Exh. CSS-1T
Dockets UE-190529/UG-190530 and UE-190274/UG-190275 (*consolidated*)
Witness: Cristina S. Steward

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY,** **Respondent.**	**DOCKETS UE-190529 and UG-190530 *(consolidated)***
In the Matter of the Petition of **PUGET SOUND ENERGY** **For an Order Authorizing Deferral Accounting and Ratemaking Treatment for Short-life UT/Technology Investment**	**DOCKETS UE-190274 and UG-190275 (*consolidated*)**

TESTIMONY OF

Cristina S. Steward

STAFF OF WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Excess Deferred Income Tax, Investor Supplied Working Capital, Gain on Sale

November 22, 2019

TABLE OF CONTENTS

LIST OF EXHIBITS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Cristina S. Steward, and my business address is 621 Woodland Square Loop SE, Lacey, Washington, 98503. My business mailing address is P.O. Box 47250, Olympia, Washington, 98504-7250. My business email address is Cristina.Steward@utc.wa.gov.

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

A. I am employed by the Washington Utilities and Transportation Commission (Commission) as a Regulatory Analyst in the Energy Section of the Regulatory Services Division.

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

A. I have been employed by the Commission since November 2017.

Q. Please state your qualifications to provide testimony in this proceeding.

A. I received my Bachelor of Business & Accounting, and my Master of Public Administration degrees from the University of Alaska. Prior to working at the Commission I worked for six years at a Certified Public Accounting firm, preparing tax returns, and performing attestation services, including private company and government audits. At the firm, I also provided financial planning, bookkeeping, and other financial services to private businesses. In addition, I oversaw the payroll department and managed the firm. In 2018, I attended NARUC rate school offered by Michigan State University.

During my employment with the Commission, I have lead the review of six general rate case filings in the Water and Transportation Section, four water and two transportation cases. In the Energy Section, I have assisted with the review of four general rate case filings. I have also worked on various other company filings at the Commission.

Q. Have you testified previously before the Commission?

A. No.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. What is the scope and purpose of your testimony?

A. I discuss Puget Sound Energy's ("PSE's" or "Company's") proposed treatment of excess deferred income tax (EDIT), Adjustment 6.03 and 6.26; investor supplied working capital (ISWC), Adjustment 5.01; and proceeds from the sale of the Shuffleton property, Adjustment 6.20. The Company's proposed treatment of EDIT is sponsored by PSE witness Matthew R. Marcelia, and the ISWC adjustment and proposal for the Shuffleton sale proceeds are presented by PSE witness Susan E. Free. My testimony provides Commission Staff's (Staff's) recommendations for the treatment of these items.

Q. Please summarize your recommendations.

A. I recommend the following:

1. For the purpose of transparency, PSE should continue to return EDIT to customers on a separate schedule, currently Schedule 141X for both electric and natural gas service;
2. The Commission should retain the use of the "average of monthly averages" (AMA) year-end convention for ISWC, even if it adopts the "end of period" (EOP) convention for rate base; and
3. For the Shuffleton sale proceeds, the Commission should allow the Company's inclusion of the sale proceeds in rates, but should remove the sold asset from rate base and its corresponding depreciation from depreciation expense.

Q. Have you prepared any exhibits in support of your testimony?

A. Yes. I prepared Exhibits CSS-2 and CSS-3.

- Exh. CSS-2 consists of an IRS Revenue Procedure titled "Safe Harbor for Inadvertent Normalization Violations."
- Exh. CSS-3 shows the revenue requirement effect of the Shuffleton sale reduction to rate base.

III. DISCUSSION

A. Adjustment 6.03 & 6.23 E, Excess Deferred Income Tax (EDIT)

Q. What is deferred income tax and "excess deferred income tax" (EDIT)?

A. Deferred income tax is the amount recorded as a deferral, due to timing differences between when the tax is collected versus when it is paid. Because deferred income tax is created mostly due to timing differences, over time this account theoretically should reverse to zero.

EDIT is the portion of the accumulated deferred income tax account that will not reverse because the federal corporate income tax rate has changed from 35 to 21 percent. EDIT must be returned to ratepayers.

Q. What are the components of EDIT?

A. The U.S. Internal Revenue Service (IRS) has implemented rules for deferred taxes that are related to accelerated depreciation. EDIT that is subject to these rules is referred to as the "protected" portion. The protected portion must be returned to ratepayers pursuant to IRS requirements in order for the utility to avoid penalties. The rest of EDIT is referred to as "unprotected." Protected EDIT and unprotected EDIT equal total EDIT.

Q. How are deferred taxes handled?

A. The deferred tax amount, in a given period, is composed of differences between tax accounting and regulatory accounting, but may not always include all differences. Using regulatory accounting, for each financial statement period, a deferred tax amount is calculated and recorded in a liability account that accumulates as an offset to rate base.

Q. Has the Company started to pass EDIT back to customers?

A. Yes. In Dockets UE-180899 and UG-180900, the Commission ordered PSE to begin returning EDIT to ratepayers on Schedule 141X, effective March 1, 2019, but the details concerning the future return of EDIT were deferred until the Company's next general rate case.[1]

Q. What is the Company recommending in this case for the pass back of its EDIT?

A. The Company is proposing to eliminate Schedule 141X. Instead, PSE proposes to pass back its EDIT through base rates as part of its federal income tax adjustment. The adjustment would include the amortized amount of its protected EDIT. There is a separate adjustment for its unprotected portion of EDIT as a contra expense. The Company has not created a separately identified EDIT account and proposes to leave its EDIT included in its deferred income tax account.

[1] *Wash. Utils. & Transp. Comm'n v Puget Sound Energy*, Dockets UE-180899 and UG-180900, Order 05, 11-12, ¶ 31-32 (adopting the all-party Settlement Stipulation and Agreement); Settlement Stipulation and Agreement, 5-6, ¶¶ 14-15.

Q. Is PSE's proposal consistent with Commission practice?

A. No. The Commission has "directed regulated companies to track federal tax savings resulting from the federal Tax Cuts and Jobs Act to ensure those savings will benefit utility customers."[2] If PSE does not separate out EDIT from its federal tax adjustment, it will be difficult for the Commission, and others, to ensure this direction is fulfilled. To achieve transparency, Staff recommends the Commission require PSE to (1) create a separate EDIT account on its balance sheet, (2) separate EDIT amortizations/reversals from the Company's federal tax adjustment, and (3) continue to return EDIT to customers on Schedule 141X. Additionally, Staff recommends the Commission order PSE to update Schedule 141X annually to include the following year's EDIT amortization amount, consistent with the average rate assumption method (ARAM).

Q. Does Staff recommend an annual volumetric true-up?

A. No, Staff does not believe an annual volumetric true-up is necessary. Because a utility's federal tax is already calculated using a regulatory framework, there is no need to true up tax amounts to avoid any other methodology. Staff recommends that the return of EDIT to customers reduce rates in the same manner that it increased rates—without volumetric true-up.

---

[2] *Wash. Utils. & Transp. Comm'n v Puget Sound Energy*, Dockets UE-180899 and UG-180900, Order 05, 11, ¶ 34 (Feb. 21, 2019), *citing* Commission Press Release, Jan. 8, 2018.

Although taxes are a pass through cost, the intrinsic nature of tax calculation and the complexity of its deferrals require that its return match its collection, in order to keep rates fair, just, reasonable, and sufficient.

Q. Is there anything else the Commission should know concerning IRS requirements for the return of EDIT?

A. Yes. The IRS has detailed and specific requirements for the return of EDIT, all of which the Commission has reviewed over the past two years, and which the Company discusses extensively in its testimony. The Company contends that returning EDIT on a standalone schedule violates the IRS consistency rule.[3]

To support this argument, PSE witness Marcelia relies on IRS materials from the Tax Reform Act 1986, which was well before the Tax Cuts and Jobs Act (TCJA). The IRS may weigh in on this issue with respect to the TCJA but has not thus far to my knowledge.

Even if the Commission were to inadvertently cause the Company to violate any IRS requirements, the IRS has provided a safe harbor for unintended violations, in Rev Proc 2017-47.[4] This means the Company could avoid consequences if there were a swift correction.

[3] The consistency rule is contained in the Internal Revenue Code: 26 U.S.C. § 168(i)(9)(B).
[4] I have provided Rev Proc 2017-47 in Exh. CSS-2.

B. Adjustment 5.01 EP & 5.01 GP, ISWC AMA to EOP

Q. Please explain the nature of this adjustment.

A. The Company proposes to adjust ISWC from an AMA year-end convention to an EOP convention.

Q. What is ISWC?

A. ISWC refers to the funds necessary to sustain a company during its day-to day operations when there is a lag between expenses and revenues. The portion of workin capital provided by investors to support the Company's day-to-day cash flow needs is called Investor Supplied Working Capital. For ratemaking purposes, ISWC is included in rate base and provided a return.

Q. What is the "average of monthly averages"?

A. AMA is a mathematical formula used to determine an average annual amount. It uses the test period financial statements,[5] takes the amount from each month, adds it to the prior month, and then divides by 2. This is done for all months in the test period. Then all of the averages are totaled to determine the average of monthly averages, or AMA.

---

[5] Test period financial statements are on an annual basis.

Q. What is "end of period"?

A. EOP is the company's actual cumulative balance of its financial statement accounts at the end of a given period. Instead of a calculation averaging each month with the prior month, this is each month's total added until the end of the period. Both AMA and EOP are different test year conventions used under accounting frameworks.

Q. What is the difference between using AMA versus EOP for the calculation of ISWC?

A. The difference, specifically with ISWC, is that AMA considers the entire year of financial statements, and EOP considers one month.[6] Due to the nature of how this Commission calculates ISWC, EOP is only representative of that one month at the end of the period.

Balance sheet and income statement accounts are cumulative and represent totals for a given time frame. In contrast, ISWC, in simplified terms, is a calculation of the lag between revenue and expenses, so when the expense is paid the gap is closed. Each month in a test period has a different calculated amount. Some months may require more funding than others, but the amount included in rates should represent the year—not the last month in the test period month.

Q. Do you agree with using AMA for ISWC even when using EOP for rate base?

A. Yes.

---

[6] For all other areas of ratemaking AMA and EOP both represent a full year.

Q. Is it more appropriate to present ISWC on an AMA basis or an EOP basis?

A. For ratemaking purposes, it is appropriate to present ISWC using an AMA convention. Using an EOP convention would provide a misleading picture of a company's annual ISWC needs, as it only represents one month in a fluctuating 12-month period.

Because ISWC is a calculation, not an account, it does not accumulate over a period of time. It fluctuates over a period of time, increasing and decreasing from month to month. Also because it is a calculation, not an account, consistency within the financial statements is not violated by using one convention for ISWC and a different convention for the financial statement accounts.

Q. Why use EOP for rate base and AMA for ISWC?

A. The rationale for using an EOP rate base is reduction of regulatory lag.[7] If the last month in the test period is used, the results will be closer to the actual rate year rate base.

The same logic does not follow for ISWC. ISWC fluctuates monthly and seasonally. Therefore, when attempting to determine an amount to provide as an annual return, it makes sense to use AMA for ISWC, in order to consider all of the months in the year.

---

[7] Reasons for using EOP for rate base are explained more in the testimony of Staff witness David Panco.

C. Gain on Sale of Shuffleton Property

Q. Please explain the nature of PSE's adjustment for the gain on the sale of the Shuffleton property.

A. This adjustment adds the proceeds from the Sale of the Shuffleton property, approved in Docket UE-190606, to the current rate case. The net pretax gain from the sale of the Shuffleton property was roughly $12 million, all of which is to be distributed to ratepayers.

Q. How does the Company propose to distribute the sale proceeds?

A. The Company proposes to amortize the gain on sale over a three year period, reducing revenue requirement by $3.5 million, not including attrition.[8]

Q. Does Staff contest this adjustment?

A. Staff does not contest this adjustment, but Staff recommends an additional adjustment reflecting a reduction of rate base and corresponding depreciation, to account for the sold property. Staff does not contest the proposed amortization of the proceeds.

Q. Please explain your proposed adjustment to rate base.

A. The sale proceeds the Company received were reduced by the net book value of the asset sold, but the net book value was not removed from rate base. The Company

[8] Free, Exh. SEF-12T at 4:1-4.

receives a return on rate base assets due to cash outlay. The Commission has determined that the total net proceeds of the sale should be distributed to the ratepayers.[9] When the proceeds of the sale are reduced by the asset amount, the Company no longer has an unrecovered cash outlay, so Staff recommends rate base be reduced by the net amount of the asset to coincide with the reduction of the sale proceeds.

Q. What is the revenue requirement effect of Staff's additional adjustment?

A. The net asset value is $550,155 and the related depreciation is $57,000. The total revenue impact of Staff's proposal is a decrease to revenue of $113,599, as shown in Exh. CSS-3.

Q. Does this conclude your testimony?

A. Yes.

[9] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Docket UE-190606, Order 05, 3, ¶ 11 (Aug. 29, 2019).