

**Exh. MCC-1Tr
Dockets UE-170033/UG-170034
Witness: Melissa C. Cheesman**

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

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

TESTIMONY OF

MELISSA C. CHEESMAN

**ON BEHALF OF THE STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

*Revenue Requirement
Adj. 13.05 and 11.05, Tax Benefit of Pro Forma Interest
Adj. 14.13, Production Adjustment
Adj. 13.12 and 11.12, Rate Case Expenses
Adj. 11.13, Deferred Gains/Losses on Property Sales*

**June 30, 2017
Revised August 8, 2017**

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1 I. INTRODUCTION

2 Q. Please state your name and business address.

3 A. My name is Melissa Cheesman. My business address is the Richard Hemstad Building,
4 1300 South Evergreen Park Drive Southwest, P.O. Box 47250, Olympia, Washington
5 98504.

6
7 Q. By whom are you employed and in what capacity?

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

11
12 Q. How long have you been employed by the Commission?

13 A. I have been employed by the Commission since 2012.

14
15 Q. Would you please state your educational and professional background?

16 A. I graduated magna cum laude from Seattle University, Albers School of Business and
17 Economics in 2010, with a Bachelor of Arts in Business Administration with a focus on
18 accounting. In 2012, I earned a Masters of Professional Accounting (MPAC) degree from
19 Seattle University, Albers School of Business and Economics.

20 I attended the Western NARUC Utility Rate School (2013) and the National
21 Association of Water Companies 2013, Staff Water Policy Forum. I have provided
22 accounting guidance in energy dockets UE-151871, UG-151872, UE-160100, UE-
23 170327, and UG-170328. Prior to moving to the energy section in June 2016, I audited

1 and provided testimony for solid waste general rate cases – notably dockets TG-140560,
2 TG-130502, and TG-130501.

3
4 **Q. Have you testified previously before the Commission?**

5 A. Yes. Most recently, I have provided written testimony on employee benefits and
6 Advanced Meter Infrastructure in UE-160228 and UG-160229. I have also provided
7 revenue requirement related written and oral testimony before the Commission in a solid
8 waste adjudicated rate case, TG-140560.

9
10 **II. SCOPE AND SUMMARY OF TESTIMONY**

11
12 **Q. What is the purpose of your testimony in this proceeding?**

13 A. The primary purpose of my testimony is to present Staff's revenue requirement
14 recommendations based on PSE's supplemental filings as filed on April 3, 2017. Staff's
15 analyses and recommendations incorporate information and data provided in PSE's initial
16 filing, but Staff uses PSE's supplemental filing as a starting point because that
17 supplemental filing changed many of the values feeding the accounting adjustments and
18 thus changed the final numbers for nearly all adjustments.

19 Next, I provide discussion on four of PSE's proposed adjustments for which I am
20 responsible. Two of these adjustments are really the fallout from the results of other
21 Staff's proposed adjustments. I also contest another two adjustments on principle.

22 In the last section of my testimony, I provide a discussion about materiality and
23 address PSE's proposed definition for pro forma revenue. Finally, I testify to the

1 importance of communicating restating and pro forma adjustments to a modified
2 historical test year. While PSE does in theory use restating and pro forma adjustments,
3 the Company is not consistent in explicitly labeling and separating restating and pro
4 forma adjustments.

5
6 **Q. How did Staff organize its presentation of the Company's revenue requirement in
7 this case?**

8 A. Because of the way PSE filed its case, there are two important sets of numbers for the
9 Commission to manage. The first revenue number reflects the 2011 base rates but
10 excludes all schedules and ratemaking mechanisms the Commission established between
11 2011 and 2017.¹ The second revenue figure includes those 2011 base rates *plus* the
12 various schedules and revenue mechanisms the Commission has allowed the Company to
13 adopt between the 2011 rate case and the current case.² The second revenue total is the
14 more practical definition of revenue requirement; that is, the 2011 rates plus the
15 additional mechanisms reflect what customers actually pay and the Company actually
16 collects in revenue. Table 1, provided below, shows a side-by-side comparison of PSE's
17 and Staff's proposed revenue requirement totals.

18 Unless expressly stated otherwise, Staff's revenue requirement totals and my
19 testimony use the second, more practical definition of revenue requirement.

20
21 **Q. Please provide a brief summary of Staff's electric revenue requirement
22 recommendation.**

¹ I refer to this first revenue requirement as "@ 2011 rates" or "2011 revenues."

² I refer to the second revenue requirement as "@ current rates" or "current revenues."

1 A. Staff recommends an annual revenue decrease of approximately \$35 46 million, or
 2 negative 1.7 2.2 percent, for PSE’s electric operations. Staff’s recommended \$35 46
 3 million decrease compares with the Company’s proposed supplemental annual revenue
 4 increase of approximately \$68 million.³

5
 6 **Q. Please provide a brief summary of Staff’s gas revenue requirement**
 7 **recommendation.**

8 A. For PSE’s natural gas (or gas) operations, Staff recommends an annual revenue decrease
 9 of approximately \$48 54 million, or negative 5.9 6.6 percent. This recommendation
 10 compares with the Company’s proposed overall annual revenue decrease of \$29 million.⁴

11
 12 **Q. How does Staff proposal compare to PSE’s request for an increase in rates?**

13 A. The following table provides a side-by-side comparison of PSE and Staff’s proposed
 14 revenue requirements for electric and gas operations:

15 **TABLE 1**

	PSE Electric Supplemental	Staff Electric	PSE Gas Supplemental	Staff Gas
Revenue Requirement - @ Current Rates	\$ 68,302,844	-\$ 34,607,339 46,440,358	-\$ 29,286,000	-\$ 48,197,748 54,304,407
Percentage Increase	3.3 percent	-1.7 2.2 percent	-3.6 percent	-5.9 6.6 percent
Revenue Requirement - @ 2011 Rates	\$144,032,066	\$ 51,600,883 39,767,864	\$ 22,812,690	\$ 3,900,942-\$ 2,205,717
Percentage Increase	7.0 percent	2.5 4.9 percent	2.8 percent	0.5 -0.3 percent

16

³ Barnard, Exh. KJB-10T at 4:3-7 and Piliaris, Exh. JAP-44 at 2:29, third column from the right.

⁴ Free, Exh. SEF-8T at 2:12-14 and Piliaris, Exh. JAP-45 at 2, middle of page, fourth column from the right.

1 **Q. What are the assumptions underlying Staff's recommended decrease in annual**
2 **revenues?**

3 A. Staff developed revenue figures using Mr. Parcell's 7.37 percent overall rate of return,
4 adjusted net operating income, and adjusted rate base for the test year ended September
5 30, 2016. Staff's analysis shows that current revenues are sufficient largely because of
6 the rate plans allowed by the Commission over the past several years.

7
8 **Q. Have you prepared any exhibits in support of your testimony?**

9 A. Yes. I prepared the following exhibits in support of my testimony:

- 10 • Exh. MCC-2, Electric Results of Operations for the Twelve Months Ended
11 September 30, 2016.
- 12 • Exh. MCC-3, Calculation of Electric Revenue Requirement Deficiency
- 13 • Exh. MCC-4, Comparison of PSE-Staff Electric Revenue Requirements
- 14 • Exh. MCC-5, Comparison of PSE-Staff Working Capital
- 15 • Exh. MCC-6, PSE Requested Overall Electric Revenue Sufficiency
- 16 • Exh. MCC-7, Gas Results of Operations for the Twelve Months Ended September
17 30, 2016.
- 18 • Exh. MCC-8, Calculation of Gas Revenue Requirement Sufficiency
- 19 • Exh. MCC-9, Comparison of PSE-Staff Gas Revenue Requirements
- 20 • Exh. MCC-10, Comparison of PSE-Staff Working Capital
- 21 • Exh. MCC-11, PSE Requested Overall Gas Revenue Sufficiency
- 22 • Exh. MCC-12, Electric Revenue Bridge
- 23 • Exh. MCC-13, Gas Revenue Bridge

- 1 • Exh. MCC-14 PSE Response to Staff Data Request 382 (Word Document)
- 2 • Exh. MCC-15 PSE Response to Staff Data Request 382 (Excel Document)
- 3 • Exh. MCC-16 PSE Response to Staff Data Request 371
- 4 • Exh. MCC-17 PSE Response to Staff Data Request 372
- 5 • Exh. MCC-18 PSE Witness, Ms. Susan Free Natural Gas Work paper Adjustment
- 6 11.13 (Excel Document)

7

8 **III. INDEX OF UNCONTESTED, CONTESTED, AND STAFF-ONLY**

9 **ADJUSTMENTS**

10

11 **Q. Please provide a list of PSE’s supplemental adjustments that Staff reviewed and are**

12 **uncontested.**

13 A. The following list contains PSE’s supplemental common (electric adjustments 13.XX and

14 gas 11.XX) and operation specific (electric adjustments 14.XX and gas 7.01) adjustments

15 that Staff reviewed and does not contest:

16 //

17 //

18 //

19

TABLE 2

Electric Adj. Number	Gas Adj. Number	Adjustment Description
13.01	11.01	REVENUES AND EXPENSES
13.03	11.03	PASS-THROUGH REVENUES AND EXPENSES
13.04	11.04	FEDERAL INCOME TAX
	11.06	DEPRECIATION STUDY
13.07	11.07	NORMALIZE INJURIES AND DAMAGES
13.08	11.08	BAD DEBTS
13.09	11.09	INCENTIVE PAY
13.10	11.10	DIRECTORS & OFFICERS INSURANCE
13.11	11.11	INTEREST ON CUSTOMER DEPOSITS
13.13		DEFERRED GAINS/LOSSES ON PROPERTY SALES
13.14	11.14	PROPERTY & LIABILITY INSURANCE
13.15	11.15	PENSION PLAN
13.16	11.16	WAGE INCREASE
13.17	11.17	INVESTMENT PLAN
13.18	11.18	EMPLOYEE INSURANCE
13.21	11.21	SOUTH KING SERVICE CENTER
13.22	11.22	FILING FEE AND EXCISE TAX
	7.01	COST RECOVERY MECHANISM
14.02		MONTANA ELECTRIC ENERGY TAX
14.03		WILD HORSE SOLAR
14.04		ACCOUNTING STANDARDS CODIFICATION 815 (FORMERLY SFAS 133)
14.06		REGULATORY ASSETS AND LIABILITIES
14.07		GLACIER BATTERY STORAGE
14.09		GOLDENDALE CAPACITY UPGRADE
14.10		MINT FARM CAPACITY UPGRADE

2

3

4 **Q. Please provide a list of PSE's supplement adjustments that Staff reviewed and does**
5 **contest.**

6 A. The following list contains Staff proposed adjustments, and PSE's supplemental common
7 (electric adjustments 13.XX and gas 11.XX) and electric operation specific (adjustments
8 14.XX) adjustments that are Staff contested adjustments:

TABLE 3

Electric Adj. Number	Gas Adj. Number	Adjustment Description
13.02	11.02	TEMPERATURE NORMALIZATION
13.05	11.05	TAX BENEFIT OF PRO FORMA INTEREST
13.06		DEPRECIATION STUDY
13.06A		REGULATORY ASSET COLSTRIP (Staff Proposed)
13.12	11.12	RATE CASE EXPENSES
	11.13	DEFERRED GAINS/LOSSES ON PROPERTY SALES
13.19	11.19	ENVIRONMENTAL REMEDIATION
13.20	11.20	PAYMENT PROCESSING COSTS
13.23		INVESTOR SUPPLIED WORKING CAPITAL (Staff Proposed Adj.)
13.24	11.24	LEGAL COSTS (Staff Proposed Adj.)
14.01		POWER COSTS
14.05		STORM DAMAGE
14.08		ENERGY IMBALANCE MARKET
14.11		WHITE RIVER
14.12		TRANSFER OF HYDRO TREASURY GRANTS IN RATEBASE
14.13		PRODUCTION ADJUSTMENT

2

3 **Q. Does Staff propose any additional adjustments?**

4 A. Yes. Staff witness Ms. Elizabeth O'Connell proposes adjustments 13.24 and 11.24 for
5 legal costs associated with electric and gas operations, respectively. And Staff witness
6 Ms. Betty Erdahl proposes new adjustments 13.23 and 11.23 to decrease PSE's investor
7 supplied working capital (ISWC) included in it's per books operations. Staff witness Mr.
8 Christopher McGuire proposes adjustment 13.06A, which creates a regulatory asset for a
9 significant portion of Colstrip.

1 which do include current decoupling, ERF, and PCORC (for electric operations).⁵ By
2 failing to account for these other revenues, PSE incorrectly calculates its total revenue
3 collected by customers.

4 Pages 2 through 6 for electric, and pages 2 through 4 for gas, show the individual
5 adjustments in the same order as provided by PSE and include new Staff proposed
6 adjustments marked as “New”. For ease of comparison, Staff uses the identical
7 numbering system as used by PSE in its supplemental filing. All contested adjustments
8 are marked “Contested”.

9 Pages 7 through 30 for electric, and pages 5 through 27 for gas, contain the
10 summary of each proposed common adjustment and the resulting net operating income
11 and rate base impacts, as applicable. Pages 31 through 45 for electric operations, and
12 page 28 for gas, contain the summary of each proposed operation specific adjustment and
13 the resulting net operating income and rate base impacts, as applicable.

14
15 **Q. Please describe Exh. MCC-3, Calculation of Electric Revenue Requirement**
16 **Deficiency and Exh. MCC-8, Calculation of Gas Revenue Requirement Sufficiency.**

17 A. Exh. MCC-3 details the calculation of the electric revenue requirement sufficiency, and
18 Exh. MCC-8 details the calculation of the gas revenue sufficiency. Page 1 of each
19 exhibit first calculates the operating income requirement by multiplying the pro forma
20 adjusted rate base by Staff’s recommended overall rate of return, see detailed on page 2.

21 The resulting amount deducts the pro forma operating income to arrive at the net

⁵ PSE discussed these revenues in the rate impacts section of Mr. Piliaris’s testimony, Exh. JAP-1T at 75:19 – 76:13. Mr. Piliaris’s testimony was updated in PSE’s supplemental filing, please JAP-34T at 16:6 – 17:2 and JAP-18:1-17 for further discussion.

1 operating income deficiency/~~sufficiency~~ for both electric and gas, respectively. The
2 electric conversion factor of 0.619051 and gas conversion factor 0.620749, shown on
3 page 3, converts the net operating income deficiency/~~sufficiency~~ to the total revenue
4 requirement for electric and gas. Specific to electric, the revenue requirement is further
5 reduced to reflect an allocated share to large wholesale and firm resale customers in the
6 retail results. The last step is to subtract current revenues related to ERF, decoupling, and
7 electric only PCORC in order to arrive at Staff's recommended sufficiency for electric
8 and gas operations.

9
10 **Q. Does Staff agree with the Company's conversion factor used to develop the electric
11 and gas revenue requirement deficiencies?**

12 A. Yes.

13
14 **Q. Please describe Exh. MCC-4, Comparison of PSE-Staff Electric Revenue
15 Requirements and Exh. MCC-9, Comparison of PSE-Staff Gas Revenue
16 Requirements.**

17 A. These exhibits serve as a ready reference for identifying the Company's and Staff's
18 positions on each adjustment. These exhibits compare the revenue requirements proposed
19 by PSE and Staff which include the effects of all adjustments used to determine the
20 revenue sufficiency for both electric and gas operations.

21
22 **Q. Please describe Exh. MCC-5, Comparison of PSE-Staff Working Capital and Exh.
23 MCC-10, Comparison of PSE-Staff Working Capital.**

1 A. This exhibit serves as a ready reference for identifying differences in the Company and
2 Staff's proposed investor supplied working capital. These exhibits (Exh. MCC-5 electric
3 and Exh. MCC-10 gas) compare the differences in the calculated totals for invested
4 capital, investment, and investor supplied working capital proposed by PSE and Staff.

5 Although PSE included its working capital adjustment as part of the actual results
6 of operations, for clarity, Staff assigns adjustment number 13.23 (electric) and 11.23
7 (gas) to our proposed adjustments to PSE's stated investor supplied working capital and
8 rate base. Ms. Erdahl provides testimony and exhibits to support Staff's investor supplied
9 working capital method.

10

11 **Q. Please provide a brief description of Ex. MCC-6 and MCC-11.**

12 A. Staff's Exh. MCC-6 (electric operations) and MCC-11 (gas operations) shows PSE's
13 proposed supplemental results of operations but slightly modified by Staff. On page 1,
14 Staff adds three column (as compared with MCC-2 electric operations and MCC-7 gas
15 operations) to remove current revenues related to PCORC (electric only), ERF, and
16 decoupling revenues. This step is needed to calculate PSE's overall revenue requirement
17 electric deficiency and gas sufficiency based on current revenues.

18

19 **Q. Please provide a brief description of Ex. MCC-12 and MCC-13.**

20 A. Staff's Exh. MCC-12 (electric operations) and MCC-13 (gas operations) bridge the
21 traditional revenue requirement calculation and PSE's actual current revenues. This is an
22 important step to support Staff's (and understanding PSE's) overall revenue requirement

1 because PSE included two proposed annual revenue changes for both electric and gas
2 operations in its filing.⁶

3
4 **V. ELECTRIC AND GAS PROPOSED ADJUSTMENTS**

5
6 **Q. Did you review and do you contest any adjustments?**

7 A. Yes. My testimony includes two types of contested adjustments; (1) I present two
8 adjustments that result from the impact of other Staff member's issues or adjustments,
9 and (2) I directly contest two adjustments.

10
11 **Q. Which two adjustments are the result of the impact of other Staff's contested issues
12 or adjustments?**

13 A. These adjustments differ from PSE due to the calculations from other Staff witnesses'
14 contested adjustments.

- 15 1. Common Adjustment 13.05 (electric) and 11.05 (gas), Tax Benefits of Pro
16 forma Interest, and
17 2. Electric Adjustment 14.13, Production Adjustment.

18
19 **Q. What are the two adjustments that your testimony directly contests?**

20 A. My two contested Company adjustments are:

- 21 1. Common Adjustment 13.12 (electric) and 11.12 (gas), Rate Case Expense,
22 and

⁶ See *supra* Table 1 p. 4.

1 2. Common Adjustment 11.13 (gas), Deferred Gains/Losses on Property Sales.

2
3 **A. Common Adjustment 13.05 (electric) and 11.05 (gas), Tax Benefits of Pro**
4 **forma Interest**

5
6 **Q. Please describe Adjustment 13.05 (electric) and 11.05 (gas), Tax Benefit of Pro**
7 **forma Interest.**

8 A. Adjustments 13.05 (electric) and 11.05 (gas), often referred to as “interest
9 synchronization” or the “pro forma interest adjustment” revise the booked interest
10 expense by multiplying the weighted cost of debt times the pro forma rate base to
11 determine the pro forma interest expense. The purpose of these adjustments is to
12 synchronize the effect of interest expense for the computation of income taxes associated
13 with plant in service to the utility operations. The derived amounts capture the proper
14 federal income tax for ratemaking purposes.⁷

15
16 **Q. Please describe briefly Staff’s proposed changes to the pro forma interest**
17 **adjustment.**

18 A. Staff does not contest the methodology. These adjustments are not really contested as
19 much as revised due to Staff’s proposed changes to pro forma rate base, Production
20 Adjustment, and to PSE’s weighted cost of debt. Mr. E. Cooper Wright explains Staff’s
21 proposed changes for pro forma rate base, Ms. Erdahl address investor supplied working
22 capital, Ms. Jing Liu addresses the Production Adjustment, and Mr. David Parcell
23 addresses Staff’s recommended cost of debt.

⁷ For PSE’s initial description of their proposed Tax Benefit of Pro forma Interest please refer to Free, Exh. SEF-1Tr at 13:18-14:5. For changes due to PSE’s supplemental filing, please refer to Barnard, Exh. KJB-10T at 6:12-7:2.

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Q. What is the impact of Staff’s proposed recommendation to Adjustment 13.05 (electric) and 11.05 (gas), Tax Benefit of Pro forma Interest.

A. Staff’s recommendation for adjustment 13.05 increases electric net operating income by \$52,406,954 ~~51,697,658~~. Staff’s Adjustment 11.05 increases gas net operating income by \$18,196,137 ~~17,578,856~~.

B. Electric Adjustment 14.13, Production Adjustment

Q. Please describe PSE’s proposed Production Adjustment, 14.13.

A. PSE proposes a reduction to fixed production rate base and variable power expenses by a customer-based factor and a load-based factor, respectively. PSE calculated fixed and variable production costs such as depreciation expense and production plant maintenance for the rate year. The purpose of the factors is to bring proposed pro forma plant additions and variable power costs in line with test year units, either customers or kWh. PSE applies the fixed production factor to production expense and rate base items with the exception of the Montana Energy Tax.

Q. How does this differ from PSE’s prior Production Adjustment?

A. Ms. Katherine J. Barnard discusses the modifications to PSE’s historical Production Adjustment methodology in her initial testimony.⁸ Per the settlement in UE-130617, PSE removed the fixed production costs from the power cost adjustment and proposes to

⁸ Barnard, Exh. KJB-1T at 60:15-61:8.

1 recover the fixed production plant on a dollars per customer basis in the decoupling
2 mechanism. If this policy is allowed, it is proper for the Company to match the
3 relationship from estimated future customers to actual customers of the test year.

4 Essentially, PSE has modified its historic Production Adjustment to reflect changes to its
5 PCA mechanism and because the decoupling mechanism tracks costs on a dollar per
6 customer basis.⁹

7
8 **Q. Does Staff's propose changes to the production adjustment?**

9 A. Yes, Staff proposes changes for weather normalization in Ms. Jing Liu's testimony which
10 includes a small change to the variable production factor and production plant adjustment
11 in Mr. E. Cooper Wright's testimony. Ms. Liu also proposes a major change to the fixed
12 production factor for production plant.

13
14 **Q. What is Staff's proposed change to the fixed production factor?**

15 A. Briefly, Staff eliminates it. Please refer to Ms. Jing Liu's testimony for a full discussion.¹⁰

16
17 **C. Common Adjustment 13.12 (electric) and 11.12 (gas), Rate Case Expense**

18
19 **Q. Please give a brief description of Common Adjustment 13.12 (electric) and 11.12**
20 **(gas), Rate Case Expense.**

⁹ Per a multiparty settlement, as approved in Order 11 in Docket UE-130617, power cost baseline composes of variable and fixed production costs. Starting in January 2017, however, only variable costs would be tracked in the PCA mechanism. Fixed production and delivery costs would be included in the decoupling mechanism if the Commission allows decoupling to continue.

¹⁰ Exh. JL-1T, section III. Decoupling Mechanism, subsection B. Staff's Analysis of PSE's Decoupling Proposals (see Fixed Production Costs).

1 A. PSE's proposal calculates an average level of rate case costs to restate test year expenses.

2

3 **Q. How is this adjustment calculated?**

4 A. For electric and gas, PSE averages the costs of the prior two general rate cases (2009 and
5 2011). This average for rate case expenses is then allocated 50/50 between electric and
6 gas operations. The allocated average rate case costs are then divided by 2 and reduced
7 by general rate case test year expense for both electric and gas operations.

8 For electric operations only, PSE takes one more additional step in the adjustment
9 by averaging two data points for PCORC costs (2013 and 2014). That relative average is
10 then divided by 4 and reduced by test year PCORC test year expense.

11

12 **Q. Why are you contesting this adjustment(s)?**

13 A. PSE's methodology overstates annual rate case costs. Rate case costs are booked to
14 FERC Account 928, Regulatory commission expenses. Based on a six-year trend analysis
15 of Account 928, the total Company six-year average is \$9,713,210. Rate case costs are
16 embedded in this total. The total Company test year balance is \$10,292,149. If PSE were
17 allowed its proposed adjustments, the total test year FERC account 928 would be restated
18 to approximately \$11.1 million. This is about \$1.4 million more than the Company's six-
19 year average and about \$839,000 more than the Company's actual test year expense.

20 PSE's current test year balance is already \$579,000 more than the six year average and
21 clearly sufficient to represent a level of expenses the Company should expect on a going-
22 forward basis.

23

1 **Q. What is the importance of the six year average in relation to the restated expense**
2 **balance?**

3 A. Staff recommends use of the six-year average as a test for reasonableness. Staff does not
4 propose that a six-year average be used to set rate case expenses. Under varying and
5 volatile account balances, a normalized level of expense is an effective gauge for
6 reasonable expenses.

7
8 **Q. What are you recommending?**

9 A. Staff recommends eliminating the proposed adjustments by PSE for rate case expense in
10 adjustments 13.12 (electric) and 11.12 (gas).

11

12 **Q. What else did you consider when evaluating FERC account 928, Regulatory**
13 **commission expenses?**

14 A. In response to UTC Staff's data request 382, PSE provided a breakdown on total dollars
15 booked to FERC account 928, Regulatory commission expense, for 2011, 2013, and the
16 test year. Staff asked the Company to use the following categories:

- 17 1. FERC Fees
18 2. UTC Fees
19 3. Regulatory FERC Filings
20 4. Regulatory UTC Filings
21 5. Internal Labor spent on Regulatory FERC Filings
22 6. Internal Labor spent on Regulatory UTC Filings

1 7. Other (for the total amount in this category please provide a brief description of
2 the types of included expenses)

3 Based on the Company's response, Staff observed that on average UTC Filings
4 are approximately 10 percent of the costs booked to FERC account 928.¹¹ The UTC
5 Filing cost percentage for the test year is approximately 15 percent. Again this informs
6 Staff that test year expense is representative.

7
8 **Q. Please describe the impact of Staff's recommendation for Common Adjustment**
9 **13.12 (electric) and 11.12 (gas), Rate Case Expense.**

10 A. Staff's recommendation removes the adjustment for rate case costs. The total cost in
11 FERC account 928 is representative of the ongoing expense.

12
13 **D. Common Adjustment 11.13 (gas), Deferred Gains/Losses on Property Sales**

14
15 **Q. Please give a brief description of Common Adjustment 11.13 (gas) Deferred Gains**
16 **and Losses on Property Sales.**

17 A. Common adjustment 11.13 (gas) Deferred Gains and Losses on Property Sales calculates
18 the realized gains and losses from sales of utility real property completed since the last
19 general rate case.

20

¹¹ See Exh. MCC-14 and MCC-15 for PSE's response to Staff Data Request 382.

1 **Q. How was Deferred Gains and Losses on Property Sales historically calculated?**

2 A. According to the settlement agreement in Docket UE-89-2688-T, the sale of utility real
3 property should be amortized over three years and the balance included in working capital.
4

5 **Q. What is at issue for Common Adjustment 11.13 (gas) Deferred Gains and Losses on**
6 **Property Sales in this case?**

7 A. In this case, Staff contests PSE's inclusion of non-utility plant balances in Deferred Gains
8 and Losses on Property Sales. The Company included an amount of \$280,362 that is
9 associated with non-utility plant in the natural gas operation. Staff recommends the
10 Commission exclude that entire \$280,362 from Deferred Gains and Losses on Property
11 Sales from the natural gas operations.
12

13 **Q. Please briefly explain the details surrounding the disputed \$280,362.**

14 A. The \$280,362 stems from a real property parcel in Kent, Washington. PSE purchased the
15 parcel several years ago for about \$489,000. PSE claimed the parcel was purchased to
16 install a high pressure gas main.¹² The Company then sold the property at a loss in 2014.
17 PSE recorded about \$209,000 in net proceeds from the sale as non-utility property.¹³ The
18 \$280,362 is the loss from the sale, and PSE seeks to have that loss included in utility
19 operations.
20

¹² Exh. MCC-17, PSE Response to Staff Data Request 372 (f).

¹³ Exh. MCC-17, PSE Response to Staff Data Request 372 (e).

1 **Q. Did PSE record the parcel in Kent as non-utility property?**

2 A. Yes. PSE recorded the property under FERC account 121 as Non-Utility Property.¹⁴

3

4 **Q. How did PSE record the net proceeds from the sale of the non-utility property?**

5 A. PSE recorded the net proceeds from the sale in FERC account 121, which is also Non-
6 Utility Property. PSE confirmed this treatment in response to Staff data request 372 (e).

7

8 **Q. How did PSE record the loss from the sale of the non-utility property?**

9 A. PSE recorded the Deferred Loss on Property Sales to FERC account 187, “Electric
10 Deferred Property Loss” in September 2014¹⁵. Subsequently, in February 2015, PSE
11 transferred this “Electric Deferred Property Loss” to natural gas operations.¹⁶

12

13 **Q. Why does Staff oppose PSE’s inclusion of non-utility plant balances in Deferred
14 Gains and Losses on Property Sales?**

15 A. The short answer is accounting mismatches. PSE recorded the property as Non-Utility
16 Property and the net proceeds from the sale as Non-Utility Property. The loss associated
17 with that sale should also be Non-Utility Property.

18 The slightly more detailed answer is PSE recorded the proceeds from sale as non-
19 utility property under FERC account 121, but the Company wants to transfer the loss
20 associated with the sale to utility property for recovery in rates. The Company also claims
21 the Kent parcel was held as utility plant in service from 2004-2014, but then PSE

¹⁴ Exh. MCC-17, PSE Response to Staff Data Request 372 (d)(f).

¹⁵ Exh. MCC-18, page 2 of 4. This is Susan Free’s workpaper for electric operation.

¹⁶ Exh. MCC-16, PSE Response to Staff Data Request 371, page 3 of 10.

1 recorded the proceeds from the sale to FERC account 121 as non-utility plant. In the end,
2 the underlying principle is that Staff believes it is very important that utilities do not
3 count proceeds, and possibly gains, as non-utility property but then count losses as utility
4 property.

5
6 **Q. If the property was actually utility plant in service beginning in 2004, why should**
7 **PSE not be able to recover the loss from the sale in rates?**

8 A. The Commission should not create accounting safety nets just because a particular
9 treatment the Company chose happens to go against the Company's economic interests.
10 If PSE did hold the Kent property in utility plant in service from 2004 to 2014, the
11 Company should not have recorded this property to non-utility property for more than a
12 decade. If this property was recorded as non-utility property initially, PSE should have
13 transferred this non-utility property to utility property when it was utilized for utility
14 operation. Additionally, retroactive rate making is a legal concern. Generally, a regulated
15 utility may not make up for a mistake in how it classified plant in a future rate case by
16 seeking to recover the loss from rate payers when it was booked as non-utility in prior
17 rate cases.

18
19 **Q. Please describe the impact of staff's recommendation for Common Adjustment**
20 **11.13 (gas) Deferred Gains and Losses on Property Sales?**

21 A. Staff removed the Deferred Losses on Property Sales for non-utility plant for the amount
22 of \$280,362 in the calculation of Deferred Gains and Losses on Property Sales. This

1 adjustment decreases gas net operating income by \$(44,345) and has zero effect on rate
2 base.

3
4 **VI. STAFF POLICY CONCERNS RELATED TO PSE'S FILING**

5
6 **A. Materiality thresholds used in Staff's review.**

7
8 **Q. Please explain the scope of Staff's review.**

9 A. Staff imposed a materiality threshold for purposes of its review of the PSE filing. Staff
10 applied a higher level of scrutiny to adjustments above that threshold. This helped to limit
11 review to the adjustments and or issues in the case with the most impact on ratepayers.

12
13 **Q. How did Staff define materiality for purposes of this case?**

14 A. For ratemaking, materiality may be defined as the significance of a transaction, balance,
15 error, or rate of return contained within a company's submitted request for rates that has
16 the potential to affect the revenue requirement. Staff considered a material effect to be
17 one that impacts the rate of return by one basis point (bps).¹⁷ By measuring the change to
18 the Company's requested rate of return, Staff's definition of materiality is relative to the
19 size and particular financial position of the Company.

20

¹⁷ A basis point is one-hundredth of one percent, or 0.01 percent.

1 **Q. What is Staff’s established materiality threshold in this case?**

2 A. Based on the Company’s supplemental filing, I established the following threshold range
3 for PSE’s electric and gas operations:

4 **TABLE 4**

	<u>Electric</u>		<u>Gas</u>
1 bps = ▲ ¹⁸ in Rate Base	\$10,000,000		\$ 3,000,000
1 bps = ▲ effect on Revenue Requirement	\$ 1,250,000		\$ 374,000
1 bps = ▲ in Net Operating Income	\$ 530,000		\$ 180,000
1 bps = ▲ effect on Revenue Requirement	\$ 856,000		\$ 290,000

5

6 **Q. How does Staff apply materiality to PSE’s requests?**

7 A. A change to electric operations rate base of \$10 million (or more), changes the revenue
8 requirement by approximately \$1.3 million (or more). Additionally, a change to electric
9 net operating income of \$0.5 million (or more), changes the revenue requirement by
10 approximately \$0.9 million (or more).

11 Depending on the adjustment or transaction, if PSE proposed adjustment fall
12 below any of these thresholds, then Staff’s review did not apply the same scrutiny as it
13 would to a proposed adjustment over the above threshold.

14

15 **Q. Can you illustrate this concept of materiality with an example?**

16 A. Yes. For example, during Staff’s analysis we look at alternative calculations to test the
17 reasonable results of a particular adjustment. Staff could believe that its alternative

¹⁸ ▲ represents the delta or change.

1 calculation is superior to PSE's calculation (for one reason or another), but unless the
2 alternative calculation provides a result that materially changes the revenue requirement
3 then Staff would probably not propose the alternative calculation.

4 Another example is the reduced time spent on adjustments that produce changes
5 to net operating income and or rate base below these thresholds. Not only does Staff
6 spend less time reviewing these PSE proposed adjustments, but Staff also has had
7 discussions on whether certain small adjustments should even be allowed for ratemaking.
8 Please see the testimony of Mr. Thomas Schooley for further discussion on immaterial
9 PSE proposed adjustments.

10
11 **Q. Why is it important to apply materiality to a general rate request?**

12 A. Applying the materiality concept to ratemaking provides two benefits. Prior to Staff
13 submitting its response to PSE's general rate case, Staff had 117 business days to:

- 14 • Review PSE's filing as compared to filing requirements.
- 15 • Understand the Company's request and which witnesses cover which topics.
- 16 • Navigate the evermore complexity of Excel spreadsheets.
- 17 • Analyze the Company's request.
- 18 • Participate in discovery and meetings with the Company.
- 19 • Formulate, rationalize, and recommend a response to the Company's request.
- 20 • Draft and finalize exhibits and testimony.

21 Staff uses materiality thresholds in this case to avoid the potential that Staff's revenue
22 requirement will fail to produce rates that are fair, just, reasonable, and sufficient. First,
23 materiality is important because of the very limited amount of time and the large amount

1 of information for review. Staff focused on the adjustments with larger impacts on
2 ratepayers. The second reason is to mitigate the risk that Staff will not complete its
3 review in time for filing testimony. This second risk becomes even more crucial when the
4 Company files a large supplemental filing several months into the case, thereby further
5 reducing Staff's opportunity to conduct a thorough analysis. In this case, PSE's
6 supplemental filing provided the Commission with over 70 new documents in native and
7 PDF formats and over 70 Excel workpapers to support the supplemental requests. This is
8 a lot of information to review and to reconcile with the initial filing during the mid-point
9 of Staff's review.

10
11 **B. The importance of communication and accurate terminology.**

12
13 **Q. Please briefly describe the basic communication model.**

14 A. The basic communication model is the process of sending and receiving a message or
15 transferring information from the sender to the receiver. The sender creates and initiates a
16 message to its intended audience, the receiver. In order for the sender's message to be
17 clear and understood, the sender must craft its message to the specific communication
18 needs of the receiver.

19
20 **Q. How does this relate to regulated companies' communications with the**
21 **Commission?**

22 A. When a regulated company (the sender) creates and initiates a message (i.e. a general rate
23 case) to the Commission (the receiver), it is incumbent upon the sender to use the

1 language, terminology, and standards of the receiver to ensure clarity and understanding.
2 Absent this important communication concept, the Commission and Staff spend an
3 excessive amount of time translating the message before beginning to analyze the
4 request. When time is a factor, the more time spent translating a message, the less time
5 the Commission and Staff have to analyze the request.
6

7 **Q. Did the Company miscommunicate in this case?**

8 A. Yes. The most significant area of miscommunication stem from the Company's use of the
9 term "pro forma revenue."
10

11 **Q. Please define the term pro forma revenue.**

12 A. The word "pro forma", as it applies to financial information, is based on financial
13 assumptions or projections. In other words, the word pro forma indicates a projection into
14 the future based on current financial information. The word revenue is the amount of
15 money that a company earns during a specific period. Thus pro forma revenue is a
16 projection of monies the company will likely receive during a specific future period.
17

18 **Q. How did the Company define the term pro forma revenue?**

19 A. In Mr. Jon Piliaris' testimony, the Company defines the term "pro forma revenue" as
20 follows:

21 "Pro forma revenue is an estimate of test year revenue based on
22 test year billing determinants (e.g., energy sales, billed demand,
23 number of bills) and the rates that are in place at the time of filing
24 for a rate change."¹⁹

¹⁹ Piliaris, Exh. JAP-1T at 10:5-7

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Q. Is PSE’s definition of pro forma revenue accurate?

A. No. PSE’s definition is actually a definition of actual revenue. PSE created unnecessary confusion in its filing.

Q. How has PSE’s confusion about pro forma revenue caused problems?

A. The Company’s misuse of the term pro forma caused confusion as to what PSE was trying to convey in Piliaris’ Exhibits JAP-3, JAP-19, JAP-28, JAP-44 and JAP-45. PSE agreed that its intent was not to project future revenues in discussions with Staff. The Company was trying to show the test year revenues per the 2011 rate schedules and current revenues from all relevant schedules. The exhibits and testimony only show test year revenues.

Q. Is there another example of PSE’s communication in its filing that has caused confusion?

A. Yes. PSE commingled restating and pro forma adjustments. PSE also inconsistently used the terms “restating” and “pro forma” throughout its general rate case. This is in spite of clear definitions in WAC 480-07-510(3)(e)(ii) and (iii).

Q. Can you please provide an example?

A. Yes. For instance, adjustment 13.21 (electric) and 11.21 (gas), South King Service Center, is a commingled restating and pro forma adjustment that restate test period costs

1 and include a pro forma plant addition for the rate year. Exh. KJB-13²⁰ at 21, clearly
2 states the adjustment to the test period as “restating”, but Exh. KJB-1T and SEF-1T refers
3 to the adjustment as a pro forma adjustment. This is but one example that has caused
4 confusion and required more time than necessary to reconcile because the Company
5 didn’t separate the restating from pro forma aspects of its proposed adjustment.²¹
6

7 **Q. Why is it important to consistently apply the use of restating and pro forma in a**
8 **general rate case?**

9 A. Consistent and accurate terminology allows for more efficient analysis and, eventually, a
10 clearer evidentiary record for the Commission to make a determination. While flexibility
11 is an important tool in the regulator’s toolkit, the consistent separation and use of
12 restating and pro forma adjustments are also essential tools for fair and just ratemaking
13 proceedings.
14

15 **Q. At the end of the day, was Staff able to properly analyze PSE’s filing?**

16 A. Yes, but this answer came uncomfortably close to being ‘no’. One can make the
17 argument that it is not always how you arrive but rather the end result that matters. Just
18 because Staff eventually made its way through the filing and supplemental filing does not
19 mean there is no room to improve. Consistently applied and separately stated restating
20 and pro forma adjustments are one important area where the Company should more
21 rigidly follow filing guidelines because these adjustments, when applied appropriately, do

²⁰ Also see SEF-11, at 21, KJB-6, at 21, and SEF-6, at 21.

²¹ For a full discussion of the Company’s proposed adjustment please refer to Exh. SEF-1T at 27:1-29:15.

1 not disturb test year relationships.²² Additionally, it is required by Commission rule.

2 For Staff, the classification of restating and pro forma provides the parameters
3 and scope of an adjustment in relation to the test year. This informs the receiver (the
4 Commission and Staff) of the need for the adjustment and how best to review the
5 adjustment. Additionally, separating restating and pro forma adjustments provides
6 temporal clarity between the test year and the rate year revenues, expenses and rate base.

7
8 **Q. Please provide a summary of your recommendations to the Commission.**

9 A. I recommend that the Commission:

- 10 • Adopt Staff’s recommended electric annual revenue decrease, of approximately
11 \$35 46 million,
- 12 • Adopt Staff’s recommended gas annual revenue decrease, of approximately \$48
13 54 million,
- 14 • Accept Staff’s recommended materiality threshold,
- 15 • Reemphasize and direct the Company to clearly state and separate restating and
16 pro forma adjustment in its next filing,
- 17 • If the Company fails to explicitly state and separate restating and pro forma
18 adjustment in its next filing, provide clear recourse and direction for Staff.

19
20 **Q. Does this conclude your testimony?**

21 A. Yes.

²² *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049, Order 08,34-36, ¶ 93 (May 7, 2012) (“2011 PSE Order”).