

**Exh. ECO-1CT
Dockets UE-170033/UG-170034
Witness: Elizabeth C. O'Connell
CONFIDENTIAL VERSION**

**BEFORE THE WASHINGTON
STATE UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

**DOCKETS UE-170033 and
UG-170034 (*Consolidated*)**

TESTIMONY OF

Elizabeth C. O'Connell

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

*Adjustments 11.19 and 13.19 Environmental Remediation Projects, Rentals, and
Adjustments 11.24 and 13.24 Legal Costs*

June 30, 2017

CONFIDENTIAL PER PROTECTIVE ORDER

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LIST OF EXHIBITS

- Exhibit No. ECO-2C, Confidential Staff's proposed environmental remediation adjustments.
- Exhibit No. ECO-3, Environmental remediation Commission orders, start dates and costs.
- Exhibit No. ECO-4, PSE Environmental remediation quarterly report, first quarter 2017.
- Exhibit No. ECO-5, PSE's response to Staff data request 279.
- Exhibit No. ECO-6, PSE's response to Staff data request 274.
- Exhibit No. ECO-7, PSE's response to Staff data request 282.
- Exhibit No. ECO-8, PSE's response to Staff data request 280.
- Exhibit No. ECO-9, PSE's response to Staff data requests 270 and 271.
- Exhibit No. ECO-10C, Confidential PSE's response to Staff data request 401, attachment W.
- Exhibit No. ECO-11, PSE's response to Staff data request 278.
- Exhibit No. ECO-12, PSE's response to Staff data request 269, attachment A.
- Exhibit No. ECO-13C, Confidential Tacoma Tide Flats letter.
- Exhibit No. ECO-14C, Confidential PSE's response to Staff data request 401, attachment K.
- Exhibit No. ECO-15, PSE's response to Staff data request 281.
- Exhibit No. ECO-16, Washington Natural Gas and PSE's Environmental Projects Quarterly reports excluding Tacoma Tide Flats.
- Exhibit No. ECO-17, PSE's summary of environmental remediation costs for gas sites including Tacoma Tide Flats. December 31, 1997.
- Exhibit No. ECO-18, PSE's response to Staff data request 364, attachment A.
- Exhibit No. ECO-19, PSE's response to Staff data request 364.
- Exhibit No. ECO-20, PSE's response to Staff data request 221.
- Exhibit No. ECO-21, PSE's response to Staff data requests 312 and 408.
- Exhibit No. ECO-22, Staff's proposed legal costs adjustments.
- Exhibit No. ECO-23, PSE's response to Staff data request 218, attachment A.

1 **I. INTRODUCTION**

2

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

4 A. My name is Elizabeth C. O’Connell. My business address is The Richard Hemstad
5 Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA
6 98504.

7

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

9 A. I am employed by the Washington Utilities and Transportation Commission
10 (Commission) as a Regulatory Analyst in the Energy Regulation Section of the
11 Regulatory Services Division. Among other duties, I am responsible for financial
12 and accounting analysis, auditing records of regulated companies, rate design,
13 analyzing cost of service studies, and reviewing affiliated interest transactions.

14

15 **Q. How long have you been employed by the Commission?**

16 A. I have been employed by the Commission since November 2015.

17

18 **Q. Would you please state your educational and professional background?**

19 A. In 2009, I graduated from Universidad Central de Venezuela in Caracas, Venezuela
20 with a Bachelor of Science in Economics, specializing in Banks and Finance. In
21 2013, I graduated from the University of Dundee in Dundee, United Kingdom with a
22 Master of Business Administration in International Oil and Gas Management. In
23 2015, I graduated from the University of Washington in Seattle, Washington with an

1 Accounting Diploma. Before joining the Commission, I worked for 3 years in the
2 financial sector assisting with brokerage of agricultural securities. I also previously
3 worked for 3 years in the Real Estate sector as an Advisor, specializing in the
4 appraisal of realty property.

5
6 **Q. Have you previously testified before the Commission?**

7 A. Yes. I presented testimony related to prudence, pro forma ratemaking policy,
8 property tax, and environmental remediation projects in Pacific Power’s General
9 Rate Case in Docket UE-152253. I also provided testimony related to leases,
10 additions to rate base, regulatory accounting principles, and general rate design in
11 Puget Sound Energy’s Dockets UE-151871/UG-151872. Finally I provided
12 testimony in Avista’s last General Rate Case in Docket UE-160228/UG-160229
13 associated with plant held for future use in production and distribution activities,
14 deferred debits and credits adjustment, and pro forma regulatory amortization
15 adjustment.

16

17 **II. SCOPE AND SUMMARY OF TESTIMONY**

18

19 **Q. Please explain the purpose of your testimony.**

20 A. My testimony addresses three issues. Initially, I address Puget Sound Energy’s
21 (“PSE” or “Company”) proposal to recover environmental remediation project costs
22 in rates. Then I propose the Commission order PSE to phase-out the Company’s
23 natural gas water heater and conversion burner rental program (“rental program”).

1 Lastly, I recommend the Commission disallow recovery of certain legal expenses
2 incurred during the rate year.

3
4 **Q. Please summarize your conclusions on the issues addressed in your testimony.**

5 A. Below I lay out each of the individual proposals from the Company and summarize
6 my conclusions:

- 7 ○ Amortization of Environmental Remediation Projects: PSE incorporated
8 adjustments “6.19E & 6.19G Environmental remediation” to account for the
9 amortization of deferred costs from Environmental Remediation projects
10 through September 30, 2016. Those project costs are predominantly caused
11 by changes in federal and state legal frameworks.¹

12 I generally find that the Company’s decision to remediate the
13 contaminated sites and comply with the applicable federal and state laws was
14 prudent. However, I recommend the Commission reject the specific
15 amounts and accounting methodologies PSE included in its proposed
16 adjustments. Most significantly, my recommendation excludes certain
17 amounts associated with the costs and recoveries related to the Tacoma Tar
18 Pits contamination site deferred before PSE’s merger with Washington
19 Natural Gas. My calculations also allocate each instance of insurance and
20 third-party proceeds that were directly assigned to a corresponding
21 remediation project. The remaining unassigned recoveries were assigned to
22 specific projects. Allocating proceeds to specific projects results in a more

¹ My testimony does not address decommissioning and remediation costs for the Colstrip generating station. See Staff witnesses Christopher Hancock and Chris McGuire for that discussion.

1 accurate accounting of the Company's obligations. Finally, I make several
2 recommendations to improve the effectiveness of the reporting process to the
3 Commission, so the Company's reporting mechanisms actually reflect up-to-
4 date, detailed information regarding the deferred balances. These
5 recommendations apply not only the costs but also all recoveries associated
6 with each environmental remediation project.

- 7 ○ Schedule 71 - Residential Water Heater Rental Service, Schedule 72 - Large
8 Volume Water Heater Rental Service, and Schedule 74 - Gas Conversion
9 Burner Rental Service: I recommend that PSE progressively phase out the
10 rental program. Rental customers are overpaying and significantly
11 subsidizing other customer classes.² Therefore, I recommend the
12 Commission:

- 13 ○ Order PSE to establish a termination date for contracts of all water
14 heater and gas conversion burner rental customers. This date should
15 coincide with the depreciation schedule of the underlying plant as of
16 September 30, 2016.
- 17 ○ For customers whose rented plant was fully depreciated as of the end
18 of the test year, their rental contract must be terminated and title to
19 the appliance must be conveyed to the customer.
- 20 ○ For the remaining customers who are renting plant that still retains
21 some book value, the contract may continue until the water heater or
22 gas conversion burner is fully depreciated.

² Ball, Exh. JLB-2, parity ratios tab.

1 ○ Consistent with Commission’s previous guidance, I recommend that
2 the Company send monthly notifications to the continuing customers
3 in their monthly bills with an offer for the customer to purchase the
4 rented appliance at the current book value.³ Once the book value is
5 zero, PSE would notify the customer that the contract is terminated
6 and the appliance is their property.

7 Also, the rental program’s public purpose is not aligned with the most recent
8 Commission rules requiring natural gas utilities to provide demand-side
9 management plans promoting conservation of natural gas usage by their
10 customers. The impact in cost of service is addressed in Mr. Ball’s
11 testimony.

12 ○ Legal costs: I recommend the Commission exclude all costs associated with
13 the development and litigation of the Leasing Program Dockets UE-151871
14 and UG-151872 from the revenue requirement. Staff also recommends the
15 Commission allocate a portion of the operation and maintenance and legal
16 costs for the Liquefied Natural Gas (LNG) facility in Docket UG-151663 to
17 non-regulated operations and then exclude that portion from recovery in
18 regulated utility rates. The Commission determined that the terms and
19 conditions of the leasing program proposed in Dockets UE-151871 and UG-
20 151872 were not fair, just, and reasonable and that the proposed leasing
21 program was not in the public interest.⁴ Therefore, ratepayers should not be

³See *Wash. Utils. & Transp. Comm’n v. Washington Natural Gas Company* Docket UE-920840, Order 04, page 17 (September 27, 1993) (WNG 1993 GRC Order).

⁴See *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy* Dockets UE-151871 and UG-151872, Order 06, 3 ¶ 8 (Nov. 16, 2016) (PSE 2016 Leasing Order).

1 burdened with the legal costs associated with such a program. Likewise, the
2 LNG settlement agreement in Docket UG-151663 provided for common cost
3 allocation between PSE and Puget LNG.⁵ All costs included in the current
4 general rate case (“GRC”) should be allocated between those regulated and
5 non-regulated operations, consistent with the Commission’s order approving
6 that settlement.

7
8 **III. RECOVERY OF ENVIRONMENTAL REMEDIATION PROJECTS COSTS**

9
10 **A. Overview of the Company’s Proposal**

11
12 **Q. Please explain PSE’s proposal for environmental remediation project costs.**

13 A PSE seeks to recover actual costs to remediate contaminated sites, net of a certain
14 amount of monies received from third party or insurance for environmental
15 remediation (“ER”). Although some of those third party funds are assigned to
16 specific sites, PSE’s proposal also leaves significant amounts of those third party
17 funds as unassigned, meaning the Company can direct those funds to any
18 remediation project in the current general rate case or for future costs. Under PSE’s
19 proposal, the Company is left with control over third party funds the Company
20 designates as unassigned and the authority to allocate and manage those funds.

21

⁵ See *Petition of PUGET SOUND ENERGY, INC. for (i) Approval of a Special Contract for Liquefied Natural Gas Fuel Service with Totem Ocean Trailer Express, Inc. and (ii) a Declaratory Order Approving the Methodology for Allocating Costs Between Regulated and Non-regulated Liquefied Natural Gas Services*, Docket UG-151663, Order 10, Settlement Stipulation (Nov. 1, 2016) (PSE 2016 TOTE Order).

1 **Q. Why does PSE perform environmental remediation?**

2 A. PSE typically performs ER in response to federal or state requirements. These
3 activities are not necessary to accomplish generation, transmission or distribution of
4 electricity and gas, but they are mandatory for the Company's good standing with
5 environmental regulatory agencies and to avoid future additional penalties. In this
6 case PSE addressed ER obligations imposed at a federal level by the Environmental
7 Protection Agency (EPA) and at a state level by the Washington State Department of
8 Ecology (DOE). Some of these sites were inherited by the Company after prior
9 owners caused environmental damages for which those owners and PSE are liable
10 according to the newer regulatory framework, while other sites were subject of
11 accidental contamination that needed to be remediated. Most of the major
12 remediation projects, like the deferrals identified as Gas Works Park and Tacoma
13 Tide Flats (or Tar Pits), are located in sites where past operations took place many
14 decades ago under less stringent regulations.⁶

15
16 **Q. Why is PSE requesting recovery of these remediation costs now?**

17 A. Company witness Ms. Free states that the Company is requesting recovery of
18 remediation costs in the current GRC because PSE has "substantially exhausted
19 known third-party claims for remediation sites."⁷

20

⁶ O'Connell, Exh. ECO-7, PSE's Response to Staff Data Request No. 282.

⁷ Free, Exh. SEF-1T at 24:13-14.

1 **Q. Has the Company documented and tracked the environmental remediation**
2 **costs?**

3 A. Yes. PSE keeps track of the total costs incurred in its ER program and of the total
4 amounts the Company recovers from other responsible parties such as insurance
5 carriers or prior owners (“recoveries”). The Company, in multiple instances, has
6 requested Commission authorization to defer the costs of specific environmental
7 remediation projects. The Commission has granted deferral authorization for
8 specific electric site projects and for all gas sites, subject to certain conditions. More
9 recently, the Commission granted a general authorization that allowed the Company
10 to use quarterly reports to inform the Commission of new electric site environmental
11 remediation projects instead of requesting individual deferral authorizations in
12 Dockets UE-070724, UE-072060, UE-081016.⁸ As noted above, PSE directly
13 assigns some of the recoveries to offset costs of specific projects but then leaves a
14 portion of the recoveries as unassigned, meaning they can be used to at the
15 Company’s discretion to offset the costs of any project.

16
17 **B. Staff’s review and recommended changes to PSE’s ER proposals**

18
19 **Q. Please summarize your review of the Company’s ER projects.**

20 A. I began by reviewing the direct testimony and exhibits of PSE’s witnesses Mr. Rork
21 and Ms. Free, PSE’s environmental quarterly reports, and PSE’s responses to data

⁸See *Petition of Puget Sound Energy, Inc. for An Accounting Order Regarding the Accounting Treatment for Costs of its Electric Environmental Remediation Program*, Dockets UE-070724 and UE-072060 and UE-081016, Order 01, 3 § (i) (Oct. 8, 2008).

1 requests from Staff and other parties in the current GRC. These documents included
2 the support of some of the recoveries received by PSE from insurance and third
3 parties. Likewise, I evaluated outside vendor contracts and invoices. I also
4 compared the instructions in all Commission orders in place that authorized the
5 deferral of environmental projects, and I reviewed the Company's compliance with
6 those instructions. The Commission's instructions were not exactly the same in all
7 orders, but most of them provided a fairly similar approach to the eligibility
8 requirements for deferred ER projects.

9
10 **Q. Please explain those Commission instructions for evaluating deferred**
11 **environmental project costs.**

12 A. In general, the Commission imposed the following terms:

- 13 1. All deferred costs are subject to a prudence review for recovery purposes.
- 14 2. Only amounts paid to outside vendors or contractors (i.e., investigation
15 and feasibility studies, sampling, evaluation, monitoring, materials,
16 remediation and removal) are eligible. Internal employee expenses and
17 legal expenses are not included.
- 18 3. Deferred costs will be reduced by any insurance proceeds or payments
19 from other responsible parties recovered by Petitioner.
- 20 4. Unamortized portion of the balance is subject to working capital
21 treatment.⁹

⁹ *Id. See also Washington Natural Gas Company's Accounting Petition for Environmental Remediation Program*, Docket UG-920781 (Nov. 25, 1992).

1 My exhibit Exh. ECO-3 provides a brief comparison of the deferral orders'
2 instructions.

3
4 **Q. Please summarize your conclusions.**

5 A. I make four recommendations. First, I recommend the Commission determine the
6 Company's ER projects are prudent because PSE's and third parties' documentation
7 demonstrates the reasonableness and practical necessity for environmental
8 remediation. Second, I recommend a change to the Company's accounting
9 methodology to offset all deferred cost electric and gas balances using the totality of
10 assigned and unassigned available recoveries from third party and insurance
11 recoveries.¹⁰ Third, I recommend the exclusion of \$34,641,077.23 in remediation
12 costs associated with the Tacoma Tar Pits deferred gas balances.¹¹ My
13 recommendation also excludes \$29,000,000 in insurance recoveries associated with
14 the Tacoma Tar Pits remediation site from the unassigned recoveries account.¹² I
15 also recommend the exclusion of certain internal costs from the unassigned
16 recoveries.¹³ Lastly, I recommend the appropriate working capital treatment for the
17 balances associated with electric and gas remediation projects.¹⁴

¹⁰ O'Connell, Exh. ECO-2C, Staff's proposed environmental remediation adjustments "Environmental remediation E" Tab, cell D6 through D22 and cell F2 through F28; "Environmental remediation G" Tab, cell D5 through D34 and cell F2 through F44.

¹¹ O'Connell, Exh. ECO-12, PSE's response to Staff data request 269, attachment A. "Attach A Staff 269" Tab, cell BF44.

¹² *Id.* Cell AN36. O'Connell, Exh. ECO-2C, Staff's proposed Environmental Remediation Adjustments, "Environmental remediation G" Tab, cell C55. O'Connell, Exh. ECO-13C Tacoma Tide Flats letter. O'Connell, Exh. ECO-14C PSE's Response to Staff Data Request 401, attachment K.

¹³ O'Connell, Exh. ECO-2C, Staff's proposed Environmental Remediation Adjustments "Environmental remediation G" Tab, cell C56 and C57. O'Connell, Exh. ECO-10C PSE's response to Staff data request 401, attachment W.

¹⁴ O'Connell, Exh. ECO-2C, Staff's proposed Environmental Remediation Adjustments "Lead Sheet E" Tab, cell C60; "Lead Sheet G" Tab, cell C58.

1 **1. PSE’s ER projects are prudent.**

2

3 **Q. Please describe the prudency review process in this case.**

4 A. My prudency review generally follows the Commission guidelines for determining
5 prudence of rate base additions because previous Commission’s orders do not
6 establish a deferral-specific set of standards. Of course, ER expenses and deferrals
7 are, by their nature slightly different than rate base additions, so the prudency
8 determination process needs to be slightly different as well.

9

10 **Q. What is the main difference between rate base additions and ER deferred**
11 **balances?**

12 A. The main difference is that rate base additions are necessary for generation,
13 transmission and distribution purposes, but ER is only necessary to maintain
14 Company’s good standing with the regulatory bodies. Determining the “need” for
15 ER thus ties to legislated obligations and processes instead of the Company’s ability
16 to provide electric or natural gas service. In any event, the traditional rate-base
17 prudency review is a valuable roadmap when forming an opinion related to
18 prudency.

19

20 **Q. What is the traditional Commission standard for a prudency review?**

21 A. The Commission has established that any decision to acquire resources has to be
22 appropriate under a reasonableness standard.¹⁵

¹⁵ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy*, Docket UE-031725, Order 12 at ¶ 19, (April 7, 2004)

1 **Q. What elements are considered to make a prudency review?**

2 A. There is no single set of elements or factors for a prudency review, but Staff has
3 recently proposed generally applying four factors. These elements are discussed in
4 section III of Mr. Wright's testimony.

5
6 **Q. Do the deferred projects included for recovery meet the standards for the
7 prudency review?**

8 A. Yes. The projects comply with Staff's recommended four prudency standards:

9 1) *The Need for the Resource* – Although ER is not a traditional rate base
10 addition, Staff can evaluate whether conducting the remediation is legally
11 necessary or otherwise required. In this case, federal and state statutes
12 require the entirety of PSE's environmental remediation program. The
13 Company's quarterly for the quarter ending March 31, 2017, also
14 provides a comprehensive and updated description of the activities
15 performed on each site and the detailed reasons why remediation was
16 necessary.¹⁶ PSE's remediation processes require arms-length
17 negotiations, and sometimes litigation, with other potential responsible
18 parties and applicable insurance policies.¹⁷ The combination of federal
19 and state requirements, site-by-site reporting to the Commission, and the
20 role of unrelated third parties convinces Staff that PSE's ER obligations
21 are legitimate and necessary.

¹⁶ O'Connell, Exh. No. ECO-4, PSE's Environmental Report for the quarter ending March 31, 2017.

¹⁷ Rork, Exh. No. JKR-1T at 4: 2-6.

1 2) *Evaluation of alternatives* – In PSE’s case, federal and state agencies
2 dictate the pre-established processes for determining the most cost-
3 effective way to accomplish appropriate remediation.¹⁸ In conversations
4 with the Company, Staff was informed that PSE personnel does not
5 perform any remediation directly on site, and the Company outsources all
6 ER activities to other service providers (SPs). PSE personnel is only
7 responsible to manage the activities of those SPs. Given the federal and
8 state requirements, proscribed process for completing remediation, and
9 the presence of third-party service providers, Staff believes PSE has
10 appropriately evaluated remediation alternatives.

11 3) *Communication with and involvement of the Company’s Board of*
12 *Directors* – PSE does not seem to have specific internal protocols for the
13 approval of ER projects.¹⁹ PSE stated that Mr. Rork transmitted
14 information to decision makers but the Company does not have a
15 consistent method to document who was responsible for which specific
16 decision. It appears that most decisions were made by vice president-
17 level executives charged with the PSE operation or operations that most
18 closely corresponded to the function of the contamination site. Those
19 executives managed the costs and recoveries associated with these
20 projects over time.

¹⁸ O’Connell, Exh. No. ECO-5 (PSE’s Response to Data Request 279).

¹⁹ O’Connell, Exh. No. ECO-6 (PSE’s Response to Data Request 274).

1 environmental remediation. Consequently, I recommend the Commission consider
2 the ER program costs as prudent.

3

4 **2. Staff proposed changes to accounting methodologies for the**
5 **management of third party and insurance recoveries.**
6

7 **Q. What is the Company’s general proposal for using insurance and third party**
8 **proceeds?**

9 A. The Company presented two different categories for insurance and third party
10 recoveries: assigned and unassigned. All proceeds in the assigned category directly
11 reduce balances of the corresponding ER project.²² Within the unassigned category,
12 PSE proposes further two subcategories. The first subcategory would go to offset
13 ER costs, but the Company would retain the remaining funds in the second
14 subcategory for future environmental remediation costs.²³

15 The underlying rationale for PSE’s management of the unassigned fund is
16 that the Generally Accepted Accounting Principles (“GAAP”) under Financial
17 Accounting Standards Board Accounting Standards Codification No. 410-30-25
18 Asset Retirement and Environmental Obligations (“ASC 410-30-25”) requires the
19 recognition of liabilities associated with environmental liabilities.²⁴ The Company
20 then proposes to create such liabilities with a portion of the funds obtained from third
21 party and insurance recoveries.

²² Free, Exh. No. SEF-1T at 25: 11-15.

²³ *Id.* At 25: 3-5. (“PSE is proposing to include only a portion of the unassigned insurance and third party recoveries to offset the actual costs included in this proceeding.”)

²⁴ O’Connell, Exh. No. ECO-11 (PSE Response to Staff Data Request 278)

1 **Q. Is the Company’s proposal for amortization of unallocated insurance and third**
2 **party recoveries consistent with orders for electric projects?**

3 A. No. The orders explicitly instruct that deferred amounts should be net of all
4 recoveries before being eligible for amortization and recovery in rates.²⁵ The
5 Commission’s orders do not provide any indication that recovery monies should be
6 used as a contingency fund for future obligations.

7
8 **Q. What is Staff’s proposal for general third party and insurance recoveries?**

9 A. My proposal eliminates that portion of unassigned third party proceeds that PSE
10 seeks to retain for future ER costs. The Company’s proposal to retain an unassigned
11 portion of third party proceeds is simply an arbitrarily-sized contingency fund and
12 departs from Commission guidance. The Company should utilize all funds available
13 at this point to offset ER obligations, as the Commission instructed in its electric and
14 gas orders.²⁶ There is no known and measurable basis to allocate any portion of
15 funds already available to the Company for future ER costs, nor is it fair or
16 reasonable.

17 PSE alleges the funds will mitigate rate impacts from future remediation
18 expenses, but in reality the retained amounts would work as a contingency fund. The

²⁵ See *Petition of Puget Sound Energy, Inc. for An Accounting Order Regarding the Accounting Treatment for Costs of its Electric Environmental Remediation Program*, Dockets UE-070724 and UE-072060 and UE-081016, Order 01, 3 § (d) (Oct. 8, 2008); *Petition of Puget Sound Power & Light. for An Order Regarding the Accounting Treatment for Costs of its Environmental Remediation Program*, Docket UE-911476, Order Authorizing Accounting Treatment, 5 § (d) (Apr. 1, 1992); *Petition of Puget Sound Energy, Inc. for An Accounting Order Regarding the Accounting Treatment for Costs of its Electric Environmental Remediation Program*, Docket UE-991796, Order Authorizing Accounting Treatment, 2 § (e) (Feb. 23, 2000); *Washington Natural Gas Company’s Accounting Petition for Environmental Remediation Program*, Docket UG-920781, 2 § (d) (Nov. 25, 1992).

²⁶ *Id.*

1 Company's logic goes against the reasoning for deferrals and amortization. If the
2 Company requires capital for future ER obligations, the Commission has already
3 provided significant guidance on how to seek deferral treatment for the costs and
4 propose recovery on and of those costs in a general rate case. Additionally, retained
5 unused funds could earn interest that ratepayers would not receive. Therefore, the
6 Company's approach to retain a portion of unassigned ER funds in a contingency-
7 type account is not fair to ratepayers, and any benefits from mitigation of future rate
8 increases from such a practice cannot be sufficiently well-quantified because future
9 costs are estimates.

10

11 **Q. Does Staff recommend the remaining accumulated actual costs – the ones that**
12 **are not offset by insurance or other third party funds - be amortized?**

13 A. Yes. Staff recommends the remaining balances that are not offset by the unassigned
14 recoveries, or net balances, be amortized into rates over a 5 year period.²⁷

15

16 **3. The Commission should exclude the recoveries and ER obligations**
17 **associated with the Tacoma Tar Pits/Tacoma Tide Flats.**

18

19 **Q. Does Staff propose removal of any specific remediation costs or recoveries?**

20 A. Yes. I recommend the exclusion of costs and recoveries associated with the Tacoma
21 Historical Coal Gasification Plant situated on the Tacoma Tide Flats ("Tacoma Tar
22 Pits" or "Tacoma Tide Flats"). Washington Natural Gas ("WNG") previously
23 operated the plant but the Tacoma Tide Flats remediation project became PSE's

²⁷ O'Connell, Exh. ECO-2C, Staff's proposed Environmental Remediation Adjustments "Environmental remediation G" Tab, cell G47, "Environmental remediation E" Tab, cell G31.

1 problem after the Company merged with Washington Natural Gas (“WNG”). My
2 recommendation amounts to removing \$34,641,077.23 in remediation costs and
3 \$29,000,000 from the insurance recovery balances. I also recommend that the
4 approximately \$5.6 million difference should not be amortized or recovered in rates.
5

6 **Q. What is the basis for Staff’s recommendation?**

7 A. First, I recommend the exclusion of \$29,000,000 from the insurance recovery
8 balances because the Company documented to the Commission over 20 years ago
9 that the recovery would cover substantially all remediation costs for the Tacoma Tar
10 Pits remediation project. The Company documented receipt of those funds in
11 September 1995.²⁸ PSE also filed evidence of the settlement agreement between
12 WNG and the insurance companies, which included the completion of the
13 transaction.²⁹ Furthermore, WNG sent a letter to the Commission on November 29,
14 1995, signed by PSE’s current VP and General Counsel Steve Secrist, in which
15 WNG notified the Commission that the \$29,000,000 would substantially cover all
16 unreimbursed remediation costs incurred in the Tacoma Historical Coal Gasification
17 Plant.³⁰ Consequently, the project was removed from WNG’s Quarterly Reports at
18 that time.³¹ All of these communications make it abundantly clear that WNG no

²⁸ Exh. No. ECO-12 PSE Response to Staff Data Request 269, Attachment A, “Attach A Staff 269” Tab, cell AN36)

²⁹ O’Connell, Exh. No. ECO-14C, PSE Response to Staff Data Request 401, Attachment K.

³⁰ O’Connell, Exh. No. ECO-13C, Tacoma Tide Flats letter.

³¹ O’Connell, Exh. No. ECO-16, Washington Natural Gas and PSE’s Environmental Projects Quarterly reports excluding Tacoma Tide Flats.

1 longer intended to recover any further costs associated with the site and the recovery
2 was sufficient to cover remediation costs.

3 The associated deferred costs balances somehow reappeared in Quarterly
4 Reports beginning in September 30, 1997, after PSE's merger with WNG.³²

5
6 **Q. Why did Staff remove the \$34 million-plus in remediation costs associated with**
7 **the Tacoma Tide Flats?**

8 A. I also recommend removing the associated remediation costs related to the Tacoma
9 Historical Coal Gasification Plant for the same reasons I recommend removing the
10 \$29 million recovery. The company documented to the Commission that the
11 recovery would offset all or substantially all of the remediation obligation. PSE
12 should not be able to bring the remediation costs back to life, so to speak. The
13 amount removed is \$34,641,077.23, which PSE had labeled the transfer of "N/A
14 Move environmental Balances to new accounts" in exhibit Exh. ECO-12.³³

15
16 **Q. Does Staff propose any other accounting adjustments related to PSE's ER**
17 **unassigned recoveries?**

18 A. Yes. I am also recommending the exclusion of company personnel costs because
19 those costs are not subject to deferral according to accounting order UG-920781
20 section 3.C. The amounts I added back to the unallocated funds account correspond

³² O'Connell, Exh. No. ECO-17, PSE's summary of environmental remediation costs for gas sites including Tacoma Tide Flats. December 31, 1997, page 1.

³³ O'Connell, Exh. ECO-12. "Attach. A Staff 269" Tab, cell 44BF.

1 to Gas Work Park internal costs for \$ 366.95, account 18608452, and Tacoma Tar
2 Pits internal costs for \$209,796.52, account 18608152.³⁴

3
4 **4. Costs eligible for deferral.**

5
6 **Q. What ER-related costs does the Commission allow for deferral?**

7 A. Costs eligible for deferred accounting treatment include only the amounts paid to
8 outside vendors or contractors such as investigation and feasibility studies, sampling,
9 evaluation, monitoring, materials, remediation, removal, disposal and post-
10 remediation work. Internal employee costs and legal costs are not considered outside
11 vendors or contractors

12
13 **Q. Do the costs included in the Company's adjustment follow the Commission's**
14 **deferral orders?**

15 A. Yes, with the exception of a small meal reimbursement amount that I excluded from
16 my calculations. PSE also noted that for the balances in certain gas-related
17 contamination sites a "lump sum" seems to be from its predecessors' accounting
18 system and further detail for those transactions was not readily accessible.³⁵ For all
19 substantive purposes, though, the Company's deferral practices accurately reflect the
20 Commission's orders.

21

³⁴ O'Connell, Exh. ECO-2C, Staff's proposed Environmental Remediation Adjustments "Environmental Remediation G" Tab, Cell C56 and C57.

³⁵ O'Connell, Exh. No. ECO-15, PSE Response to Staff DR 281. O'Connell, Exh. No. ECO-9, PSE Response to Staff Data Request 270, Data Request 271.

1 **Q. Did the Company account for internal employee costs?**

2 A. The Company did not include any internal employee costs in the deferred accounts
3 presented in the current GRC. However, as noted above, I found that the Company
4 had deducted \$209,796.52 for Tacoma Tar Pits internal costs and \$366.95 for Gas
5 Work Park internal costs from the unassigned recoveries account. This was done
6 with the purpose of clearing all legal costs accounts deferred in gas sites, offsetting
7 those cost accounts with funds held in the unassigned recoveries account. All
8 accounts, with the exception of the Thea Foss legal costs, were credited to show a
9 zero balance by debiting gas unassigned recoveries accordingly.³⁶ I added the
10 internal costs figures back to the unassigned recoveries amount because internal
11 company costs are generally not allowed for deferral and are recovered as part of the
12 expenses adjustments in the course of the General Rate Case.³⁷

13
14 **Q. How did the Company account for legal costs?**

15 A. The Company did not include any legal costs in the deferred accounts presented in the
16 current GRC. For the electric sites, Commission order in Docket UE-911476, Page 4,
17 (1), (April 1, 1992) explicitly requires the company to expense legal costs for the electric
18 remediation sites authorized in that occasion. For the gas sites, as it was previously
19 mentioned, PSE cleared most of its legal costs associated with deferred gas accounts in
20 2012, offsetting with those costs with funds previously classified as unassigned.

³⁶ O'Connell, Exh. No. ECO-10C, PSE Resp. to Staff DR 401 Attachment W.

³⁷ *Washington Natural Gas Company's Accounting Petition for Environmental Remediation Program*, Docket UG-920781, 2 § (c) (Nov. 25, 1992).

1 I consider the Company's practice consistent with the relevant Commission order because the
2 legal costs were incurred to obtain the recoveries from responsible third parties or
3 insurance carriers through litigation or settlement.³⁸
4

5 **5. Working capital treatment of environmental remediation projects.**
6

7 **Q. Is PSE requesting working capital treatment of the entirety of PSE's**
8 **environmental remediation electric and gas projects?**

9 A. No. The Company is requesting working capital treatment only for electric-related
10 remediation sites.
11

12 **Q. What is your recommendation for working capital treatment?**

13 A. I recommend the working capital treatment for both electric and gas environmental
14 deferred balances. The reason the Company is not requesting working capital
15 treatment of their gas facilities is because in Fourth Supplemental Order in Docket
16 UG-920840 denied WNG's request for working capital treatment in 1993. The main
17 cause for the denial was that prudence of the deferred projects was not determined at
18 that point in time and that the litigation for additional recoveries was about to start.
19 The Commission made it clear that determination of working capital treatment in
20 that occasion did not preclude WNG from requesting recovery of the costs, including
21 interest, in a future rate case. The underlying reasons for the prior Commission order
22 clearly no longer exist. Consistent with my recommendation of amortization of

³⁸ *Id.* Page 2, Section d.

1 balances, I also recommend working capital treatment of the unamortized net
2 balances for the electric and gas side.

3

4 **Q. How does Staff calculate the working capital treatment?**

5 A. As I previously explained, the difference between ER obligations and the proceeds
6 recovered from third parties for those ER obligations should be amortized over a 5
7 year period. This means that the Company will recover one-fifth of the net
8 remaining balance associated with ER projects in the rate year. In order to avoid
9 double recovery of that one-fifth amortized amount through rate expenses and
10 working capital, I recommend an adjustment to the working capital allowance. My
11 lead sheets in Exh. ECO-2 shows the specifics of this calculation. This way, PSE
12 will recover one fifth of its net balances directly through rates, and the working
13 capital general calculations will account for the remaining four-fifths that are not
14 being amortized in the rate year.

15 Ms. Erdahl's testimony addresses the general working capital calculations.
16 The effect of my adjustment is a reduction of working capital allowance of \$552,786
17 for electric and \$2,089,549 for gas.

18

19 **IV. RECOMMENDATIONS FOR IMPROVING THE PROCEDURAL**
20 **REQUIREMENTS AND REPORTING PROCESSES FOR DEFERRAL**
21 **OF ENVIRONMENTAL REMEDIATION PROJECTS COSTS**
22

23 **Q. Please describe the cost deferral process.**

24 A. Once the company performs environmental remediation activities, the associated
25 costs are accumulated in FERC accounts 182.3-Other Regulatory Assets and 186-

1 Miscellaneous Deferred Debits. These deferred balances are reported to the
2 Commission in PSE's quarterly reports. Included in the reports are the recoveries
3 from third parties and insurance companies. PSE also voluntarily included estimates
4 for future costs for each project.

5
6 **Q. What is your recommendation for recording amounts deferred in future
7 remediation projects?**

8 A. During the auditing process I encountered multiple aspects of the deferral and
9 reporting process that should be improved. My recommendations are:

10 1) Instead of quarterly reports, the Company should submit annual reports that
11 contain:

12 (a) Project amounts authorized for deferral with the Commission order
13 number that gives authority to PSE to do so.

14 (b) Beginning date of the deferral of each project.

15 (c) Beginning balances at the start of deferral.

16 (d) Year-end deferred balances for the reporting year.

17 (e) Location of projects and internal naming convention (e.g., Tacoma
18 Tar Pits and or Tide Flats).

19 (f) Total amount of third party and insurance recoveries received during
20 the reporting year by month. Each recovery is received by the
21 Company must reduce the balance of corresponding project cost
22 balances. If the Company receives lump sums for multiple projects,

1 documentation that supports all the projects that caused the claim
2 against third party and insurance should be included in the report.

3 2) For improved recordkeeping, and consistent with the most recent
4 Commission order for deferral of ER projects in electric sites, PSE should
5 record costs incurred in remediation in the electric and gas sites that the
6 Company wishes to preserve for Commission's review and possible request
7 for recovery in the future in FERC account 186. Balances of projects that
8 have been authorized for amortization and are currently being amortized
9 should be transferred to FERC account 182.3.

10 3) All projects that are being amortized should be included in the annual
11 report to the Commission, along with Commission's order that authorized
12 deferral number, Commission's order that authorized amortization,
13 beginning balances when the amortization started, year end balances, and
14 amortization start and end date.

15

16 **V. PHASE OUT OF THE RENTAL PROGRAM**

17

18 **Q. Please describe the Company's rental program.**

19 A. PSE's rental program consists of Schedule 71, 72, and 74. Schedules 71 and 72 are
20 the rental water heater program, and Schedule 74 refers to the rental of gas
21 conversion burners.

22

1 **Q. Please summarize Staff’s recommendation to sunset the rental program.**

2 A. I recommend the Company phase out the rental program. This involves a series of
3 steps: 1) Add an end date for all Schedule 71, 72, and 74 customers’ contracts; the
4 end date of the contracts should coincide with the depreciation schedule of the
5 underlying plant as of September 30, 2016; 2) For water heater or gas conversion
6 burner customers whose leased plant value has been fully accrued, i.e., book value is
7 equal to zero, as of September 30, 2016, transfer the property to the customer and
8 end the contract; 3) For those customers whose leased plant value is greater than zero
9 inform the customer of the expiration date of the contract and transfer the property
10 once the plant is fully depreciated; and 4) In the case of an appliance that is damaged
11 beyond repair, PSE should replace the appliance at no charge to the customer and
12 automatically end the contract.

13
14 **Q. Has the Commission ordered PSE to offer the rented water heaters to**
15 **customers for purchase?**

16 A. Yes. In 1993, the Commission ordered PSE’s predecessor WNG to offer customers
17 the leased water heaters for purchase:

18 “The Company should offer the leased water heaters for customer purchase,
19 in place, at depreciated book value”³⁹
20

21 Staff’s proposal of transferring water heaters and gas conversion burners once the
22 plant has zero book value is a natural extension of the order. Moreover, the

³⁹ WNG 1993 GRC Order, p. 17.

1 Commission also ordered the Company to design “an inexpensive and effective way
2 of communicating this offer to the customers.”⁴⁰

3

4 **Q. Are you making any recommendations to improve the communication of the
5 option to purchase to customers?**

6 A. Yes. The Company should send monthly notifications to rental customers in their
7 gas bills with an offer to transfer the rented water heater or gas conversion burner at
8 remaining net book value. The option to purchase is not published in PSE online
9 resources or schedules.⁴¹ It appears to be that the customer currently has to contact
10 PSE Lease Services Call Center and then go through an authentication process
11 before knowing that there is an option to purchase the rented appliance.⁴²

12

13 **Q. Please explain fundamental reasoning behind Staff’s recommendations.**

14 A. After reviewing data requests and cost of service, it is clear that the program has rate
15 design and overearning problems. The depreciation figures of the plant associated
16 with the water heater and gas conversion burners rental program show that 18,544
17 customers have appliances in service that are fully accrued (i.e., fully depreciated).⁴³
18 According to PSE all appliances from 2009 or older have been fully accrued, 13,178
19 water heaters that are in service fall in this category.⁴⁴ PSE even acknowledges that

⁴⁰ *Id.*

⁴¹ Puget Sound Energy, <https://pse.com/accountsandservices/YourAccount/Pages/Lease-Services.aspx> visited on 06/26/2017 at 13:30.

⁴² O’Connell, Exh. No. ECO-20, PSE Response to Staff Data Request 221.

⁴³ O’Connell, Exh. No. ECO-18, PSE Response to Staff Data Request 364, Attachment A.

⁴⁴ O’Connell, Exh. No. ECO-23, PSE Response to Staff Data Request 218, Attachment A.

1 rental customers are “currently paying in excess of their cost of service under
2 existing rates.”⁴⁵ Under the current rental program, the Company receives a
3 perpetual return on fully depreciated rate base and customers effectively pay for the
4 asset indefinitely. Under these circumstances the customer is the only party in the
5 transaction that is constantly harmed.

6

7 **Q. Has the Commission ever acknowledged flaws with the Company’s rental**
8 **program?**

9 A. Yes. Twenty-four years ago the Commission stated in fourth order in Docket UG-
10 920840 (September 27, 1993) that the program was flawed:

11 “The Commission agrees that the leasing program has flaws,
12 including the rental of less than efficient water heaters, and the failure
13 of the program to earn an adequate return”⁴⁶
14

15 The Commission ordered the Company to not add new customers to the program.⁴⁷

16 The program continues to have flaws, but now it is an overearning problem that hurts
17 customers because revenues are divorced from the cost of service. As a result, the
18 rental programs rates will never be fair, just, and reasonable and the Company will
19 receive an unending return on fully depreciated rate base if the program is not ended
20 in its entirety.

21

⁴⁵ O’Connell, Exh. No. ECO-19, PSE Response to Staff Data Request 364, section C.

⁴⁶ WNG 1993 GRC Order. Page 16.

⁴⁷ *Id.* Page 17.

1 **Q. Is there a policy reason for the program to continue?**

2 A. No. There is no longer a legitimate policy reason for the program to exist. The
3 public purpose of renting water heaters as a means to “promote greater use of natural
4 gas” is obsolete.⁴⁸ Furthermore, a recent Commission order discusses how much the
5 electric and gas distribution utilities have changed in the last 46 years since this issue
6 was addressed at Washington’s Supreme Court:

7 “Since the Cole decision, circumstances in both the electric and
8 natural gas distribution utilities have changed remarkably, as certain
9 state and federal laws require or encourage reduced or more
10 efficient use of energy commodities. For example, the citizens of
11 the state of Washington in 2006 passed Initiative 937, now codified
12 in RCW 19.285 as the Energy Independence Act, which requires
13 certain utilities to achieve all cost-effective conservation in
14 providing electric service. In addition, Commission rules require
15 natural gas utilities to provide demand-side management plans to
16 promote conservation of natural gas usage by their customers. In
17 other words, Washington utilities are required to develop creative,
18 cost-effective methods to reduce consumption of both electricity
19 and natural gas.”⁴⁹
20

21 There is no obligation in the existing tariffs in the rental program to install
22 only appliances that promote conservation of natural gas usage. Therefore,
23 there is not a convincing connection between current state policy goals of
24 reducing consumption of gas and the rental program because it was not
25 designed for that purpose. Consequently, it should be not only closed to
26 new customers but also should be ended in its entirety. This will avoid the
27 perpetuation of the problems associated with this program.

28

⁴⁸ PSE 2016 Leasing Order, p. 16, ¶ 61.

⁴⁹ *Id.* p. 16, ¶ 62

1 **Q. What will the Company do if the water heater needs to be replaced before the**
2 **contract ends?**

3 A. PSE would be obligated to provide a new water heater free of charge to the customer
4 if the one in service is damaged beyond repair. After the replacement is installed, the
5 contract would be terminated.

6

7 **Q. Under Staff's proposal, can the Company maintain the contracts with**
8 **customers that wish to stay in the rental program even if the book value of the**
9 **plant in service is fully accrued?**

10 A. No. Under Staff's proposal, the Company will not maintain the program under these
11 conditions. Once book value of the plant is fully accrued PSE will immediately
12 make the transfer of the asset to the customer and terminate the contract.

13

14 **Q. How does Staff's proposal benefit rental customers?**

15 A. Rental customers that have fully accrued plants will no longer pay for a service with
16 an underlying plant account book value that is zero. In other words, a customer will
17 only pay the cost of the plant and no more. Remaining customers will only pay until
18 the plant has been fully depreciated. The main point is that Schedule 71, 72, and 74
19 customers would no longer cross-subsidize other customer classes.

20

21 **Q. What is the effect of your recommendation in rate design?**

22 A. As discussed by Mr. Ball in his testimony, Staff proposes imputing the rental
23 contract revenues for class in the cost of service study. This is because it is unclear

1 exactly how quickly revenues, rate base, and expenses for this program will change
2 throughout the rate year under Staff's proposal.

3

4 **VI. RECOVERY OF LEASING SOLUTIONS AND LIQUIFIED NATURAL GAS**
5 **LEGAL COSTS**
6

7 **Q. Please explain PSE's request for recovery of leasing program expenses.**

8 A. The company included in its general legal costs for the test year the costs associated
9 with the Leasing Program Dockets UE-151871 and UG-151872 and with the Docket
10 associated with the Special Contract for Liquefied Natural Gas (LNG) Fuel Service
11 with Totem Ocean Trailer Express Docket UG-151663.⁵⁰

12

13 **Q. Does Staff agree with PSE's recommendation?**

14 A. No, I recommend the exclusion of the costs associated with the Leasing Program and
15 a portion of the costs associate with the LNG docket.

16

17 **Q. Why are you recommending the exclusion of the legal costs associated to the**
18 **Leasing Program incurred in the test year?**

19 A. The Commission determined that the terms and conditions of the leasing program
20 were not fair, just, and reasonable and that the proposed leasing program was not in
21 the public interest.⁵¹

22

⁵⁰ O'Connell, Exh. No. ECO-21, PSE's response to Staff data requests 312 and 408.

⁵¹ PSE 2016 Leasing Order, Page 3, paragraph 8

1 **Q. Why are you recommending the exclusion of a portion of the legal costs**
2 **associated to LNG incurred in the test year?**

3 A. The various parties in the settlement in Docket UG-151663, including PSE, agreed
4 that the common costs associated with the LNG facility would be allocated
5 according to the Common Items allocators in the agreement. These legal costs were
6 incurred to gain regulatory approval of the operation of the plant. The legal costs
7 should therefore be apportioned between regulated and non-regulated operations per
8 the settlement agreement in Docket UG-151663.⁵²

9
10 **Q. Could PSE own the LNG plant for unregulated customers without**
11 **Commission’s authorization?**

12 A. No. The Commission’s permission was necessary to establish an independent
13 subsidiary of Puget Holdings,⁵³ now known as Puget LNG, to own the maritime
14 fueling portion of the LNG plant. PSE may operate the LNG facilities for both
15 regulated and unregulated customers with a fair allocation of costs between the two.
16 Hence, both sides, the regulated and the unregulated businesses, benefit from the
17 arrangement, and both should bear the costs of gaining the regulatory authorization
18 for PSE to own and operate the Tacoma LNG facility.

19

⁵² See *Petition of PUGET SOUND ENERGY, INC. for (i) Approval of a Special Contract for Liquefied Natural Gas Fuel Service with Totem Ocean Trailer Express, Inc. and (ii) a Declaratory Order Approving the Methodology for Allocating Costs Between Regulated and Non-regulated Liquefied Natural Gas Services*, Docket UG-151663, Order 10, Settlement Stipulation (November 01, 2016) (PSE 2016 TOTE Order).

⁵³ Puget Holdings is also the parent company of PSE.

1 **Q. What is the Net Operating Income impact of your recommendation of excluding**
2 **the Leasing Program and a portion of LNG legal costs from the test year?**

3 A. My recommendation increases NOI by \$315,757 on the electric side and \$ 587,729
4 on the gas side.⁵⁴

5
6 **Q. Does this conclude your testimony?**

7 A. Yes.

⁵⁴ O'Connell, Exh. No. ECO-2C2 (Staff's proposed legal costs adjustments).