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 MICHAEL P. GORMAN
ON BEHALF OF THE
WASHINGTON STATE OFFICE OF THE ATTORNEY GENERAL
PUBLIC COUNSEL UNIT

EXHIBIT MPG-1CT

August 6, 2024

Shaded Information is Designated Confidential Per WAC 480-07-160

RESPONSE TESTIMONY OF MICHAEL P. GORMAN

DOCKET(S) 240004 and UG-240005 (Consolidated)

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Exhibit MPG-3	Revenue Requirement Impact Under Changed Capital Structure Weights

I. INTRODUCTION & SUMMARY

Q. Please state your name and business address.

A. Michael P. Gorman. 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 Managing 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 my Exhibit MPG-2.

Q. What exhibits are you sponsoring in this proceeding?

A. I am sponsoring the following exhibits:

- Exhibit MPG-2: Qualifications of Michael P. Gorman
- Exhibit MPG-3: Revenue Requirement Impact Under Changed Capital Structure Weights

Q. Please summarize your testimony.

A. I will respond to the following:

First, I comment on Puget Sound Energy's (PSE or Company) statement that changes or enhancements in the multiyear rate protocols are necessary to bolster its financial standing, credit rating, and credit metrics to support its ability to attract capital. The Company asserts this capital is needed to make significant investments to meet the requirements of the Clean Energy Transformation Act (CETA) and fund wildfire risk mitigation measures.

As outlined below, the Company's credit rating and financial standing are already "Stable," and credit analysts note positive cost recovery aspects from the implementation of the new multiyear rate plan included in this filing. Further, PSE ignores that prioritizing rate affordability is a critically important aspect for maintaining its financial integrity while meeting its regulatory and other obligations – rate affordability stabilizes revenue and promotes operational efficiency. Adding instability to customers' bills by implementing unnecessary tariff mechanisms and/or unnecessarily increasing the cost of purchased power agreements (PPA) undermines managing rate affordability. The proposed tariff mechanisms are not necessary additions to the multiyear rate plan.

Second, I specifically respond to the Company's proposal for several new tariff mechanisms: (1) Clean Generation Resources (CGR) Tariff, Sch. 141CGR; (2) Wildfire Prevention Plan Adjustment Rider, Sch. 141WFP; and (3) Decarbonization Rate Adjustment, Sch. 141DCARB.

Implementation of the proposed tariffs is unnecessary and unjustified in combination with implementation of a multiyear rate plan. Indeed, the tariff mechanisms' charges will add an additional layer of costs to customer bills. These costs will reflect incremental capital investments and escalations to operation and maintenance (O&M) expenses that are already reasonably tracked by use of a multiyear rate plan and related multiyear adjustments to rates. The Company has simply failed to demonstrate that implementation of the riders, in combination with a new multiyear rate plan, which already enhances the Company's cost recovery over the rate-effective period, are fair to both the Company and to its customers. The evidence does not support approval of these proposed new tariff regulatory mechanisms and the Commission should reject the Company's proposals.

I will respond to the Company's proposal for a return on PPAs. I will explain why allowing for a rate of return on PPAs is unjustified and does not produce a reasonable cost impact on customers, particularly in recognition of the increased cost needed to balance the increased cost of the ratemaking capital structure, via increased common equity ratio, when needed to balance the additional financial leverage risk of the debt-like characteristics of PPAs. Before approving a rate of return on PPAs, the Washington Utilities and Transportation Commission (Commission) should be certain that the costs imposed on customers for PPAs are just and reasonable, and that the additional costs imposed on top of the PPAs do not create an economic bias toward utility investments, as opposed to economic PPAs with third-party suppliers. Rate affordability is an important consideration if the utility is allowed a return on PPAs and is also permitted to increase the common equity ratio of its ratemaking capital structure. Increasing the ratemaking capital structure equity ratio increases the utility's cost of capital because utility equity is the most expensive form of capital and is subject to income tax expense. The common equity ratio, of course, needs to be reasonable, but not excessive, to balance all financial leverage risk, including off-balance sheet contractual obligations. A return on PPAs increases cash flow and can produce a level of financial leverage risk mitigation in addition to an increased common equity ratio, but this increased cash flow is produced by increases to customers' rates. I recommend the Commission not allow a return on PPA costs because a return is not reasonable. Permitting a return on PPAs does not reflect costs on customers that are created by adjusting the ratemaking capital structure to reflect the PPA debt-like characteristics. But if a return on PPAs is allowed, it should be no more than the authorized cost of debt to minimize the escalation to cost of service and to prioritize rate affordability.

I will comment on the Company's proposal to include construction work in progress (CWIP) in rate base for CETA investments. The Company argues that a current return on CWIP will lower the cost of resources and improve PSE's cash flows during the construction of the resources, which in turn will support its bond rating. The Company's arguments, however, fail to consider the intergenerational inequity caused by charging a current return on CWIP to customers that receive no benefits from the resource because it is not yet placed in-service. After the resource is placed in-service, it benefits customers by supplying capacity and energy needed to meet customers' service demands. For Beaver Creek, as an example, this means lower energy costs and production tax credits that reduce PSE's energy charges to customers as it is placed into service. The Commission should restrict allowing a current return on CWIP based on financial distress of the utility, and the need for customer support of all generation resources to comply with CETA. Absent a clear demonstration that the Company's construction program is placing too much stress on its credit metrics, a non-traditional ratemaking practice for allowing a current return on CWIP should not be allowed.

II. FINANCIAL INTEGRITY

Q. Please describe PSE's claimed need for adjustments to the multiyear rate plan to enhance its financial integrity and credit standing, and to support its ability to attract capital to fund CETA, and wildfire ignition risk mitigation objectives included in its rate filing.

A. PSE witness Daniel Doyle outlined the Company's proposals at page 26 of his testimony (Doyle, Exh. DAD-1CT). There, Doyle states that PSE must make significant capital investments over the next three to five years to achieve the clean energy requirements outlined in CETA. He states these investments require PSE to access external capital funding at a level that cannot be accomplished without a stronger financial profile. He specifically requests cost of service that will result in additional cash flow to PSE, which he recommends achieving through a higher authorized return on equity, a higher equity ratio in its ratemaking capital structure, the inclusion of CWIP in rate base (as opposed to accruing an Allowance for Funds Used During Construction (AFUDC), and recognition of PSE's ability to earn a return on PPAs.[1]

[1] Direct Test. of Daniel A. Doyle, Exh. DAD-1CT at 26:11–23.

Q. Please summarize your response to Doyle's proposed enhanced regulatory mechanisms to the multiyear rate plan to achieve these objectives.

A. Doyle ignores the need to manage rate affordability. Managing rate affordability is not only fair and reasonable, but the utility has an obligation to prioritize managing rate affordability as a component of managing its capital expenditures and operating expenses budgets to maintain safe and reliable service, all of which are critical factors in managing the utility's financial integrity and credit standing. Managing rate affordability stabilizes revenue and promotes operational efficiency. Affordable rates stabilize revenue by enabling customers to more easily afford to pay their utility bills on time and in full. Predictable revenue streams allow for more stable and predictable strong amounts of internal cash generation, enhanced financial planning and greater ability to make timely debt service payments. From this standpoint, the Commission should carefully weigh the impact on customers' rates against the proposed changes in regulatory mechanisms which erode customers' tariff rate protections. The implementation of regulatory mechanisms that increase customer bills to support stronger cash flows and earnings that PSE alleges are needed to support improved credit ratings metrics and financial integrity is unsupported by the evidence. Further, in discussing the enhanced regulatory mechanisms proposed by the Company in this case, the Company fails to acknowledge the importance of preserving customer rate-setting protections and managing rate affordability as a continuing and critical planning factor that must also be reflected in its compliance with the Clean Energy Transformation Act (CETA) and wildfire risk mitigation planning.

Moreover, a multiyear rate plan already imposes increased rate pressure on customers, which benefits the utility by reducing regulatory lag through rate adjustments, which reflect projected increases in cost of service via rate base increases and operating expense cost escalation over forecasted periods when rates will be in effect. That is, under a multiyear rate plan, the Company can project increases to its cost of service over several future annual test years, reflecting increased plant investment and escalation of operating expenses, which are in turn reflected in consecutive planned rate adjustments over the forecasted multiyear period. This is possible because multiyear rate plans provide certainty that revenues will increase annually as the result of higher customer rates. Hence, as noted by credit rating agencies, implementation of a new multiyear rate plan in Washington already enhances the utility's ability to recover its increasing cost of service and will do so at a great burden on customers to shoulder an increase in utility rates/bills to accommodate those planned annual increases to future costs of service.

Nevertheless, in this case PSE also proposes new tariff mechanisms that will impose additional utility bill increases on customers, which will further erode customers' rate-setting protections and ignore the requirement to manage rate affordability during a multiyear rate plan period. I will address each of these aspects of financial integrity and credit standing below.

Q. Do credit rating agencies express concerns that support Doyle's assertions that PSE's current bond rating and its ability to attract capital to support its capital program under CETA and/or for wildfire mitigation risk investments are at risk?

A. No. All credit rating agencies' outlooks for PSE's bond rating are "Stable," and agencies make positive comments about the implementation of a multiyear rate plan to support PSE's ability to recover its cost of service.

As part of S&P's "Stable" BBB credit rating outlook for PSE, it states:

> The stable outlook on PSE reflects that of parent [Puget Energy] and our expectation that ratemaking under the WUTC, including the <u>multiyear rate plan, will reduce regulatory lag and cash flow volatility</u>. Under our base case, we expect [Puget Energy]'s FFO to debt will be 13%-14% through 2026.[2]

In reaching this outlook, S&P reviewed PSE's significant increase in capital spending necessary to comply with CETA, and its elevated wildfire risk requiring more proactive management of wildfire risk, including monitoring for wildfire risk events, and responding to the improved wildfire risk mitigation operating procedures.[3]

Moody's also has a "Stable" Baa1 credit rating outlook for PSE, stating:

> Puget Sound Energy, Inc's (PSE) credit profile is supported by its rate regulated utility operations that benefit from a number of credit supportive cost recovery mechanisms authorized by its primary regulator, the Washington Utilities and Transportation Commission (WUTC). PSE's credit quality continues to be constrained by high holding company debt at its parent, Puget Energy, Inc. (Puget, Baa3 stable).

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[2] S&P Global Ratings: *Puget Sound Energy Inc.*, at 2 (May 16, 2024).
[3] *Id.* at 2.

> PSE's 2022 general rate case (filed January 2022) concluded in a multiparty settlement for a two year rate plan. In early January 2023, the WUTC approved the settlement with new rates effective in January 2023. We view the conclusion of the 2022 general rate case as credit positive and indicates that Washington regulation has become more consistent following the state's passage of SB 5116 and SB 5295 in 2019 and 2021, respectively.
>
> As of the last twelve months ending 30 June 2023, PSE's credit metrics improved including a ratio of cash flow from operations before changes in working capital (CFO pre-WC) to debt to about 19% from 16% at the end of 2022. The improvement is driven by stronger cash flow generation primarily because of the new rates as well as collection of the purchase power and fuel costs that were deferred in 2022. We expect credit metrics to be sustained between 18% and 20% over the next two years.[4]

Fitch Ratings also has a "Stable" BBB+" credit rating outlook for both Puget Sound Energy Inc. (PSE) and "BBB" for its parent Puget Energy Inc. (PE). Commenting on the "Stable" credit outlook for PSE, Fitch notes a positive regulatory environment suggesting regulatory treatment of PSE can support improvement to its current corporate bond rating.[5]

> Puget Energy Inc.'s (PE) ratings are driven by the regulated gas and electric utility operations at subsidiary Puget Sound Energy, Inc. (PSE). PSE is regulated by the Washington Utilities and Transportation Commission (WUTC).
>
> The approval of PSE's first multiyear rate plan has resulted in improved credit metrics for PE and PSE. Nonetheless, Fitch considers the WUTC to have a mixed record of credit-supportive decisions. Additionally, Washington is one of the most progressive states and imposes stringent environmental regulations and aggressive renewable and social objectives that, without appropriate recovery mechanism, can negatively affect credit.[6]

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[4] Cara G. Peterman, Exh. CGP-9 at 20 (Moody's Investor service, Credit opinion, Puget Sound Energy, Inc. Sept. 15, 2023).
[5] *Id.* at 1.
[6] *Id.*

Implementation of a multiyear rate plans improves the utility's ability to recover its cost of service when the rates are in effect, under effective and economic management of the utility.

III. MANAGING RATE AFFORDABILITY IS CRITICAL TO SUPPORT CREDIT RATINGS AND FINANCIAL INTEGRITY

Q. Do S&P, Moody's and Fitch comment on the implementation of the multiyear rate plan's ability to support PSE's ability to recover its cost of service during its elevated capital expenditure program?

A. Yes. As noted above, S&P, Moody's and Fitch all comment that the multiyear rate plan is credit-supportive and improves the credit metrics each of the credit rating agencies consider in assigning PSE's bond rating. Also of note is this multiyear rate plan not only will support PSE's credit rating but likely will support PSE's ability to increase dividend payments up to PE to help support its much greater debt leveraged balance sheet compared to its utility subsidiary. These comments from the credit rating agencies are noted above.

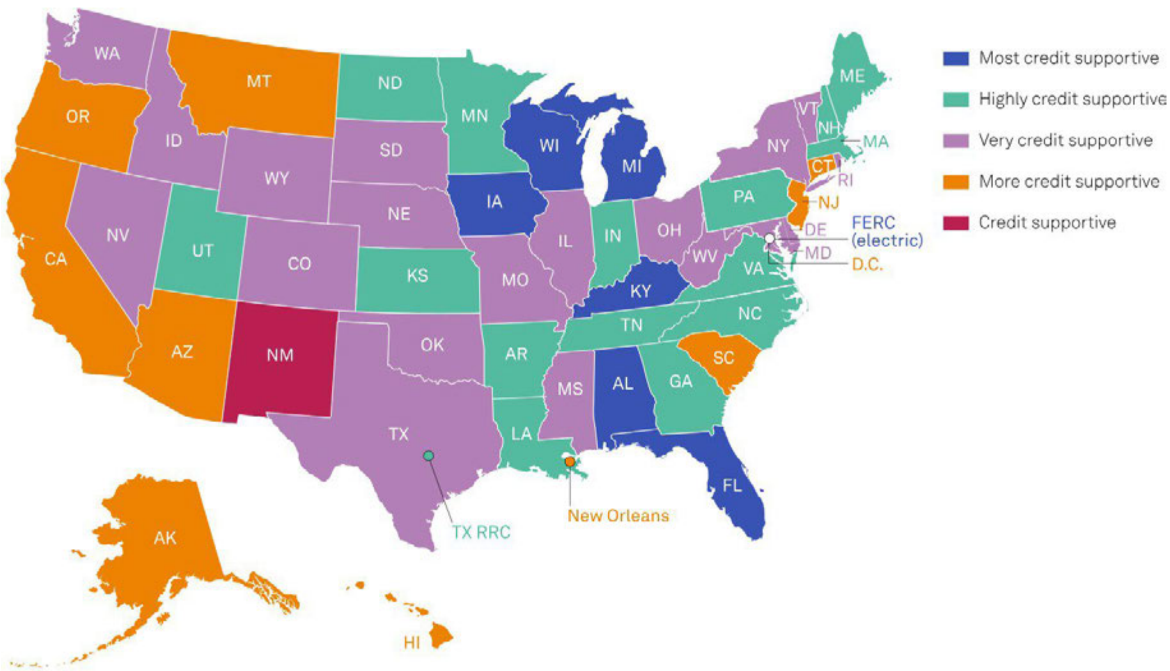
Q. Does S&P rate regulatory treatment of utilities in the U.S.?

A. Yes, and the WUTC is rated as "very credit supportive,"[7] and this rating preceded the implementation of a new multiyear rate plan, which as noted by credit analysts is expected to improve Washington utilities' cost recovery risks. S&P's regulatory risk rating of U.S. jurisdictions is copied below.

[7] *Id.* at 9.

Figure 1

<u>Regulatory Assessment by State</u>[8]
(as of November 2023)



Source: S&P Global Ratings.

As outlined in the figure above, Washington has a rating of "Very Credit-Supportive," which places it among the highest rating credit-supportive categories of the 50 U.S. jurisdictions.

Many credit-supportive regulatory mechanisms reduce the utility's cost recovery risk, but also place greater bill impact on customers to the extent rates will be modified, or tariff mechanisms implemented, that allow the utility to recover costs that cannot be controlled or managed. Hence, implementing

[8] S&P Global, *Ratings Industry Credit Outlook 2024*: *North American Regulated Utilities* at 8 (Jan. 9, 2024).

additional regulatory mechanisms that reduce cost recovery risk to the utilities will simultaneously have the impact of increasing bill volatility to customers. All of this should be carefully weighed in implementing regulatory mechanisms that support the utility's financial integrity, while also prioritizing the management of rate affordability to customers.

Q. Please outline credit agencies' stated concern about rate affordability as a credit risk to utilities.

A. Credit rating agencies have been <u>emphasizing rate affordability</u>, maintaining adequate financial coverages of debt obligations, and supporting utilities' overall investment grade bond ratings.

In a recent industry report, Moody's Investors Service ("Moody's") explained that the regulated electric and gas utilities' outlook remains "Negative" largely due to increased pricing pressures on customers. Moody's stated that it changed its outlook from "Positive" to "Negative" due to the following:

> We have revised our outlook on the US regulated utilities sector to negative from stable. We changed the outlook because of increasingly challenging business and financial conditions stemming from higher natural gas prices, inflation and rising interest rates. These developments raise residential <u>customer affordability issues</u>, increasing the level of uncertainty with regard to the timely recovery of costs for fuel and purchased power, as well as for rate cases more broadly.[9]

[9] Moody's Investors Service Outlook, *Regulated Electric and Gas Utilities – U.S. 2023 outlook negative due to higher natural gas prices, inflation and rising interest rates*, at 1 (Nov. 10, 2022) (emphasis added).

S&P identifies commodity price volatility, in combination with significant increases in capital investments as driving utility rate increases which are raising affordability concerns.[10]

Finally, Fitch Ratings (Fitch) opined that the regulated electric and gas utilities' outlook is deteriorating due to elevated capital expenditures that put pressure on credit metrics. Fitch also notes bill affordability concerns for ratepayers, and regulators' ability to balance the rate requests with increasing customer bills.

Specifically, Fitch states:

> Authorized ROEs could prove to be sticky despite an increase in cost of capital. Higher weather-normalized retail electricity sales, driven by datacenter growth and onshoring of manufacturing activities, and tax transferability provisions of the Inflation Reduction Act could somewhat offset headwinds to utilities. Ongoing management actions to sell assets and issue equity, in some cases, is supportive of parent companies' ratings. <u>Within Fitch's coverage, 90% of ratings hold Stable Rating Outlooks. We expect limited rating movement in 2024. The number of upgrades in 2023 so far exceeds the number of downgrades, and is driven by positive rating actions on several parent holding companies and their regulated subsidiaries</u>.[11]

IV. CREDIT METRICS

Q. Did PSE file historical and projected cash flow coverage metrics consistent with S&P's and Moody's credit rating metrics considered in PSE's bond rating?

[10] S&P Global Ratings, *Industry Credit Outlook 2024: North America Regulated Utilities* at 8 (Jan. 9, 2024).
[11] Fitch Ratings, *North American Utilities, Power & Gas Outlook 2024* at 1 (Dec. 6, 2023) (emphasis added).

A. Yes. PSE witness Cara G. Peterman outlines the credit rating cash flow debt coverage metrics anticipated to be realized by the Company under its multiyear rate plan based on S&P and Moody's' methodologies.

Witness Peterman's projected S&P and Moody's cash flow metrics were included in Table 8 at page 26 of Exh. CGP-1CT and are replicated below in my Confidential Table 1, below.

Table 1
PSE S&P and Moody's Recent Key Credit Metrics Performance

1	S&P						Projections*
		2018	2019	2020	2021	2022	[redacted]
2	FFO	$1,079	$1,068	$1,073	$1,152	$1,047	[redacted]
3	Debt	4,853	5,091	5,283	5,820	5,873	[redacted]
4	FFO to Debt Ratio	22.2%	21.0%	20.3%	19.8%	17.8%	[redacted]
5	Moody's						[redacted]
		2018	2019	2020	2021	2022	[redacted]
6	CFO pre-WC	$928	$731	$898	$900	$880	[redacted]
7	Debt	4,578	4,828	4,957	5,268	5,483	[redacted]
8	CFO Pre-WC/Debt	20.3%	15.1%	18.1%	17.1%	16.1%	[redacted]
	* Based on PSE's current plan						

As shown above, based on existing regulatory mechanisms, i.e., prior to the implementation of setting rates using a multiyear rate plan, historical credit metrics have supported PSE's "Stable" credit rating outlook. Peterman's table shows that under S&P's methodology, PSE earned a Funds From Operation (FFO) to Total Debt ratio in the range of 17.8 percent to 22.2 percent over the period 2018-2022. These metrics reflect a time period where PSE did not earn

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close to its authorized ROE.[12] This metric would improve by the implementation of a multiyear rate plan, and enhance PSE's ability to fully recover its cost of service. This metric indicates if the utility regulatory mechanisms and under effective management are expected to generate cash flow from operations that are large enough to assure the utility can pay debt service obligations, and to fund ongoing capital expenditure obligations to maintain service reliability.

These earned FFO/Debt ratios, in 2018-2020 comply with the target debt ratio S&P made for PSE through 2025 of 20 percent to 21 percent, but have fallen short more recently in 2022. These projected metrics, and the parent company Puget Energy's credit metrics of 13 percent to 14 percent, support a "Stable" credit rating outlook, as quoted above through 2025.[13]

[redacted]

For its cash flow credit metric, Cash Flow From Operations Pre-Working Capital to Total Debt (CFO pre-WC")/Debt), [redacted].[14]

[12] *See* Direct Test. of Daniel A. Doyle, Exh. DAD-1CT, Figure 1 at 24. PSE's earned ROE was on average more than 2.0% below its authorized ROE – 2020-2024.
[13] S&P Global Ratings, *Puget Sound Energy Inc.*, at 4 (May 11, 2023).
[14] Peterman, Exh CGP-9 at 21.

Of significance, the historical credit metrics over this time period were negatively impacted by the Company's failure to earn its authorized return on equity.[15] The recent rate-setting issues have been resolved, and the start of setting rates based on a multiyear rate plan is expected to improve the utility's ability to recover its cost of service, which will improve the utility's actual earned return on equity and will also improve its internal cash flow. All of this will enhance the utility's earned credit metrics and improve the credit analysts' confidence that they can project the utility's ability to achieve expected returns and credit metric over time.

Q. Did Peterman comment on regulatory issues that have depressed PSE's credit metrics over her forecast period?

A. Yes. Peterman states that the Company experienced a stagnation in cash flows and an increase in debt that caused the Company's metrics to decline. She notes that the S&P FFO/Debt ratio decreased by over 440 basis points from 2018 to 2022, and Moody's CFO pre-WC declined by 420 basis points over the same time period. She attributes this cash flow stagnation primarily to two issues: (1) passage of the Tax Cuts and Jobs Act (TCJA) in 2017, which was implemented in 2018; and (2) the outcome of the rate proceeding in Dockets UE-190529, et al. (the "2019 General Rate Case).

Peterman's stated concern about the TCJA is not limited to only PSE. Indeed, it was an industry-wide impact on cash flow credit metrics due to the

[15] *See* Doyle, Exh. DAD-1CT at 24, Figure 1.

TCJA federal corporate tax rate change. The reduction in cash flow experienced by PSE was also experienced by every other regulated utility and non-regulated company in the country to the extent they had adequate taxable income that benefited from Modified Accelerated Cost Recovery System (MACRS) accelerated depreciation of capital investments. Importantly, credit analysts and the investment public are fully aware of the TCJA, and stated credit metric outlooks published by credit rating agencies now reflect utilities' cost recovery and revenue requirements based on current tax laws. Indeed, all the credit metrics included in Peterman's table are for the post-TCJA implementation period.

With respect to the 2019 General Rate Case, the credit rating reports above also discussed these rate case outcomes. The 2019 rate case was known to analysts when they rated the WUTC as a highly credit-supportive jurisdiction. While Moody's notes that the 2019 rate case was contentious, it also notes that PSE's 2022 General Rate Case resulted in a credit-positive settlement that was approved in 2023, and opines that implementation of a multiyear rate plan may lead to more consistent and predictable regulations in the state of Washington.[16] Similarly, S&P views PSE's regulatory treatment before implementation of a multiyear rate plan as credit-supportive, and opines that use of a multiyear rate-setting plan will improve its regulatory treatment. Washington's regulatory mechanisms already promote predictability and lowers uncertainty for the utility

[16] Peterman, Exh. CGP-9 at 22–23.

and its stakeholders, and the new multiyear rate plan will further lower this operating risk.[17]

Significantly, Peterman did not mention how the new multiyear rate plan is expected to improve PSE's ability to recover its actual cost of service and how that will strengthen its cash flow credit metrics.

Q. Do Peterman's projected cash flow metrics support the Company's request to implement several new tariff mechanisms in addition to the multiyear rate plan in order to improve credit metrics in this proceeding?

A. No, the multiyear rate-setting process is sufficient. Customer rates will be adjusted based on increases to PSE's cost of service. The proposed new tariff rate mechanisms are not needed to support improvements to PSE's credit metrics.

V. PROPOSAL TO INCLUDE CETA QUALIFYING CWIP IN RATE BASE IS NOT BALANCED NOR NECESSARY TO SUPPORT PSE'S FINANCIAL INTEGRITY AND CREDIT STANDING

Q. Is PSE proposing to earn a current return on CWIP in rate base rather than accrue an AFUDC and recover construction period carrying charges after the asset is placed in-service?

A. Yes. PSE witness Doyle outlines the Company's proposal to include a CWIP in rate base methodology for the Beaver Creek Wind Project, which is proposed to be recovered in the Clean Generation Resources Tariff (Schedule 141CGR). Doyle states that for certain qualifying CETA investments, a current return on

[17] S&P Global Ratings, *Puget Sound Energy Inc.* at 1–2 (May 11, 2023).

CWIP, rather than an AFUDC accrual methodology, provides certain benefits to the Company and its customers. He outlines estimated benefits to include:

- The asset will have lower capitalized costs and will increase rate base by using the CWIP methodology relative to the AFUDC accrual method.
- Allowing for a current return on CWIP increases the utility's cash flows which reduces the utility's need for other outside financing.
- CWIP in rate base increases the quality of the Company's cash earnings.
- Greater risk associated with higher levels of non-cash earnings, such as AFUDC, would ultimately be reflected in higher rates of return required by investors.
- Investors understand CWIP in rate base is an important tool that supports the utility's financial integrity and attenuates some of its financial risks associated with new infrastructure investments.[18]

Q. Did Doyle outline the costs and benefits to customers from the Company's proposal to include CWIP in rate base?

A. No. Witness Doyle and, in part, PSE witness Susan Free commented on a comparison of the net present value of including CWIP in rate base as opposed to traditional AFUDC treatment of construction period carrying costs. The witnesses acknowledged that the net present value costs are comparable between the two regulatory treatments; however, neither witness addressed the intergenerational equity differences to customers between the two regulatory treatments.

[18] Doyle, Exh. DAD-1CT at 64–65.

Q. What are the intergenerational equity problems with including CWIP in rate base before the resource is placed in-service?

A. Including CWIP in rate base will create economic harm to the customers that are obligated to pay a current return on CWIP in rate base but will not receive any benefits from the operating output of Beaver Creek that commences after the unit is placed in-service. Specifically, customers obligated to pay a return on the Beaver Creek wind facility CWIP will not benefit by the reduced energy charges via the operation of the wind facility energy output and accredited capacity benefits and will not receive any benefits from production tax credits (PTC) available based on that energy generation after the resource is placed in-service. Specifically, operation of a wind facility produces energy at no fuel cost, producing a zero-cost component. Further, PTCs offer tax credits based on energy produced and further reduce the costs of the utility's energy during operation of the renewable resource. While customers pay the fixed costs to produce these energy savings, facilities that have been operating benefit through these lower energy charges. The facilities also provide a certain level of accredited capacity, which is used to support service reliability and system integrity. Hence, while customers pay slightly higher rates to compensate the Company for construction period AFUDC charges, they receive significant benefits from the operation of the renewable resource after it is placed in-service. In contrast, customers that would be asked to pay a current return on CWIP balance of the renewable resource pay higher rates to compensate the Company for these construction period carrying charges but receive none of these energy benefits from the resource.

Hence, prior to Beaver Creek being placed in-service, customers that are paying a current return on CWIP in rate base will be charged for significant costs of the resource but will not receive any of the operating benefits of the resource.

On the other hand, under traditional AFUDC treatment of CWIP carrying costs, customers will pay slightly higher rates after Beaver Creek is placed in-service due to the capitalization of AFUDC carrying costs, but those same customers will benefit through lower energy charges produced by both operation of zero-cost fuel sources and by the PTCs for qualifying energy generation. Hence, there are slightly higher costs under traditional ratemaking practices to capitalize AFUDC, but these costs are balanced by the operating benefits of the resource. These are critical elements in assessing the balance between paying the Company a current return on CWIP investment versus the traditional practice of allowing the utility to accrue an AFUDC return on that investment.

Q. Please comment on Doyle's comments that allowing for a current return on CWIP would increase the non-cash levels of AFUDC earnings, which would be perceived as an increase in PSE investment risk and would require a higher rate of return required by investors.

A. Doyle has addressed this issue completely backwards. Under traditional ratemaking, utilities accrue construction period carrying charges in an AFUDC deferred amount and recover that investment after the asset is placed in-service. Customers start paying the full cost of the asset after the asset is placed in-service and the asset provides service benefits to those customers. Accruing AFUDC during construction is the traditional, widely accepted ratemaking practice.

If the utility is provided a current return on CWIP that lowers its investment risk relative to traditional ratemaking practices, then this proposed new non-traditional rate-setting practice would reduce PSE's investment risk and should be accompanied by a reduced return on equity. Once again, Doyle has this issue turned upside down.

Q. Is there any merit to Doyle's suggestion that including a current return on CWIP would improve the utility's cash flow metrics?

A. Yes, PSE witness Doyle is correct that a current return on CWIP would improve cash flow credit metrics during the development of the infrastructure plant. However, Doyle has not established that this cash flow improvement is fair to the customers that pay higher rates to improve PSE's cash flow but receive no offsetting benefits from the resource. Furthermore, Doyle has not considered the improvement to PSE's ability to receive forecasted increases over a multiyear period to better track changes in cost of service that are produced via a multiyear rate plan. As noted above, the implementation of a multiyear rate-setting procedure will already enhance the Company's ability to adjust rates to track increases in cost of service that will improve its ability to recover its cost of service and will improve its internal cash flow generation and improve credit metrics. That in combination with a "Stable" credit outlook for PSE based on its current regulatory mechanisms, does not justify additional regulatory mechanisms that improve credit metrics particularly if they impose unjustified rate burdens on customers for resources that are not yet being used to provide service.

If, for the sake of argument, the Company's construction program is creating a significant cash flow constraint on the utility, a quid pro quo may justify imposing rate burdens on customers to mitigate temporary cash flow constraints that are provably needed to support credit rating during the abnormally large capital program. However, the Company's filing in this case simply does not justify that extraordinary ratemaking practice and the Commission should reject PSE's proposal in this case.

VI. RATE OF RETURN ON PPAS

Q. Is PSE seeking to earn a rate of return on PPAs in this filing?

A. Yes. PSE witness Doyle outlines his understanding that the Commission can consider including a rate of return on PPAs in connection with the Company's Clean Energy Action Plan or those resulting from all-source requests for proposals.[19] As outlined in his testimony, PSE is proposing to earn a pre-tax rate of return on the aggregate of annual qualifying PPA costs for inclusion in its cost of service.

Doyle excerpts Section (2)(b) of RCW 80.28.410:

> For the duration of a power purchase agreement [that correspond to an electrical company's clean energy action plan pursuant to RCW 19.280.030(1)(1) [*sic*]], a rate of return of no less than the authorized cost of debt and no greater than the authorized rate of return of the electrical company, which would be multiplied by the operating expense incurred under the power purchase agreement [may be considered and included in rates by the Commission].[20]

[19] Doyle, Exh. DAD-1CT at 90:14-18.
[20] *Id.* at 91:1–92:22. (Bracketed text added by Doyle).

Q. In determining whether or not a current return on PPAs should be permitted or the level of return allowed, should the Commission consider the full PPA cost of service impacts on customers?

A. Yes. PPAs, as noted by Doyle at pages 29-30 of Exh. DAD-1CT, are considered by credit rating agencies as off-balance sheet contractual financial obligations. Hence, a credit analyst will often attribute debt-like characteristics to PPAs. In order to produce a ratemaking capital structure that balances the amount of debt leverage with the utility's cost of service, utilities often increase their ratemaking common equity ratio to offset its total leverage risk including on-balance sheet and off-balance sheet debt equivalents. Increasing the common equity ratio of the ratemaking capital structure increases the utility's revenue requirement to recognize the existence of PPAs and their debt-like characteristics.

Indeed, in the Company's proposed ratemaking capital structure in this proceeding, as more fully addressed in this proceeding by PC witness Dr. J. Randall Woolridge, the Company's proposed ratemaking capital structure (equity ratio of 50 percent in 2025 increasing to 51 percent in 2026) is an increase from the 49.0 percent common equity ratio approved in PSE's last rate case.[21] The combination of increasing the ratemaking common equity ratio and providing a full return on PPAs imposes a double cost impact on customers for the existence of PPAs. Specifically, as outlined on my Exhibit MPG-3, increasing the ratemaking common equity ratio from 49 percent to 51 percent would increase the

[21] *Wash. Utils. & Transp. Comm'n, v. Puget Sound Energy*, Dockets UE-220066 & UG-2200067.

Company's revenue requirement for the 2026 test year by $12.765 million. In that same year, the Company proposes a rate of return on PPAs of $1.3 million (operating income) which increases revenue requirement by $1.73 million.[22] Hence, the total cost to customers by reflecting adders to the cost of a PPA in 2025 is about $14.495 million per year. Also, noteworthy is that S&P projected debt-like equivalents of PSE PPAs decreased through 2023, from the amount in prior years.[23]

Q. Did Doyle provide evidence that an increase in the Company's ratemaking common equity ratio is needed to support its current bond rating?

A. No. Current metrics addressed earlier include total debt leverage considered by credit rating agencies that must be covered by the utility's internal cash flow. These total debt ratios include the utility's on-balance sheet and off-balance sheet debt equivalents that are based on the credit analysts' assessment of the debt-like characteristics of PPAs' contracts, operating leases and pension obligations. PSE simply has not provided evidence to support the need for an increased common equity ratio of the ratemaking capital structure to manage its overall leverage risk, considering both on-balance sheet and off-balance sheet debt, and internal cash flows coverage of debt. Unjustified changes in these ratemaking factors unnecessarily increase cost of service and erode rate affordability.

Q. Should the Commission approve a return on PPAs?

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[22] Doyle, Exh. DAD-1CT at 91, and tax conversion factor of 0.751313.
[23] S&P Capital IQ (Apr. 10, 2024). PPA debt equivalent decreased from $480 million in 2021 to $305 million in 2023, and is being amortized down toward zero by approximately $65 million per year. This does not reflect new PPA contracts.

A. No. I recommend no return on PPA, because customers are already paying the cost of a rate of return reflecting a ratemaking capital structure that balances leverage risk including PPA debt equivalents to support strong credit rating. A return on a PPA expense does not result in reasonable compensation to the utility and double counts PPA credit enhancement cost to customers.

However, if the commission choses to provide a return on PPA costs, I recommend a return no higher than the utility's cost of debt be provided to the PPAs. Providing a return based on the overall cost of capital would impose a higher carrying charge on the PPAs that includes both adjustments to equity and debt costs, and the related income tax associated with the equity return. Further, the financial leverage associated with PPAs is already accounted for in the determination of a reasonable ratemaking capital structure, thus limiting the additional cost imposed on customers.

VII. CLEAN GENERATION RESOURCES TARIFF RATE (SCHEDULE 141CGR)

Q. Is PSE requesting the Commission to approve the implementation of a Clean Generation Resources Tariff Rate – Schedule 141CGR?

A. Yes. PSE witness Free states that the Company is proposing to implement this rate to recover the fixed cost associated with building or purchasing large-scale CETA compliant generating resources. In this case, the Company is proposing to recover the costs of the Beaver Creek Wind Project (Beaver Creek) in its Clean

Generating Resources (CGR) tracker. PSE is also proposing to recover CWIP in rate base associated with Beaver Creek in this tracker.[24]

PSE witnesses Free, Doyle, and Peterman maintain that the CGR tracker is necessary to improve PSE's cash flows to allow it to maintain credit metrics for reasonable access to capital markets. Free states the CGR tracker will provide more timely cash flows to match construction schedules as PSE undergoes an exponential increase in acquisition of clean generation resources.[25] Free further states that the CGR tracker will also provide flexibility in the timing of recovery as opportunities arise or shift over the multiyear rate plan.[26]

Free states that the Company will recover the fixed cost of CETA compliant generating facilities through the proposed CGR tracker and will be able to recover variable costs of those resources in base rates or through Schedule 95 in a power cost only rate case (PCORC) filing.[27]

Q. Should the Commission approve the proposed CGR tracker for recovery of large-scale utility built or purchased CETA for any resources?

A. No. This rider in addition to a multiyear rate-setting process is not necessary to allow the Company to develop and/or purchase large-scale generating facilities and to reflect the cost in rates within the multiyear rate schedule. But just as importantly, the proposed rider in addition to the multiyear rate plan, does not give sufficient priority, or any priority, to managing rate affordability.

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[24] Direct Test. of Susan E. Free, Exh. SEF-1T at 7–8.
[25] *Id.* at 8:9–12.
[26] *Id.* at 8:12–15.
[27] *Id.* at 13:15–18.

Q. Please explain why implementing this proposed new rate tracker in addition to a multiyear rate plan is not necessary to allow the Company to include the expected cost of new utility plant investments or new PPAs to meet the CETA objectives in its cost of service and retail rates.

A. The Company's resource planning that goes into identifying the lowest-cost and best resource alternatives is accomplished over time. Hence, this planning process allows for sufficient time for the Company to identify resources to invest in, and PPAs and contracts to execute. This planning and development/contract execution process provides the utility sufficient time to include the costs of these new resources in its forecasted test years' cost of service within a multiyear rate plan forecast. Since the Company's needs may be sufficiently addressed through the multiyear rate plan, it is unnecessary to implement the proposed CGR tariff.

Q. Is the proposed rider in addition to a multiyear rate plan necessary to strengthen the Company's credit metrics to align with metrics needed to support an investment grade bond rating, and to access external capital for CETA resources?

A. No. The multiyear rate plan, as discussed above, already improves the Company's cost recovery risk, which will increase credit metrics while the rates are in effect. Indeed, as noted above, the problem with the Company's historical credit metrics is its inability to earn its authorized rate of return. The multiyear rate plan will allow for rate adjustments over the forecasted period, which should allow the Company to timely recover its cost of service and earn its rate of return when those rates are in effect with economic and efficient management. An additional rider mechanism is not necessary to accomplish the same objectives.

Q. Please explain why customers could be harmed from inaccurate measurements of cost of service if the proposed CGR tracker mechanism is combined with a multiyear rate plan rate-setting approach.

A. Customers can be harmed by a combination of the CGR tracker mechanism charges and the multiyear rate plan base rate charges as a result of the combined charges recovering more than the Company's cost of service. Together, these additional charges could provide the Company with recovery of more than its cost of service and provide the Company with something greater than its authorized rate of return. This is more likely to occur if the revenue requirement were included in base rates and the tracker mechanisms were not synchronized with each another to ensure a level of revenues the Company collects in the two combination mechanisms accurately align with its actual cost of service. This is likely to result in unfair and unnecessary charges to customers.

Q. Please explain why a failure to synchronize the revenue collected through new rate trackers and the new multiyear rate plan would not accurately track the Company's cost of service and revenue requirement that it should be entitled to collect from customers.

A. To accurately track the net plant component of infrastructure, i.e., the amount of gross investment that is offset by recoveries of depreciation expense booked as accumulated depreciation, one must perform a careful review of total system in-service investment, rate recovery of depreciation expense, and buildup of accumulated depreciation. The Company proposes separating certain production plant investments from all other plant base rate investments. Separating these two items can result in the combination of the CGR rates and general base rates inaccurately tracking the Company's change to total Company rate base.

Rate base changes are driven both by additions to gross plant in-service through capital expenditures and by increases to accumulated depreciation reserves. The combination of these changes in gross plant and accumulated depreciation reserve results in changes in net plant in-service from year to year. The change in net plant in-service is largely what drives changes in rate base.

PSE witness Free outlines the Company's changes in the 2025 and 2026 rate base reflecting all these rate base components as I have outlined in Table 2, below.

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Table 2
Electric Rate Base and Adjustments

Line	Description	End of Period 2024 Balances (1)	Restating Adjustments to Get to 2025 Average Rate Base (2)	2025 Average Test Year Rate Base (3)	Restating Adjustments to Get to 2026 Average Rate Base (4)	2026 Average Test Year Rate Base (5)
1	Gross Utility Plant in Service	$12,764,132,949	$285,564,138	$13,049,697,086	$849,756,371	$13,899,453,457
2	Accum Depr And Amort	$(5,750,961,352)	$(228,780,260)	$(5,979,741,611)	$(29,744,404)	$ (6,009,486,015)
3	Deferred Debits and Credits	$ 636,269,645	$(16,047,878)	$ 620,221,767	$(27,518,408)	$ 592,703,359
4	Deferred Taxes	$ (1,174,423,588)	$10,123,821	$(1,164,299,767)	$18,088,706	$ (1,146,211,061)
5	Allowance for Working Capital	$ 222,518,806	$ -	$ 222,518,806	$ -	$ 222,518,806
6	Other	$ (141,993,530)	$ -	$ (141,993,530)	$ -	$ (141,993,530)
7	Total Rate Base	$6,555,542,930	$50,859,821	$6,606,402,752	$810,582,265	$7,416,985,017

Source: PSE Exh. SEF-3-2-15-24, Tab SEF-4 at 1

In the table above, for the 2025 rate base, average test year plant investment of $285.6 million results in an increase in rate base of $50.9 million. That is because the accumulated depreciation reserve increased, on average, by around $228.8 million. This number stems from the Company's projection that it would recover over $420 million of depreciation expense and $91.2 million of amortization expense throughout calendar year 2025.[28] The rate base in 2026 will also be impacted by plant additions and changes in accumulated depreciation. Note that changes in accumulated depreciation under Free's forecast were reduced below the additional recovery of depreciation expense for the prior year as a result of the accounting offset to accumulated depreciation reserve for early retirement

[28] Free, Exh SEF-3, tab SEF-4, page 1:37–38 (Filed Feb. 15, 2024).

of plant investments in 2026. These early retirements significantly reduced the increase in accumulated depreciation and amortization in 2026 to well below the recovery of depreciation expense and amortization expense from customers in prior periods. This depreciation reserve offset in 2026 is not an annual recurring adjustment.

In order to accurately measure total changes in rates, one must synchronously measure changes in gross plant in-service while offsetting changes in accumulated depreciation.

If plant investment is recovered in both base rates and tracker mechanisms, synchronizing the change in total Company net plant in-service with changes to the separate tariff rate mechanisms is more difficult and less exact. Because base rates and tracker mechanisms' rate charges are not changed synchronously outside of a multiyear rate case, the combined charges to customers may not accurately reflect the combined changes to total Company net plant in-service. Thus, the proposed tariff will likely impose excessive charges on customers by inflating the utility's rate of return on actual total rate base investments. Instead, the Company should be required to recover its cost of service through the multiyear rate plan. The Company has not provided compelling evidence that the multiyear rate plan is insufficient to meet its needs, and its CGR tariff proposal should therefore be rejected.

Q. Do you oppose PSE's request to recover the costs of CETA plant investments in its cost of service within a multiyear test year?

A. No, not if the plant is needed to meet compliance obligations and PSE's decision to invest in CETA resources is prudent and reasonable. My concern is implementing adjustments to tariff rates in a synchronous manner that aligns with PSE's actual cost of service during the period rates are in effect. Adjusting rates by an accurate assessment of the Company's total cost of service is a critical element in managing rate affordability, particularly as PSE and many other utilities seek to prudently manage CETA obligations and other increases in cost of service.

VIII. WILDFIRE PREVENTION TARIFF RATE (SCHEDULE 141WFP)

Q. Is PSE proposing to implement a Wildfire Prevention Tariff Rate?

A. Yes. Like its CGR tariff, PSE is proposing to recover forecasted capital additions, insurance premiums, and operation and maintenance costs attributable to its wildfire mitigation plan through a new rider mechanism–Wildfire Prevention Tracker–Schedule 141WFP.

Q. Is the Company's proposal to implement a new Wildfire Prevention Tracker reasonable?

A. No. Like its proposed CGR tracker, the costs the Company seeks to recover in this tracker mechanism are more appropriately included in its rate cost recovery over a multiyear rate plan period. As noted above, use of a multiyear rate plan allows the Company to adjust rates by measuring rate adjustments during multiple projected test years. The proposed new tariff rate tracker for these costs is not necessary in combination with a multiyear rate-setting process.

For the insurance premium costs proposed to be recovered through this rider, I recommend the Company recover such costs based on stated premiums from third-party insurance companies over the multiyear rate plan period. This will protect the Company from at least short-term unexpected variation in insurance premium costs to the extent the Company can secure bids over various time periods within the multiyear planning period. Therefore, the Commission should reject PSE's proposal.

Q. Should the Commission consider other alternatives to providing PSE damage cost protection from wildfire costs to the extent third-party insurance becomes too expensive or unavailable?

A. Yes. One option may be to compare the cost of a self-insurance reserve versus the cost of insurance from a third-party provider. An initial wildfire damage cost trust fund reserve could be funded via securitization bonds, and withdrawals and deposits to the wildfire damage trust fund reserve could be based on strict regulatory protocols and approvals by the WUTC. If the cost of securitization bond annual payments are less than third-party annual insurance premium payments, and damage coverages are comparable, then customers could benefit from this type of self-insurance reserve. This type of option may be more likely if wildfire insurance premiums costs continue to escalate and/or damage claim protections are reduced.

IX. DECARBONIZATION TARIFF RATE (SCHEDULE 141DCARB)

Q. Is the Company proposing a decarbonization rate adjustment?

A. Yes. The Company is proposing Schedule 141DCARB, a decarbonization rate adjustment. PSE witness Free states the purpose of the schedule is to recover the cost of incremental decarbonization efforts that are not recovered in the multiyear period in base rates.

Q. Is the Company's proposal for a separate decarbonization rate reasonable?

A. No. The Company's costs associated with decarbonization may be included in base rates within a multiyear rate plan period planning horizon and can be recovered by accurately measuring the Company's cost of service over a multiyear rate plan period. Free states that the Company is proposing to implement this new rider mechanism because it believes there are a few alternatives that meet the cost-effectiveness test established for cost recovery and decarbonization efforts in the Climate Commitment Act (CCA) tariff rate, based on the Commission's standard prudency requirements.[29]

Q. Has the Company established the need for a separate DCARB rate adjustment, Schedule 141DCARB?

A. No. The Company has not established that it cannot sufficiently recover its costs through the multiyear rate plan process. The Commission should reject PSE's proposal.

[29] *Id.* at 24:3–10.

Q. Does this conclude your response testimony?

A. Yes, it does.