**Exh. CRM-6T**

**Dockets UE-170033/UG-170033**

**Witness: Chris R. McGuire**

**BEFORE THE WASHINGTON**

**UTILITIES AND TRANSPORTATION COMMISSION**

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| **WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,**  **Complainant,**  **v.**  **PUGET SOUND ENERGY, INC.**  **Respondent.** | **DOCKETS UE-170033 and**  **UG-170033**  **(*Consolidated*)** |

**CROSS-ANSWERING TESTIMONY OF**

**Chris R. McGuire**

**STAFF OF**

**WASHINGTON UTILITIES AND**

**TRANSPORTATION COMMISSION**

***Colstrip Units 1 and 2 – Depreciation Rates and Rate Base***

**August 9, 2017**

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# INTRODUCTION AND PURPOSE

**Q. Please state your name.**

A. My name is Christopher R. McGuire.

**Q. Are you the same Christopher R. McGuire who submitted response testimony on behalf of Staff on June 30, 2017, in this docket?**

A. Yes, I am.

**Q. What is the purpose of your cross-answering testimony?**

A. My testimony serves two purposes. First, I summarize the various parties’ positions on the depreciation and net plant in service concerning Colstrip Units 1 and 2. Here I alert the Commission to the difficulties of comparing the revenue requirement effects of the various parties’ proposals and invite the Commission to ask the parties to provide clearly identified overall revenue requirement impacts directly or indirectly associated with their recommendations for Colstrip Units 1 and 2. If the Commission does so, it should specify a set of conditions under which the parties’ analysis is performed. Second, I provide the Commission with brief commentary on what each party’s position means in terms of policy preference on intergenerational equity and balance of burden between ratepayers and the Company’s investors.

# COLSTRIP UNITS 1 AND 2 – DEPRECIATION AND RATE BASE

**Q. Can you please summarize the basic elements of the various parties’ recommendations in response testimony regarding Colstrip Units 1 and 2?**

A. Yes. Please note that I only attempt to summarize the parties’ positions on depreciation expense and net plant in service (and, where applicable, amortization of a regulatory asset) for Colstrip Units 1 and 2. In some cases, however, particularly in attempting to summarize ICNU’s position, a party’s recommendation on Colstrip decommissioning and remediation affects what would be recovered through a regulatory asset and also the appropriate depreciation expense and rate base for other facilities. Although Staff witness Mr. Hancock sponsors cross-answering testimony to the parties’ recommendations concerning the decommissioning and remediation of Colstrip Units 1 and 2, it is not always possible to cleanly delineate between the treatment of decommissioning and remediation costs and the appropriate depreciation or amortization expense associated with Colstrip Units 1 and 2.

Staff witness Mr. McGuire recommends the following:

1. Current net plant in service: adjusted downward by increasing the reserve for accumulated depreciation.
2. Depreciation expense: set to recover reduced plant in service over the next 4.5 years.
3. Regulatory asset: yes, created now (capturing the adjustment to accumulated depreciation).
4. Amortization period for the regulatory asset: begins January 1, 2018, and continues through December 31, 2035.
5. Rate of return on the reduced net plant: Weighted Average Cost of Capital (WACC) until closure.
6. Rate of return on the regulatory asset: 0 percent.

Sierra Club witness Mr. Hausman recommends the following:

1. Current net plant in service: unadjusted.
2. Depreciation expense: current rates remain in effect until closure.
3. Regulatory asset: yes, created at closure.
4. Amortization period for the regulatory asset: begins upon closure, but amortization period unspecified.
5. Rate of return on net plant: WACC until closure.
6. Rate of return on regulatory asset: 0 percent.

ICNU witness Mr. Mullins recommends the following:

1. Current net plant in service: adjusted downward by moving “end of life costs” to a regulatory asset.
2. Depreciation expense: current rates remain in effect until closure.
3. Regulatory asset: yes, created now but capturing projected unrecovered balance at closure and incorporating a portion of decommissioning and remediation costs.
4. Amortization period for the regulatory asset: begins January 1, 2018, and continues through December 31, 2029.
5. Rate of return on net plant: WACC.
6. Rate of return on regulatory asset: WACC until closure, cost of debt after closure.

Public Counsel witness Ms. McCullar recommends the following

1. Current net plant in service: adjusted downward for Colstrip Units 1 and 2 by reallocating accumulated depreciation from other production plant to Colstrip Units 1 and 2.
2. Overall production rate base: unchanged, though rate base for Colstrip Units 1 and 2 is lower.
3. Depreciation expense: set to recover reduced plant in service over the next 4.5 years (though the higher net plant for other production plant is recovered over the expected remaining lives of those facilities).
4. Regulatory asset: no (unnecessary because instead of using a regulatory asset to recover the reserve imbalance, the reserve imbalance is addressed by reallocating accumulated depreciation from other production plant to Colstrip Units 1 and 2).
5. Amortization period: N/A.
6. Rate of return on net plant: WACC.
7. Rate of return on regulatory asset: N/A.

**Q. Can you please provide a summary of the revenue requirement impacts of the various parties’ recommendations regarding Colstrip Units 1 and 2?**

A. I cannot. After significant effort, Staff could not produce revenue requirement summaries that it believed were fair representations of each of the parties’ positions. Summarizing depreciation expense, amortization expense, and rate base across the parties’ recommendations requires making a large number of simplifying assumptions to control for the parameters that the parties treat inconsistently. Controlling for these inconsistencies, however, creates the risk of misrepresenting the parties’ recommendations.

As a few examples, in order present revenue requirement impacts while controlling for parameter inconsistencies across the parties, one would have to a) use a single rate of return to identify the revenue requirement impact of changes to rate base, even though the parties recommend different rates of return, b) assume the original cost is represented at a specific point in time, such as at the end of the test year though not all parties use that approach,[[1]](#footnote-2) c) assume net salvage equals zero, though that does not fairly represent the positions of all parties,[[2]](#footnote-3) and d) assume amortization periods where amortization periods are unspecified.[[3]](#footnote-4)

Moreover, various parties’ recommendations create revenue requirement impacts that ripple across Puget Sound Energy’s rate case, creating the need to make a decision about where the boundaries lie for producing a summary of the revenue requirement impact of the parties’ perspectives.

For example, Public Counsel recommends, essentially, that accumulated depreciation be moved from certain production plant to Colstrip Units 1 and 2. This would lower both rate base and depreciation expense for Colstrip Units 1 and 2. However, it would be misleading to simply present the components of revenue requirement for only Colstrip Units 1 and 2 given that net plant associated with other production facilities would be changed as a direct result of Public Counsel’s recommendation. The boundary of the analysis clearly would impact the presentation of the position summary. Staff does not wish to put itself in the position of determining the frame within which another party’s recommendation is presented. Further, even if it were willing to determine the frame for presenting Public Counsel’s recommendation, it is likely impossible for Staff to identify depreciation expense impacts to other facilities, particularly as we progress through time, given that the affected production plant (from which accumulated depreciation would be moved) consists of a smattering of expected useful lives over which to spread the revised net plant in service.

As another example, ICNU’s recommendation that treasury grants and production tax credits not be used to offset decommissioning and remediation has two distinct effects that confound a straightforward, apples-to-apples comparison of revenue requirement impacts. First, the proposal would effectively lower depreciation expense for certain hydro facilities (relative to PSE’s proposal). Second, the decommissioning and remediation expense that would have been offset by the treasury grants or production tax credits largely would be included within ICNU’s proposed regulatory asset.

The first of those effects creates issues similar to the ones created by Public Counsel’s proposal. Given that under ICNU’s recommendation treasury grant balances would continue to act as depreciation expense offsets for hydro facilities (specifically for Lower Baker River and Snoqualmie Falls), if we only focus on depreciation expense for Colstrip Units 1 and 2, we miss the depreciation effects of the proposal on other facilities.

As to the second effect, the negative net salvage value of Colstrip Units 1 and 2 created as a result of not offsetting decommissioning and remediation with treasury grants or production tax credits becomes a component of “end of life” costs which ICNU proposes to recover through amortization of a regulatory asset. ICNU’s proposal, then, includes multiple factors that affect revenue requirement in various directions and to varying degrees; ratepayers would experience additional costs through amortization of a larger regulatory asset but would receive an offsetting benefit through lower depreciation expense associated with Snoqualmie Falls and Lower Baker River, and an additional very large benefit associated with the amortization of production tax credits over the next 4.5 years. Focusing the lens solely on Colstrip Units 1 and 2, it would appear as if ICNU’s recommendation represents only a modest change relative to PSE’s proposal; a wider lens would capture a much different picture.

From Staff’s perspective, attempting to summarize the revenue requirement impacts of the various parties’ positions on Colstrip Units 1 and 2 is a fool’s errand, as it requires Staff to set the terms of comparison and speak for other parties with regard to those terms. Doing so will almost certainly result in revenue requirement summaries that are travesties of the various parties’ positions. Each party should itself be responsible for clarifying the aggregate revenue requirement impact of its own proposal on Colstrip Units 1 and 2, and over a time horizon that clarifies intergenerational effects.

**Q. How does Staff recommend the Commission obtain clarity on the revenue requirement impacts of the various parties’ proposals regarding Colstrip Units 1 and 2?**

A. To the extent that the Commission seeks clarification of the revenue requirement effects of each party’s proposal on Colstrip Units 1 and 2, Staff recommends that the Commission issue bench requests to each of the parties requiring clear summarization of the distinct revenue requirement impacts of its recommendation. Such a summarization should include identification of each individual component of the revenue requirement calculation for each element that the recommendation affects. Referring to the examples provided above, 1) Public Counsel would identify the aggregate impact of its recommendation on annual depreciation expense and rate base and 2) ICNU would identify the effects of its recommendation on hydro depreciation expense.

If the Commission does issue such bench requests, Staff recommends that the Commission set parameters that would allow for meaningful comparison, such as specifying the point in time at which original cost is presented and the period of time over which any regulatory asset should be amortized (for the purposes of clarifying intergenerational effects for parties that do not specify an amortization period). Additional parameters could include clear delineation between Colstrip-specific elements of overall depreciation expense and other recommendations (such as Public Counsel’s recommendation on salvage estimates within the depreciation study), and treating novel recommendations on production tax credits as independent of Colstrip Units 1 and 2 (such as ICNU’s proposal to amortize production tax credits over the next 4.5 years). If these parameters aren’t drawn, it becomes very difficult to ascertain the revenue requirement impact associated specifically with a party’s recommendation on Colstrip Units 1 and 2. Given that the treatment of Colstrip is a substantial revenue requirement driver in this general rate case, it is essential that the aggregate revenue requirement effect of each proposal is clear.

Given that the Commission undoubtedly will be weighing intergenerational equity considerations when it makes its final decision, Staff recommends that the Commission request representations across at least two points of time: 1) the rate year (2018), and 2) a year in which Colstrip will no longer be in service (e.g., 2023).

**Q. Do you have criticism of any party’s proposals regarding Colstrip Units 1 and 2?**

A. Not really. Each party’s recommendation merely reflects a different policy perspective on intergenerational equity and the extent to which ratepayers should continue to pay a return on an impaired asset or a return on the regulatory asset capturing abandoned plant. Staff stands by its own proposal as representing the best balance of fair rates, intergenerational equity, and distribution of burden between ratepayers and the Company’s investors.

**Q. Can you please provide a general sense of what each of the parties’ recommendations demonstrate in terms of policy preference?**

A. Yes. Staff’s proposal represents the position that the next 4.5 years of ratepayers should not be on the hook for the full depreciation reserve deficiency. Rather, those costs should be spread out through 2035 through a regulatory asset, aligning the life of the regulatory asset with the life of Colstrip Units 3 and 4. While other parties propose waiting until the plant closes to begin amortization, Staff proposes to begin amortization immediately under the rationale that current ratepayers should not be spared that burden at the expense of future ratepayers. Staff does not recommend ratepayers pay a return on the regulatory asset for abandoned plant. Consequently, for the rate year Staff’s recommended rate base for Colstrip Units 1 and 2 is substantially lower than what other parties recommend.

Sierra Club’s proposal is very similar to Staff’s proposal, though with two notable differences: Sierra Club recommends 1) waiting until the plant closes to begin amortization of the reserve deficiency and 2) providing the Company with a return on the full net plant balance while the plant remains in service. Thus, Sierra Club’s position, relative to Staff’s position, is that future ratepayers should pay a larger portion of the reserve deficiency while current ratepayers should provide investors with a return on a larger rate base balance. The net effect of those preferences is that ratepayers in 2018 would pay a similar amount under both Staff’s and Sierra Club’s positions, but ratepayers post-closure would pay more under Sierra Club’s proposal.

Public Counsel’s position on intergenerational equity, albeit achieved through an entirely different approach, is similar to Staff’s position in that it aims to spread the depreciation reserve deficiency over a period of time that is substantially longer than 4.5 years. The reserve deficiency for Colstrip Units 1 and 2 effectively would be spread over the useful lives of other (non-Colstrip) production plant. The effect of immediately reallocating accumulated depreciation to longer-lived assets is that the reserve deficiency begins to be “amortized” immediately, consistent in its effect with Staff’s approach. Public Counsel’s position on intergenerational equity thus is consistent with Staff’s position. However, the rate base associated with Public Counsel’s position is much higher than that under Staff’s position, meaning that the Company’s investors continue to profit from the investment in Colstrip Units 1 and 2, despite plant abandonment.

ICNU’s position is much more complicated to summarize, given that it proposes to handle regulatory liabilities (i.e. treasury grants and production tax credits) in a substantially different manner than the other parties. Ignoring that fact for the moment, in a sense ICNU’s proposal is similar to Staff’s in that it entails a lower depreciation expense (relative to PSE’s proposal) and begins amortization of “end of life” costs immediately. However, that is where the similarity ends. First, ICNU recommends allowing the Company a return on an inflated plant balance as well as a return (at the cost of debt) on the regulatory asset over the life of the regulatory asset. Second, under ICNU’s proposal the benefit of treasury grants accrue as normal (i.e. as an offset to hydro rate base and depreciation expense), while decommissioning and remediation expenses accruing through 2029 would be amortized as a piece of a larger regulatory asset. In other words, current (2018) ratepayers get the benefit of treasury grants while contributing to some amount of the decommissioning and remediation costs. Decommissioning and remediation costs that are expected accrue between 2030 and 2051 not included as a component of ICNU’s rate calculation.

Setting aside for a moment ICNU’s recommendation on amortization of production tax credits, ICNU’s recommendation achieves some sense of intergenerational equity, though by excluding a portion of the decommissioning and remediation costs from the regulatory asset, ICNU demonstrates a preference for having future generations (beyond the amortization period) cover future remediation expenses. Add to that the fact that ICNU is recommending amortizing $200 million in production tax credits over the next 4.5 years and the result is that current ratepayers would be much better off than under anyone else’s proposal. The policy preference for ICNU is very clearly that rate relief in the near term is a higher priority than intergenerational equity. Although Staff does not endorse this approach, the approach does represent a specific perspective on intergenerational equity and is an option if the Commission wishes to give preference to near-term ratepayers.

**Q. Does that conclude your testimony?**

A. Yes, it does.

1. ICNU witness Mr. Mullins, for example, appears to walk accumulated depreciation and certain transfers to plant forward to July 1, 2022. [↑](#footnote-ref-2)
2. ICNU witness Mr. Mullins, for example, recommends regulatory liabilities (i.e., treasury grants and production tax credits) not be used to offset decommissioning and remediation, implying that a net salvage is substantially less than zero. [↑](#footnote-ref-3)
3. Sierra Club, for example, recommends that unrecovered plant be transferred to a regulatory asset upon closure, but does not opine on the proper amortization period which, in its view, will be considered by a future commission once the plant is retired. [↑](#footnote-ref-4)