requested revenue requirement.

A. On February 15, 2024, PSE filed a request with the Washington Utilities and Transportation Commission (Commission) to increase its base rates for electric and natural gas service via a multi-year rate plan (MYRP) with base rate increases in 2025 and 2026. PSE requested the following increases in electric and natural gas revenues during the multi-year period:

TABLE GRM-1

Puget Sound Energy Claimed Revenue Deficiency

Line	Description	2025 Increase Amount	2025 Increase Percent	2026 Increase Amount	2026 Increase Percent	Total
		(1)	(2)	(3)	(4)	(5)
1	Electric Operations[1]	$ 192.2	6.74%	$ 259.9	8.48%	$ 452.1
2	Gas Operations[2]	$ 196.0	18.96%	$ 25.4	2.07%	$ 221.4
3	Total Revenue Deficiency	$ 388		$ 285		$ 674

Sources:
[1]See Company Exhibit SEF-3.
[2]See Company Exhibit SEF-7.

In addition to the requested revenue increases listed above, PSE requests several new special regulatory mechanisms. Specifically, PSE requests the following:

- The Clean Generation Resources Rate Adjustment;
- The Decarbonization Rate Adjustment; and
- The Wildfire Prevention Tracker.

In analyzing the electric and natural gas revenue requirements requested by PSE, Public Counsel's witnesses performed the following procedures:

- Read the direct testimony of the PSE witnesses;
- Issued discovery requests;
- Reviewed the discovery request responses to Public Counsel and other parties;
- Reviewed the workpapers of PSE witnesses; and
- Developed positions regarding certain aspects of PSE's rate request.

Based on the investigation described above, the requested increases to PSE's electric and natural gas multi-year rate plan are significantly overstated. Based on the results of our review, we believe PSE's electric and natural gas revenue requirements for 2025 are overstated by $142.0 million and $96.8 million, respectively. We also believe that PSE's electric and natural gas revenue requirements for 2026 are overstated by $143 million and $115.2 million, respectively.

Q. Please identify the witnesses who filed direct revenue requirement testimony and the issues they addressed.

A. We present the direct testimony of six witnesses in this filing, who are listed below with a brief description of their rate case areas.

- Dr. J. Randall Woolridge – Return on Equity and Capital Structure;
- Dr. Robert Earle – Power Costs and Gas Demand Forecasts;
- David Garrett – Depreciation;
- Dr. David Dismukes – Class Cost of Service, Rate Spread, and Rate Design;
- Michael Gorman – will address the following issues:
  - Return on Purchase Power Agreement;
  - Return on Construction Work in Progress (CWIP);
  - Clean Energy Renewable Tracker; and
  - Wildfire Tracker.
- Greg Meyer – will address the following issues:
  - Storm Expense Normalization;
  - Long-Term Incentive Plan (LTIP);

- Short-Term Incentive Compensation;
- Regulatory Asset/Liability;
- Advanced Metering Infrastructure ("AMI") Plant;
- Inflation;
- Employee Levels; and
- Non-Labor Forecast.

To the extent we do not address a specific issue, it should not be construed as acceptance of that issue. Additionally, we reserve the right to adopt other parties' positions.

Q. Have you prepared a summary of the adjustments you are proposing to PSE's electric and natural gas revenue requirements?

A. Yes. Table GRM-2 (Electric) and Table GRM-3 (Natural Gas) summarize our proposed adjustments to PSE's electric and natural gas cost of service.

TABLE GRM-2

PC Electric Revenue Requirement Adjustments to Puget Sound Energy's Multi-Year Rate Plan
(By Year in $000)

Line	Description	Witness	2025 Electric (1)	2026 Electric (2)
1	PSE's Claimed Revenue Deficiency[1]		$ 192,218	$ 477,386
	PC's Adjustments to Revenue Requirement			
2	Return on Equity	Woolridge	$ (25,060)	$ (56,764)
3	Capital Structure	Woolridge	$ (5,160)	$ (11,711)
4	Power Costs	Earle	$ (3,563)	$ -
5	Return on Purchase Power Agreement	Gorman	$ (1,618)	$ (1,663)
6	Removing CWIP from CGR	Gorman	$ (27,507)	$ 2,763
7	Storm Costs	Meyer	$ (1,021)	$ (1,021)
8	Long Term Incentive Compensation	Meyer	$ (563)	$ (583)
9	Short Term Incentive Compensation	Meyer	$ (4,469)	$ (4,471)
10	Forecasted Expenses	Meyer	$ (68,153)	$ (61,959)
11	Amortizations	Meyer	$ (4,839)	$ (7,622)
12	PC's Total Adjustment to Revenue Requirement		$ (141,953)	$ (143,032)
13	PC Adjusted Revenue Deficiency		$ 50,265	$ 334,354
14	PC Adjusted Incremental Revenue Deficiency		$ 50,265	$ 284,090

Source:
[1] See Company Exhibit SEF-3.

TABLE GRM-3

PC Gas Revenue Requirement Adjustments to Puget Sound Energy's Multi-Year Rate Plan
(By Year in $000)

Line	Description	Witness	2025 Gas (1)	2026 Gas (2)
1	PSE's Claimed Revenue Deficiency[1]		$ 196,040	$ 221,391
	PC's Adjustments to Revenue Requirement			
2	Return on Equity	Woolridge	$ (10,832)	$ (21,828)
3	Capital Structure	Woolridge	$ (2,225)	$ (4,494)
4	Depreciation	Garrett	$ (73,268)	$ (69,814)
5	Short Term Incentive Compensation	Meyer	$ (1,672)	$ (1,673)
6	Long Term Incentive Compensation	Meyer	$ (404)	$ (418)
7	AMI Plant Return Amortization	Meyer	$ (6,014)	$ (14,608)
8	Forecasted Expenses	Meyer	$ (2,359)	$ (2,359)
9	PC's Total Adjustment to Revenue Requirement		$ (96,774)	$ (115,194)
10	PC Adjusted Revenue Deficiency		$ 99,266	$ 106,197
11	PC Adjusted Incremental Revenue Deficiency		$ 99,266	$ 6,930

Source:
[1] See Company Exhibit SEF-7.

II. STORM EXPENSE NORMALIZATION

Q. Please explain PSE's storm expense normalization adjustment.

A. As PSE witness Susan E. Free explains, Adjustment No. 6.40 increases PSE's normalized storm expense to the $10 million threshold level of storm expense that can be included in rates.[1]

Q. Do you have any concerns with PSE's proposal?

A. Yes. As shown on Adjustment No. 6.40, PSE grosses up its six-year average storm costs of $8,978,655 to the $10 million threshold.[2] The $10 million threshold was set in the Dockets UE-170033/170034 Settlement Stipulation which

[1] Direct Test. of Susan E. Free, Exh. SEF-1T at 86:14-16.
[2] *See* Free Exh. SEF-6 at 37.

increased the threshold from $8 million to $10 million. I believe the Commission should consider whether PSE's proposed $1,021,345 revenue increase is necessary in this proceeding given the $10 million threshold is above PSE's six-year average storm costs and PSE has not supported an increase above the six-year average. Limiting the storm expense normalization adjustment to just the six-year average storm costs would lower PSE's electric revenue requirement by $1,021,345.

III. INCENTIVE COMPENSATION

A. Long-Term Incentive Plan (LTIP)

Q. Please describe PSE's proposal regarding its LTIP costs.

A. PSE witness Susan E. Free supports Adjustment Nos. 6.37 (electric) and 11.37 (natural gas) which increase cost of service to recover 10 percent of PSE's LTIP expenses for executive compensation. PSE witness Thomas M. Hunt supports PSE's employee compensation expenses generally, including LTIP. As explained by Free, PSE has excluded its LTIP expenses from cost of service since Docket UE-090704 where the Commission found these costs should not be paid for by customers.[3] LTIP was previously referred to as Supplemental Excess Benefit Retirement Plan (SERP).

> 81. As to SERP, we find persuasive the arguments recommending removal of these costs. PSE has failed to provide an adequate justification for continuing to require ratepayers to fund supplemental retirement benefits for a small number of executives who already are highly compensated and entitled to

[3] Free, Exh. SEF-1T at 82.

> the same levels of qualified retirement plan benefits as other employees, within the limits of what the IRS allows.[4]

Incentive compensation is typically awarded to employees based on the achievement of either targeted operational goals (such as increased customer satisfaction or service reliability) or financial performance goals. Incentive compensation programs designed to align the interests of executives with shareholders via rewarding increases in financial performance should be paid for by the shareholders who benefit.

LTIP is primarily an incentive plan for PSE's employee directors and officers that incentivizes financial goals. Hunt provides a description of 2020-2022 LTIP in Hunt, Exhibit TMH-5. The exhibit shows that the plan's purpose was to align the interest of executives with shareholders and that payouts under the plan were based on achieving a targeted return on equity.[5] Therefore, LTIP costs were appropriately excluded from rates. Shareholders are responsible for paying for LTIP as Hunt explains.

> Investors have funded and continue to fund the majority of PSE's multiyear incentive plan, the LTIP, which is the single largest component of CEO compensation and is also a significant part of compensation for other officers. This plan is a market-competitive pay program that has been fully funded and beginning with the 2023-2025 LTIP cycle will be 90 percent funded by PSE's investors.[6]

[4] *Wash. Utils. & Transp. Comm'n v. PSE*, Dockets UE-090704 and UG 090705, Order 11, ¶ 81 (Apr. 2, 2010).
[5] Thomas M. Hunt, Exh. TMH-5 at 5.
[6] Direct Test of Thomas Hunt, Exh. TMH-1T at 21:2–7.

Hunt explains that beginning with the 2023-2025 cycle of LTIP, PSE included a new set of performance goals resulting from goals specified by Washington laws, including the Clean Energy Transformation Act (CETA).[7] Specifically, at issue in this proceeding, LTIP now includes Environmental, Social and Governance (ESG) goals which are 10 percent of the plan. Therefore, PSE asserts that customers should fund the 10 percent of LTIP tied to environmental goals because these new goals benefit customers.[8]

Q. Can you provide an overview of PSE's 2023-2025 LTIP?

A. Yes. This information was provided in response to Public Counsel Data Request No. 87, Confidential Attachment A. The attachment describes the purpose of the plan and the goals tracked under the plan.

[redacted][9]

[7] Hunt, Exh. TMH-1T at 20:9–11.
[8] *Id.* at 20:14–20.
[9] Meyer, Exh GRM-5C at 2 (PSE's Response to Public Counsel Data Request No. 87, Confidential Attachment A).

[redacted]

[redacted]

[redacted]

[redacted][10]

Q. Do you support PSE's proposal to include 10 percent of LTIP in cost of service?

A. No. PSE filed its proposed rate increase, in part, because of its significant investments in clean energy. PSE witness Matt Steuerwalt explains that the Company will be "increasing the percentage of CETA-compliant energy from 34% in 2020 to a projected 60% by the end of 2025."[11] Increasing rate base is the primary way in which PSE executives will achieve the environmental goals laid out in LTIP. Therefore, it is inappropriate to ask customers to pay for incentive compensation that will increase earnings for shareholders as PSE grows rate base. In addition, as noted above, LTIP is primarily an incentive plan designed to align the interests of executives with shareholders. PSE has not shown why the new component of LTIP qualifies for rate recovery given the Commission's decision in Docket UE-090704.

Furthermore, from a ratemaking perspective, it is important to question whether the incentive compensation costs are known and measurable and if

[10] *Id.* at 1.
[11] Direct Test. of Matt Steuerwalt, Exh. MS-1T at 8.

customers would receive benefits from the achievement of the incentive targets. As explained in PSE's response to Public Counsel Data Request No. 87, Confidential Attachment A, [redacted][12] [redacted][13]

Because achieving the environmental goals is uncertain, the MYRP cost of the incentives is simply not known and measurable. Costs that are not known and measurable are typically excluded from ratemaking cost of service. Including the 10 percent of LTIP tied to environmental goals in the development of PSE's rates requires customers to pay these incentive costs irrespective of whether the goals are achieved and requires customers to fund incentive awards that executives would meet through growing rate base.

Unlike customers, shareholders would only assume 10 percent of LTIP costs to the extent that the environmental goals are achieved. From that standpoint, shareholders only pay the incentive compensation costs if the goals are achieved, and then can pay for the incentive costs out of the enhanced financial performance of the Company. Shareholders are not harmed if they pay the incentive costs from the enhanced financial performance of the Company, and

[12] Meyer, Exh GRM-5C at 2 (PSE's Response to Public Counsel Data Request No 87, Confidential Attachment A).
[13] Meyer, Exh GRM-5C, Confidential Attach. A at 3.

shareholders will not pay the costs if the environmental goals are not achieved. Unlike customers, shareholders are protected in either scenario. Therefore, it makes sense to continue excluding 100 percent of LTIP costs from customers' rates.

Finally, meeting clean energy targets and providing customer benefits are not simply aspirational goals for the Company. Rather, CETA is a statutory requirement and PSE is required to meet the mandated targets for 2030 and 2040 contained within the law. PSE's customers should not be forced to fund executive compensation and bonuses simply because PSE meets regulatory requirements and follows the law.

Q. Please describe your adjustment.

A. I recommend the Commission reject PSE's proposed Adjustment Numbers 6.37 (electric) and 11.37 (natural gas). Disallowing 100 percent of PSE's LTIP costs would lower PSE's electric revenue requirement by $563,097 in Rate Year 1 and by an additional $19,708 in Rate Year 2 (or $582,805 total). This adjustment would also lower PSE's gas revenue requirement by $403,759 in Rate Year 1 and by an additional $14,132 in Rate Year 2 (or $417,890 total).

B. Short-Term Incentive Compensation

Q. How much short-term incentive compensation is built into PSE's revenue requirements?

A. The Company has included approximately $8.9 million in short-term incentives and associated payroll tax for its electric revenue requirements and about $3.3 million for its gas revenue requirements.[14]

Q. Please describe the Company's annual short-term incentive plan.

A. PSE sponsors an annual short-term Goals and Incentive Plan. In this plan, the Company "triggers funding of the incentive pool" by meeting adjusted earnings before interest, tax, depreciation and amortization (EBITDA) threshold of 90 percent.[15] The EBITDA may be modified to remove the impacts of events that may affect the financials of the Company but weren't the result of performance.[16]

PSE also has a second threshold measure that is required before incentive payments are made. The Company must meet at least six out of 10 measures of the Company's Safety and Service Quality Index. This secondary measure also impacts the funding level of the pool.[17]

Assuming that the thresholds are met, funding is adjusted based on the Company's success on these two measures. If PSE beats its adjusted EBITDA target by 135 percent and makes all of its safety and service quality measures, the funding level is set at a maximum of 200 percent to the target incentive of 10

[14] *See,* Free, Exh. SEF-6 at 11 and Exh. SEF-11 at 11.
[15] *See,* Hunt, Exh. TMH-11 at 4.
[16] *Id.*
[17] *Id*.

percent of base salary for each eligible employee. If, however, PSE only achieves 90 percent of adjusted EBITDA and only accomplishes six out of the 10 measures of safety and service quality, then 30 percent of funding is applied to the target incentive. These targeted incentives are further adjusted by an individual or team performance rating depending on whether or not the employee is a bargaining unit employee.[18]

Q. Has the Commission reviewed this plan, or one substantially similar, in prior cases?

A. Yes. In the Company's 2019 rate case, a similar plan was approved by the Commission, noting that the Commission did not "wish to delve too deeply into the Company's management of its human resources and the manner in which it determines overall compensation policy."[19]

Q. Do you support this position?

A. No, and I respectfully request the Commission to reconsider this position. I do not dispute that these are market-based measures of compensation, but the issue in this case is determining what should be properly included in regulated cost of service. For the reasons outlined here, incentive compensation goals that are tied to service quality and reliability, and public and employee safety, are appropriate for inclusion in cost of service, since they are tied to direct customer benefits. However, incentive compensation payments that are tied to financial performance

[18] *Id*. at 3-8.
[19] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.,* Dockets UE-190529 and UG-190530, Order 08 ¶ 314 (July 8, 2020), quoting *Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, Docket UE-100749, Order 06 ¶ 250 (Mar. 25, 2011).

should be removed from cost of service because they directly benefit PSE's investors and not its ratepayers. The cost of these payments will only be incurred to the extent the targeted financial performance is achieved, in which case investors can only pay these incentive compensation costs out of the results of this targeted financial performance. If the payments are included in cost of service as proposed by PSE, customers would pay these financial incentive compensation awards irrespective of whether the financial targets are earned. Hence, investors would only pay these costs to the extent they are earned, where customers would pay these costs regardless of whether the financial targets are earned. Including these costs in cost of service is imbalanced and unreasonable. If removed from cost of service, investors are unharmed because the financial incentive costs are only paid if the financial incentive targets are achieved.

Moreover, significantly, to the extent financial awards are earned, it is reasonable to believe that revenue at current rates would be stronger and the necessary projected increase in MYRP revenue requirements would be lower. There is no evidence in this case that achieving financial awards benefits customers by producing lower proposed revenue increases.

Q. Why should incentive compensation costs tied to corporate financial goals or metrics be removed from PSE's forecasted cost of service?

A. Incentive compensation costs tied to the financial performance of the Company should be excluded from cost of service because these costs are designed to primarily benefit shareholders. There are also sound ratemaking policy reasons to exclude them in the development of just and reasonable rates.

First, if incentive compensation tied to financial performance is excluded from cost of service, then shareholders would bear this cost only if incentive compensation results are achieved. In this case, the benefits and burdens of the incentive program are closely coupled, with the incentive compensation being paid out of the enhanced financial performance of the Company. In significant contrast, if incentive compensation programs tied to financial performance are included in cost of service, customers will bear this expense irrespective of whether the financial incentive results are achieved. This will be the case regardless of whether enhanced financial performance has any positive impact on cost of service or utility rates, from a ratepayer perspective.

Second, customers may pay the incentive costs but not receive any commensurate benefits. PSE has not demonstrated that its claimed revenue deficiency in this case was reduced or impacted by the achievement of incentive compensation financial targets. Hence, customers may be asked to pay for the cost of the incentive compensation but will not receive any benefits of the financial targets via reduced rates or cost of service growth mitigation.

There is no justification to include incentive compensation related to corporate financial goals in cost of service. Its inclusion exposes customers to the risk of paying incentive compensation costs, without any assurance that the financial targets will be achieved or provide any additional benefit to customers. Financial performance is a risk that should be faced by investors alone, not customers. If these financial compensation awards are excluded from cost of service, shareholders will directly incur the costs of these programs, and can pay for them out of higher corporate earnings if the financial goals are achieved.

Q. Please describe your proposed adjustment to the amount of short-term incentive compensation expense included in PSE's revenue requirements.

A. Given that 50 percent of the overall funding position for the target incentive is determined by the adjusted EBITDA performance, I recommend that 50 percent of the proposed expenses associated with the Goals and Incentive Plan be removed from the proposed revenue requirements. For electric operations, the proposed reduction in expense and payroll tax would be approximately $4.5 million in each year's revenue requirement and for gas operations, this would be about $1.7 million per year.

IV. AMORTIZATIONS

A. Regulatory Asset/Liability

Q. Have you reviewed the Amortization of Regulatory Asset/Liability work paper prepared by PSE?

A. Yes, I have.

Q. Do you support the workpaper prepared by PSE?

A. No. I found two amortizations that are set to expire in January 2026. In reviewing the workpaper, it appears that PSE has included a full year of those amortizations in its 2026 cost of service. By including a full year of those amortizations, PSE is overstating its revenue requirement in 2026.

Q. Please identify those amortizations.

A. The amortization descriptions are listed below:

- GTZ-T2 DEPRECIATION UE-220066 (FERC 407.3) (Ends Jan 2026)
- GTZ-T2 CARRYING CHARGES UE-220066 (FERC 407.3) (Ends Jan 2026)

Q. What level of amortization expense is PSE requesting recovery?

A. For the Depreciation amortization, PSE requests recovery of $2,787,552. For the Carrying Charge amortization, PSE requests recovery of $116,817. I would note that in both instances the historical amortization expense matched the level of 2026 expense for which PSE requests recovery. Clearly, this is an overstatement of amortization expense since it is based off of a twelve-month period instead of only one month of expense.

Q. What is your proposed adjustment to amortization expense for these two items?

A. I recommend that the annual level of amortization expense be reduced to reflect the end of those amortizations on January 15, 2026 (mid-point of January 2026). Therefore, my adjustment would reduce PSE's electric amortization expense by approximately $2.8 million.

Q. Is this same adjustment needed for the gas cost of service?

A. No.

B. AMI Plant

Q. Have you reviewed the adjustment proposed by PSE regarding the AMI plant recovery of the deferred equity and debt returns?

A. Yes, I have.

Q. Please discuss your understanding of this issue.

A. In 2016, PSE began installation of AMI meters that replaced the previous vintage of Automated Meter Reading (AMR) meters.[20] PSE was not allowed to include both the debt and equity return on the AMI investments in rates.[21] In its last rate case, PSE was allowed to begin to recover the debt return on the AMI investment, but was required to defer the equity return.[22] In this rate case, PSE requests to amortize the equity and debt returns previously deferred over a three-year period.[23]

Q. Do you have any concerns with the proposal made by PSE?

A. Yes. If the Commission determines that the deferred equity and debt returns can be recovered through an amortization period in this rate case, then I recommend the amortization period be six years. Six years is more consistent with the period over which the deferred return accumulated and, therefore, is the more appropriate amortization period.

Q. What effect does the change in amortization periods have on PSE's cost of service?

A. Using a six-year amortization reduces PSE's electric cost of service by approximately $4.8 million and its gas cost of service by approximately $2.4 million.

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[20] Direct Test of Roque B. Bamba, Exh. RBB-1T at 15:7-8.
[21] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-190529 and UG-190530 et al., Final Order 08/05/03 ¶ 153 (July 8, 2020).
[22] *Id.*
[23] Direct Test of Susan E. Free, Exh. SEF-1T at 74:15-18.

V. FORECASTED EXPENSES

Q. Please describe how PSE developed the forecasted Operations and Maintenance (O&M) costs for its two-year MYRP.

A. PSE's forecasted O&M is based on the approved levels in its Board of Directors' approved plan. The forecasted O&M costs for 2025-2026 are supported by PSE witness Joshua A. Kensok. He explains that the Board's Business Planning Committee ("BPC") oversees the Company's annual five-year financial planning and budgeting process.[24] The process includes PSE employees forecasting O&M expenses in current dollars and then escalating those dollars using escalation factors. Kensok provides some additional details on page 13 of his direct testimony.

> This method allows PSE to control for the consistent application of cost escalators across unique business departments and a population of more than 250 individual forecasters, which are prone to variability based on individual judgment and user input. This method also allows PSE to evaluate the impacts of different inflationary scenarios in the future and impacts to customer bills, a valuable tool when evaluating strategic priorities. PSE will update these cost escalators on a regular cadence, moving forward consistent with PSE's annual business and financial planning process.[25]

As noted above, PSE's O&M forecast relies heavily on its escalation factors, including inflation. The escalation factors are supported by PSE witness Dr. Mark N. Lowry. The escalation factors used by PSE are outlined on Dr. Lowry's Table 1 (wage rate inflation forecast), Table 2 (material and

[24] Direct Test. of Joshua A. Kensok, Exh. JAK-1CT at 3.
[25] *Id.* at 13.

service (M&S) price inflation forecast), and Table 3 (capital expenditures inflation forecast).

PSE's forecasted O&M expenses are included on Kensok, Exhibit JAK-5C and are summarized in Kensok's Table 3. Kensok, Exhibit JAK-5C includes all the O&M expenses approved by the Board. Table GRM-4C summarizes only the O&M expenses derived using the inflation escalators provided by Dr. Lowry. As explained below, I have some concerns with how the inflation escalators are applied.

TABLE GRM-4C

[redacted]

The Board-approved O&M forecast was then used to create the MYRP revenue requirements supported by PSE witness Susan E. Free. PSE witness

Kensok provides a reconciliation between the Board-approved O&M forecast and the O&M included in Ms. Free's exhibits on page 24 of Kensok Exhibit JAK-1CT (Table 4. Reconciliation of Total O&M).

Q. Do you have any concerns with how PSE developed its forecasted O&M costs?

A. Yes. PSE uses a two-year compounding escalation factor to calculate its 2025 labor and non-labor O&M costs. Expenses in 2025 are developed by escalating PSE's 2024 costs by a 2023-2025 growth rate. PSE uses a two-year inflation rate to escalate one year of costs, or 2024 to 2025. This can be seen in Table GRM-4C above. PSE forecasts the increase in labor costs between 2024 and 2025 using a growth rate of 7.83 percent and non-labor costs using a growth rate of 1.57 percent. The values are the result of combining the forecasted inflation rates for 2024 and 2025 and represent more than one year of inflation. PSE states they took this approach because the Company held these costs at 2023 levels in 2024. PSE described holding the costs level as a "stopgap measure to address projected financial pressures (e.g., worsening credit metrics) in 2024."[26]

PSE provided more details on the 2024 costs in response to Public Counsel Data Request No. 216. For labor expenses, PSE held these costs level by assessing its staffing levels[27] and reducing its workforce's overall size, presumably in part by not filling unfilled employee positions. PSE's workforce

[26] Meyer, Exh. GRM-6 (PSE's Response to Staff Data Request No. 150).
[27] Meyer, Exh. GRM-7 at subpart a (PSE's Response to Public Counsel Data Request 216).

did receive a merit increase, which kept labor costs in 2024 equal to PSE's labor costs in 2023.

PSE also held its overall non-labor O&M at 2023 levels. This was accomplished by offsetting cost increases in some areas with cost decreases in other areas. PSE stated that its non-labor O&M costs in 2024 were expected to be approximately $1.3 million lower than 2023.[28]

Q. Is it reasonable to apply a two-year compounding inflation rate to forecast costs in the first year of PSE's MYRP?

A. No. PSE's approach is inappropriate for both non-labor costs and labor costs. For non-labor costs, it is unreasonable for PSE to include two years of O&M inflation in the first year of its MYRP when the Company has shown an ability to manage these costs. For labor costs, PSE misapplies the wage inflation escalator to capture costs with currently unfilled positions. I address both of these issues below.

A. Inflation

Q. What do you recommend for PSE's forecasted non-labor O&M costs?

A. I recommend the Commission limit PSE's non-labor O&M cost increases for the first year of the MYRP to one year of inflation. As shown above, PSE successfully manage these costs in 2024. By applying two years' worth of inflation to its 2024 costs to forecast non-labor O&M costs in the first year of the MYRP, the Company will effectively undo the efficiencies it captured in 2024. Importantly, this is not PSE's proposal for 2026. PSE escalates its 2025 costs by

[28] Meyer, Exh. GRM 7 at subpart d (PSE's Response to Public Counsel Data Request 216).

only one year of inflation to forecast its 2026 costs. I simply recommend the Company take the same approach for 2025 costs that the Company uses for 2026.

Q. Why did PSE propose to use a two-year inflation rate to forecast non-labor O&M in the first year of the MYRP?

A. PSE argues it can only manage its non-labor O&M costs for so long.

> PSE is able to operate in 2024 at 2023 levels for a short time but staying at this level of expenses is not a sustainable measure and the application of inflation growth rates as utilized in this filing is intended to restore O&M to a level of funding that better approximates the costs expected to occur during the multiyear rate plan.[29]

I disagree with PSE applying this argument to its 2025 forecast. To approximate costs in 2025 the Company should only apply one year of inflation. Double counting inflation does not forecast anticipated costs to be incurred but instead only serves to increase the Company's revenues at customers' expense. PSE has shown it can manage these costs, and non-labor O&M in 2024 is expected to be lower than 2023. PSE's request to double count inflation is unsupported and escalating 2024 expenses for only one year is reasonable. As PSE states in the data response above, the Company can and has managed its O&M costs for a short time and my recommended adjustment allows 2024 costs to increase during the MYRP. Again, it is reasonable to use the existing 2024 forecast as a starting point escalated for one year of inflation, as PSE proposes to do between 2025 and 2026.

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[29] Meyer, Exh. GRM-7 at subpart d (PSE's response to Public Counsel Data Request 216).

Q. Please describe your adjustments for non-labor O&M inflation.

A. My adjustments are developed on Exhibit GRM-3C and Exhibit GRM-4C. For non-labor O&M inflation, instead of using a two-year compound annual inflation rate for these O&M costs, I applied the average of the 2024 and 2025 inflation rates PSE relied on, for a one-year inflation rate of 0.78 percent. I applied my one-year inflation rate to the 2024 non-labor O&M costs subject to an inflation escalator. My methodology was identical to PSE's method, except I used a different inflation rate. This adjustment lowers PSE's non-labor O&M costs in the first year of the MYRP by approximately $2,361,000. Based on the Company's workpapers provided in discovery and that I used to develop my exhibit, I estimate the reduction to electric non-labor O&M is approximately $1,997,000 and the reduction to gas non-labor O&M is approximately $363,000. While I made no changes to the inflation rates PSE uses to escalate its 2025 non-labor costs to 2026, the revised 2025 expenses result in a small incremental adjustment to the forecasted 2026 non-labor O&M expenses as shown on my exhibit.

B. Employee Levels

Q. Do you have any concerns with PSE's labor forecast?

A. Yes. I believe the 7.83 percent inflation rate PSE applies between 2024 and 2025 is excessive because PSE does not use the escalation factor to capture only wage increases for employees. Instead, PSE describes a 7.83 percent increase as the labor expense ceiling in 2025. PSE believes labor costs will increase <u>up to</u> 7.83

percent between 2024 and 2025 because of both salary increases and new employee hires. PSE argued in discovery:

> The 7.83 percent inflation factor provided by the Pacific Economics Group ("PEG") was used to calculate the Labor Expense ceiling for 2025. When compared to 2024 levels, changes to labor cost will certainly result from salary increases provided to existing staff as well as adjustments to staffing levels that are deemed necessary to achieve its goals and objectives.[30]

I am concerned that PSE's forecasted labor expense is based on an unknown number of employees, which are not known and measurable and should not be included in the development of the test year labor expense. In discovery, PSE stated it does not use employee headcount or Full-Time Equivalents ("FTE") in its forecasting process. However, PSE relies on an increasing level of employees to make up the difference between its forecasted merit increases and the 7.83 percent labor escalator.

> Instead, for operations and maintenance ("O&M") forecasting purposes, PSE estimates labor hours and/or outside service costs based on the work that is being forecasted. Average activity rates are applied to the forecasted labor hours to establish the amount of labor costs to include in the forecast for O&M. These labor costs are then escalated by 3.5 percent annually for the standard merit increase, and any additional inflation assumptions as necessary to arrive at the total forecasted O&M labor expense. This process can be used for O&M labor forecasting because the labor hours are generally consistent and stable from month to month. Therefore, labor hours can be planned with relative accuracy.[31]

PSE assumes a 3.5 percent merit increase for existing employees and then an unknown number of additional positions that equals the difference between the 3.5 percent merit increase and 7.83 percent labor cost increase. Importantly, PSE

[30] Meyer, Exh. GRM-7 (PSE's Response to Public Counsel Data Request 216).
[31] Meyer, Exh. GRM-8 (PSE's Response to Public Counsel Data Request 92).

will not incur costs associated with the additional positions unless and until those positions are filled. Therefore, a MYRP forecast that includes additional positions which have not yet been hired, and with an unknown hire date, will allow PSE to over-recover its actual labor expense. Filling an unknown number of additional positions will not only be challenging because it requires finding qualified employees, but also because at the same time the Company is trying to fill the positions, additional positions become vacant as employees retire or leave the Company.

PSE uses a two-year compounding escalation factor to calculate a single year increase of labor costs by assuming any budgeted O&M expenses above the salary increases given to existing employees will be used via hiring to increase staffing levels. The 7.83 percent escalation factor combines 2024 and 2025 wage rate inflation rates. A wage inflation rate should not be used to forecast increases in labor costs driven by new employee hires.

In addition, PSE has not shown that it has taken employee attrition into account. As noted above, as PSE hires new employees, it will also lose employees due to retirements, transfers, or other factors. If PSE assumes that it will only add employees in the first year of MYRP, then the Company is overstating its forecasted labor costs by not accounting for labor cost decreases due to employee attrition.

Q. Do you recommend an adjustment to remove unfilled positions?

A. Yes. The number of unfilled positions is not known or measurable and should not be included in PSE's forecasted cost of service.

I continue to include a wage escalation factor in my revised labor expense forecast as it applies to existing employees. For unfilled employee positions, I removed the portion of PSE's 7.83 percent labor escalator tied to unfilled positions, or the difference between the proposed escalator of 7.83 percent and the typical wage inflation rate of 3.88 percent.[32] Removing the unfilled positions lowers PSE's O&M costs in the first year of the MYRP by approximately $9,841,000. Based on the Company's workpapers provided in discovery that I used to develop my exhibit, I estimate the reduction to electric labor O&M is approximately $4,191,000 and the reduction to gas labor O&M is approximately $5,650,000. I then use the same 3.25 percent wage escalator that PSE uses to escalate 2025 costs to 2026. However, my revised 2025 expenses result in an approximate $320,000 incremental decrease to PSE's 2026 expenses, as shown on Exhibit GRM-3C and Exhibit GRM-4C.

Q. Does your recommendation impact current employee wages or represented labor contracts?

A. No, it does not. My proposed adjustment does not impact PSE's ability to recover reasonably forecasted existing represented and non-represented employee wages. Rather, my adjustment simply removes PSE's excessive and unsupported escalation factor that could lead to over-collection through customer rates.

[32] Direct Test. of Dr. Mark N. Lowry, Exh. MNL-1T at 14 (Table 1).

C. Administrative and General (A&G) Non-Labor Forecast

Q. Have you reviewed the Electric Non-Labor Operation and Maintenance expenses for a five-year historic period (2019-2023) and the 2025 and 2026 MYRP years?

A. Yes, I have.

Q. Did you find any abnormal non-labor expense increases not attributable to inflation?

A. Yes, I did. Specifically, I have concerns with non-labor expense increases in FERC Account 920 (A&G) Salaries. This account is projected to experience significant increases over historical expenses for 2025 and 2026 for PSE's electric operations and a similarly significant growth over historical expenses projected for the 2026 rate year for gas operations. I would note that we asked for reasons for the growth in expenses that were not attributed to inflation in Data Request No. 209. The response to Data Request No. 209 did not mention any reasons for increases in these accounts.[33]

Q. Can you please document why you assert these accounts have significant increases in expense for either 2025 or 2026?

A. Yes, I have prepared Table GRM-5 that shows the increases in expense for each of these accounts.

[33] *See* Meyer, Exh. GRM-11.

TABLE GRM-5

Non-Labor Expense Increases for A&G Salaries

Year	Electric	Gas
2021	$ 9,822,014	$ 4,561,298
2022	$ 14,995,602	$ 6,982,173
2023	$ 19,321,840	$ 9,121,092
2025 Rate Yr.	**$ 81,286,408**	**$ 9,673,648**
2026 Rate Yr.	**$ 74,801,305**	**$ 18,195,905**

Source:
For 2021 to 2023 see PSE's Response to PC DR 072 (Exhibit GRM-10).
For 2025 and 2026 See PSE's Response to PC DR 209 (Exhibit GRM-11).

As can be seen from the table there are significant increases projected for this account. As previously mentioned, there was no explanation provided for these increases in response to Public Counsel Data Request No. 209. It should also be noted that these are non-labor expense increases. Typically, most expenses in this account are related to labor charges. While there are labor expenses shown in this account, the non-labor charges are significantly increased over 2023 levels. These increases need further explanation.

Q. Do you propose an adjustment to the non-labor expenses booked to A&G salaries?

A. Yes. I would propose the following adjustment to capture the unexplained increases in expenses for this account. For the electric operations, I would propose reducing the level of significant expense increases in the above table (increases in bold) to the highest level experienced in the previous three years. I am; therefore, proposing to adjust 2025 and 2026 expenses to reflect an annual expense level of $19,321,840 (2023 actual level). This results in a decreased revenue requirement in 2025 of $61,964,568 and a decreased revenue requirement of $55,479,465 in 2026 for PSE's electric operations.

For the Company's gas operations, I propose limiting the 2026 expense to the $9,673,648 projected for 2025. This results in no change for the 2025 rate year and a reduction of $8,522,257 for the 2026 rate year.

Q. Does this conclude your response testimony?

A. Yes, it does.