EXH. SEF-1T
DOCKET UE-18____
PCA 16 COMPLIANCE FILING
WITNESS: SUSAN E. FREE

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of **PUGET SOUND ENERGY** **For Approval of its April 2018 Power Cost Adjustment Mechanism Report**	**DOCKET UE-18____**

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF

SUSAN E. FREE

ON BEHALF OF PUGET SOUND ENERGY

APRIL 30, 2018

PUGET SOUND ENERGY

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
SUSAN E. FREE

PUGET SOUND ENERGY

PREFILED DIRECT TESTIMONY OF SUSAN E. FREE

I. INTRODUCTION

Q. Please state your name, business address and present position.

A. My name is Susan E. Free. My business address is 10885 N.E. Fourth Street, P.O. Box 97034, Bellevue, Washington 98009-9734. I am the Manager of Revenue Requirement for Puget Sound Energy ("PSE").

Q. What is your educational and professional experience?

A. The First Exhibit to my Prefiled Direct Testimony, Exh. SEF-2, describes my educational and professional experience.

Q. What are your duties as Manager of Revenue Requirement for PSE?

A. My present responsibilities include overseeing general and power cost only rate case filings, tariff rate change filings, and accounting petitions. Additionally, I am responsible for issuing internal accounting instructions that are used to ensure adherence to the regulatory approvals obtained through PSE’s various filings and petitions.

Q. What is the purpose of this filing?

A. As explained below in Section II, "Background Regarding the PCA Mechanism", PSE is filing its Power Cost Adjustment ("PCA") Mechanism annual true-up for calendar year 2017. Through its Petition, PSE is requesting approval of its PCA Mechanism Report ("PCA Annual Report") for the Twelve Months Ended December 31, 2017 ("PCA Period 16"). The PCA Annual Report is provided in this filing as the Second Exhibit to my Prefiled Direct Testimony, Exh. SEF-3.

II. BACKGROUND REGARDING THE PCA MECHANISM

Q. Please provide a brief summary of the Power Cost Adjustment Mechanism.

A. At its inception, as authorized by the Commission, PSE's PCA Mechanism accounted for differences in PSE's modified actual power costs relative to a power cost baseline. The calculation was performed using the methodology shown in PCA Exhibit B from the Settlement Stipulation approved in the Commission's Twelfth Supplemental Order in Docket No. UE-011570 ("2002 PCA Settlement"). That mechanism accounted for a sharing of costs and benefits that were graduated over four levels of power cost variances. The 2002 PCA Settlement defined the specific sharing levels and conditions.

A PCA Collaborative was initiated as part of the settlement terms from the 2013 Power Cost Only Rate Case ("PCORC"), Docket UE-130617. The PCA Collaborative resulted in a settlement stipulation involving modifications to

PSE's PCA mechanism ("2015 PCA Settlement"). The 2015 PCA Settlement was approved in Order 11 of PSE's 2013 PCORC ("Order 11"). As a result, beginning January 2017, the power cost baseline rate is comprised of both variable production costs, which will continue to be tracked in the PCA mechanism, and fixed production and delivery costs, which are now included in the decoupling mechanism approved in PSE's most recent general rate case ("GRC"), Docket UE-170033. Because this is the first report filed under the 2015 PCA Settlement, only the variable portion of the power cost baseline rate is being reported. PCA Period 15 was the last compliance filing submitted pursuant to the 2002 PCA Settlement.

Additional modifications to PSE's PCA mechanism approved in Order 11 as outlined in the 2015 PCA Settlement are discussed further below.

Q. Please describe the scope of the 2015 PCA Settlement and its principal aspects.

A. The 2015 PCA Settlement changed PSE's PCA Mechanism pursuant to the 2002 PCA Settlement, which was effective through the twelve months ended December 31, 2016, and is the product of the year-long collaborative process to address concerns of various parties regarding the mechanics of the initial PCA Mechanism. The key modifications in the 2015 PCA Settlement include:

- Removal of fixed production costs from the PCA imbalance calculation.
- Adjustment of the dead bands and sharing bands for under- and over-recovery of allowed costs to:

- narrow the deadband from $20 million to $17 million to provide earlier sharing of both costs and benefits;
- adjust the first sharing band ($17 million to $40 million) such that customers will receive 65 percent of the benefits of power cost over-recoveries rather than the 50/50 sharing that previously occurred in the first sharing band, and
- eliminate the third sharing band, thus limiting customers' sharing of under- or over-recoveries over $40 million to 90 percent.

- Reduction of the threshold for determining the timing of rate refunds or surcharges to $20 million from the existing $30 million cumulative deferred balances.
- Continuation of the existing PCORC filing provisions, which allow for a full update to power costs (both variable and fixed production costs) in a PCORC.
- Streamlining and clarification of the exhibits required for power costs in a PCORC or GRC filing and those required in the annual PCA compliance filings.

Q. Are there additional components of the 2015 PCA Settlement?

A. Yes. There were several additional key components to this settlement, which are described below.

- **Five-year moratorium for changes to the PCA Mechanism:** The parties to the 2015 PCA Settlement ("Settling Parties") agreed to a five-year moratorium on further changes to the PCA mechanism, effective from the start of the modified PCA mechanism, January 1, 2017. During the moratorium, the requirement to file a GRC following a PCORC filing will be removed. Below, I discuss an additional agreed-upon change to the PCA Mechanism that resulted from PSE's 2017 GRC.

- **PCORC filing moratorium –** During the five-year moratorium, discussed above, the 2015 PCA Settlement provides for a limited stay-out period by PSE of six months following the rate effective date of any PCORC filing. This is not considered to be a permanent change to the PCA Mechanism, but PSE has agreed to such a stay-out during the five-year moratorium period discussed above.

- **Cost categories** – The 2015 PCA Settlement recognizes that certain costs will no longer be included in the PCA imbalance calculation but they will still be updated through a PCORC filing. To continue with the PCORC updates without unduly burdening others and the Commission, the Settling Parties agree to separately identify costs using three categories: 1) variable production costs (recovered and tracked through the PCA imbalance calculation), 2) fixed production-related costs (that are be included in the electric decoupling mechanism, and 3) delivery costs (all other costs including those currently in the decoupling mechanism).

- **Fixed Production Costs:** Fixed production costs were removed from the mechanism effective January 1, 2017. They were included in the decoupling mechanism pursuant to PSE's 2017 GRC, effective December 19, 2017. During the interim period, PSE deferred the revenue variances associated with recovery of its fixed production costs pursuant to an accounting petition approved in Docket UE-161112. Accordingly, fixed production costs are not a subject of this compliance filing.

- **Variable Costs:** PCA variable costs include actual monthly amounts recorded in FERC Accounts 501 – Steam generation fuel, 547 – Other power generation fuel, 555 – Purchased power, 447 – Sales for resale, 565 – Transmission of electricity by others, 456 – Purchases and sales of non-core gas, 408.1 – Montana electric energy tax, and 557 – Brokerage fees. As discussed above, costs related to the hedging line of credit have been removed from the PCA imbalance calculation and are now included in PSE's cost of capital as approved in its 2017 GRC. The 2015 PCA Settlement also modified the PCA imbalance calculation to no longer include Colstrip major maintenance amortization, variable costs and credits for transmission revenue for specifically identified transmission lines and the regulatory return on regulatory assets and liabilities associated with items formerly approved to be recovered through the PCA mechanism.

- **Adjustments to Variable Costs:** The following adjustments to variable costs are part of the PCA Mechanism:

  Adjustments reflected on Exhibit B:[1]

  1) PPA Equity Adjustment – An adjustment to variable costs is required for the equity component of the Transalta Centralia Coal Transition Power Purchase Agreement ("Coal Transition PPA")

[1] Exhibits F (Colstrip Availability) and G (New Resource Adjustment) were removed from the PCA Mechanism effective with Order 11, which approved the 2015 PCA Settlement in Docket UE-130617.

approved by the Commission by Order 03 in Docket UE-121373. Pursuant to paragraph 125 of Order 03, PSE accounts for the cost associated with the equity return component on Schedule B of the PCA Mechanism. By including the costs associated with the equity return component on the lines designated in the Adjustments section of Schedule B, the PCA Mechanism will account for the total costs associated with the Coal Transition PPA. This type of adjustment is necessary to make actual booked expenses, which do not include regulatory adjustments, match the recovery built into rates. The equity component of PSE's authorized rate of return for the Coal Transition PPA is earned by PSE and recovered in an amount equal to $1.49/MWh[2] for each MWh of energy paid for by PSE under the Coal Transition PPA. During calendar year 2017, PSE purchased 3,328,801 MWh through the Coal Transition PPA, resulting in an adjustment of $4,959,913 under Exhibit B.

2) <u>Energy Imbalance Market Costs Adjustment</u> – As part of the settlement stipulation in PSE's 2017 GRC, which became effective December 19, 2017, a line item for all costs related to the California Independent System Operator ("CAISO") Energy Imbalance Market ("EIM") was approved to be included as actual costs in the annual PCA filing. For purposes of calculating the PCA imbalance in the PCA mechanism, the amount for capital items (depreciation and return on) and labor related to the CAISO EIM as included in Exhibit D to the 2017 GRC settlement or a monthly amount of $704,939 will be included as a line-item in actual allowed power costs in Schedule B. Pursuant to the 2017 GRC settlement, these costs would be included in Schedule B in a manner similar to the Equity Adder for the Coal Transition PPA, in that they will be included in the Adjustments section of Schedule B. The 2017 GRC settlement recognized that the moratorium on changes to the PCA mechanism remained in effect but for this limited change approved through the 2017 GRC settlement agreement.

[2] Order 03 in Docket UE-121373, paragraph 123.

Adjustments related to prior period:

1) Variable costs incurred may be adjusted for items pursuant to the Methodology for Adjustments of Costs Outside of the PCA Period ("Restatement Methodology").[3]

2) Adjustments to variable costs for items from prior periods that do not meet the requirements for prior period restatement under the Restatement Methodology are flowed through the current month PCA calculation.

III. PCA PERIOD 16 ACCOUNTING

Q. Please explain how PSE has tracked its PCA Period 16 power costs.

A. PCA Period 16 is the first period containing the changes approved by the Commission in the 2015 PCA Settlement in Docket UE-130617, effective January 1, 2017. These changes are summarized above. Each month PSE calculates the power costs subject to PCA sharing using the methodology presented above. Allowed power costs include the variable costs, net of the adjustments discussed above. These total allowable costs are then compared to the approved baseline power cost rate, multiplied by the actual delivered load, and any difference is allocated to PSE or customers based on the different levels of sharing defined in the PCA Mechanism. Any difference allocated to customers is recorded in FERC Account 182.3, Other Regulatory Assets.

Under the PCA Mechanism, the deferred amount at the time of the next PCA annual true-up filing, along with the projected variable costs through the next proposed rate year, could be considered in the determination of any rate change for the subsequent PCA period. Amounts deferred, when authorized, will be amortized to FERC Account 407.3, Regulatory Debits, or 407.4, Regulatory Credits, as they are recovered from or refunded to customers. PSE accrues interest monthly on any deferred balance (debit or credit) at the interest rate calculated in accordance with WAC 480-90-233(4). At this time, PSE is not requesting recovery of the amounts deferred under the PCA Mechanism.

Q. Did the baseline power cost rate change during PCA Period 16?

A. Yes. Pursuant to Order 04 in Docket UE-141141, PSE was authorized to implement the December 1, 2016 price and volume changes associated with the Coal Transition PPA through a compliance filing made in 2016 ("Centralia Compliance Filing"). Additionally, paragraph 8c of the Joint Petition to Modify Order 07 in Dockets UE-121697 and UG-121705 (consolidated) and Dockets UE-130137 and UG-130138 (consolidated) provided that a limited update to variable power costs would be made by PSE on or before October 1, 2016 under the previously authorized Centralia Compliance Filing. The fixed costs would remain the same. The updated baseline rate of $33.453, found on page eight of Exh. SEF-3, was approved in Docket UE-161135, and went into effect on December 1, 2016. On December 5, 2017, the Commission issued Order 08 in PSE's 2017 GRC, approving a multi-party settlement agreement that updated the baseline rate to $32.895. This updated baseline rate is

[3] Section 11 of Attachment A to the 2015 PCA Settlement.

found on page ten of Exh. SEF-3 and went into effect on December 19, 2017.

Q. What is the actual average power cost rate experienced for PCA Period 16?

A. As shown on page five (Exhibit A-1 Power Cost Rate Updated) of Exh. SEF-3, the calculated average variable power cost rate experienced for PCA Period 16 is $33.976 per MWh.

Q. Why do the total allowable costs on page five, line 27, of Exh. SEF-3 differ from the total allowable costs in effect during PCA Period 16 presented on pages 8 and 10, line 27, column (V) of Exh. SEF-3?

A. The total variable allowable costs differed from the baseline power costs in effect during PCA Period 16 due to changes in the variable components of the PCA Mechanism, which are discussed in the Prefiled Direct Testimony of Paul K. Wetherbee, Exh. PKW-1CT.

Q. How do the actual power costs compare to the average baseline power cost rates in effect during PCA Period 16?

A. Actual power costs were higher than the average baseline power cost in rates in effect during PCA Period 16 by $11,694,279 (after adjustment for Firm Wholesale). PSE's share of this under-recovery of power costs is $11,694,479.

The customers' share of this under-recovery of power costs is $0. See page four of Exh. SEF-3.

Q. What is the distribution of the resulting cumulative imbalance for sharing at the end of PCA Period 16?

A. Considering the activity that occurred in PCA Period 16, the cumulative imbalance for sharing at the end of PCA Period 16 for PCA Periods 1 through 16 is an under-collection of \$25,868,732. PSE's share of this imbalance is \$22,414,387, with the remaining \$3,454,344 assigned to the customer: See page four of Exh. SEF-3. As stated above, PSE is not requesting recovery of the PCA deferral at this time.

IV. ADJUSTMENT OF COSTS MADE UNDER THE RESTATEMENT METHODOLOGY

Q. Were there any adjustments made under the Restatement Methodology for power costs in PCA Period 16?

A. Yes, there were two adjustments made to SAP variable costs during PCA Period 16. These two adjustments did not meet the requirements for restatement of prior periods and thus were flowed through the PCA calculation in the month of PCA Period 16 in which they were identified, pursuant to Section 11. a. i. of Attachment A to the 2015 PCA Settlement. These adjustments include the following:

In April 2016, PSE began recording the 1) Jackson Prairie ("JP") Inter-book and 2) the JP Northwest Pipeline ("NWP") demand and capacity demand charges for storage to Fuel FERC 547. When the JP Inter-book contract expired and a replacement contract became effective on April 1, 2016, PSE aligned the accounting for the JP Inter-book and NWP contracts to be consistent with the existing FERC accounting associated with the Plymouth demand and capacity demand charges. Without the gas storage, PSE would be unable to deliver the fuel for its generation. Because gas storage is an integrated component of gas transportation service and is used daily to afford the efficient management of fuel supply for generation, it is treated as a fuel cost and charged to FERC 547. An adjustment to remove these costs from "actuals" was required for the PCA since PSE was treating JP storage costs as a fixed component in Production O&M, as approved in the baseline rate in PSE's 2014 PCORC through December 18, 2017, when new rates went into effect from PSE's 2017 GRC. A total of $1,010,793 was removed from the SAP variable costs to arrive at PCA allowed costs between January 1, 2017 and December 18, 2017.

In December 2017, PSE recorded a debit of $1,063,362 in FERC Order 547 to adjust the distillate used for fuel at PSE's combustion turbines to the lower of cost or net realizable value. This debit was removed from SAP variable costs to arrive at the PCA 16 total allowable costs via a credit adjustment because an inventory write-down is considered a non-cash financial adjustment to costs so should not impact the PCA. For PCA 17, PSE recorded the reversal of this $1,063,362 PCA debit during January 2018.

Q. Does this conclude your testimony?

A. Yes, it does.