EXH. KJB-1T
DOCKETS UE-18___/UG-18___
2018 PSE EXPEDITED RATE FILING
WITNESS: KATHERINE J. BARNARD

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of: **PUGET SOUND ENERGY** **Expedited Rate Filing**	**Docket UE-18____** **Docket UG-18____**

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF

KATHERINE J. BARNARD

ON BEHALF OF PUGET SOUND ENERGY

NOVEMBER 7, 2018

PUGET SOUND ENERGY

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PUGET SOUND ENERGY

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I. INTRODUCTION

Q. Please state your name, business address, and position with Puget Sound Energy.

A. My name is Katherine J. Barnard. My business address is 355 110th Ave. NE, Bellevue, WA 98004. I am the Director, Revenue Requirements and Regulatory Compliance for Puget Sound Energy ("PSE" or the "Company").

Q. Have you prepared an exhibit describing your education, relevant employment experience, and other professional qualifications?

A. Yes. It is Exh. KJB-2.

Q. What is the purpose of your testimony?

A. My testimony provides the background leading up to this expedited rate filing ("ERF") and an overview of this filing. My testimony also discusses an update to PSE's cost of debt that has been incorporated into this filing.

II. OVERVIEW OF THE EXPEDITED RATE FILING

A. History of the ERF

Q. What is the basis for the expedited rate filing presented in this case?

A. In PSE's 2017 general rate case filed in Dockets UE-170033 and UG-170034 ("2017 general rate case"), PSE requested that the Commission formalize procedures for an expedited rate filing. Ultimately, the majority of the parties entered into a multiparty settlement stipulation ("2017 Settlement Agreement") and the settling parties agreed that PSE may file one ERF that is consistent with the process and procedures used by the Commission in Dockets UE-130137 and UG-130138 and the parameters identified in Exhibit I to the 2017 Settlement Agreement, a copy of which is included as Exh. KJB-3.

Q. What is an ERF?

A. An ERF is a limited refresh of electric and natural gas rates and is completed on an expedited basis. An ERF is able to be completed on an expedited basis because it (i) is based largely on a commission basis report ("CBR") filing, (ii) does not include pro forma adjustments or new methodologies or annualizing adjustments, (iii) does not consider forward-looking power costs, (iv) does not adjust the allowed return on equity from the most recent general rate case, and (v) uses the rate spread and rate design from the most recent general rate case. By ensuring that the requested revenues do not exceed three percent, both in total and by customer class, the filing does not meet the criteria outlined in WAC 480-07-505 that would initiate a general rate proceeding.

Q. Why is an ERF necessary?

A. As explained in more detail later in my testimony, an expedited rate filing is necessary to update PSE's rates and allow PSE a better opportunity to earn its authorized rate of return. Due to Washington's traditional approach to ratemaking, which relies on the use of a modified historical test period with limited pro forma adjustments, the rates established in PSE's general rate case can be stale by the time they are implemented. For example, the rates established in PSE's 2017 general rate case became effective approximately 15 months following the end of the test year on which the rates were based. Worse, these rates were developed on an average of monthly average ("AMA") basis, which adds 12 months of additional lag, for a total of 27 months for the investments to be fully captured in rates. As a result, and as discussed more fully below, PSE's expenses and rate base have exceeded the revenue levels established in the general rate case and are insufficient to allow PSE the opportunity to earn its authorized rate of return. Moreover, PSE has no reason to believe that filing another general rate case at this time would result in a significantly better outcome considering the general rate case 11-month procedural schedule, PSE's ongoing required capital spending, and concerns about the Commission's authority to use projected rate base in light of the recent Avista court decision. Since PSE in within two years of approval of its last general rate case, it makes more sense to use an ERF to address its earning erosion. An ERF is a suitable alternative that the Commission has endorsed. It leverages the work from the prior case while using known and measurable amounts from a subsequent account period.

While PSE's recent general rate case was filed with up to 27 months of lag, its proposed ERF reduces this lag to eight to nine months. As illustrated later in my testimony, this reduction in lag makes a material difference on PSE's ability to earn its authorized rate of return.

Q. Has the Commission encouraged utilities to consider ERFs?

A. Yes. Staff first proposed an ERF-like filing in PSE's 2011 general rate case, and the Commission stated it "appreciate(s) Staff's willingness to bring forward the outline of a proposed process mechanism to help address the particular problems associated with PSE's current position in a cycle of capital investment."[1] The Commission stated it would give fair consideration to a PSE filing along the lines Commission Staff suggested in that case. Additionally, the Commission stated it "would be particularly interested in proposals that might break the current pattern of almost continuous rate cases."[2] Consistent with this direction from the Commission and Commission Staff, PSE filed an ERF in 2013.

The Commission has also discussed ERFs as an option in other cases, including a recent Avista general rate case in which the Commission referenced positively the use of ERFs to update rates between general rate case filings to break the pattern of annual general rate case filings.[3]

Most recently, in the final order of PSE's 2017 general rate case, the Commission recognized that PSE has the option to seek rate relief between general rate cases irrespective of the 2017 Settlement Agreement.[4] However, the Commission "agree(d) with the guidance offered by the settlement stipulation"[5] and "require(d) that PSE and other parties follow the limits agreed to in the Settlement Stipulation"

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[1] *WUTC v. PSE,* Dockets UE-111048 & UG-111049, Order 08 ¶ 506 (May 7, 2012).

[2] *Id*. ¶¶ 506-07.

[3] *WUTC v. Avista Corp.*, Dockets UE-160228 & UG-160229, Order 07 ¶¶ 76-77 (December 15, 2016).

[4] *WUTC v. PSE,* Dockets UE-170033 & UG-170034, Order 8 ¶ 221 (Dec. 5, 2017) (noting that seeking rate relief between general rate cases is "an option available to the Company in any event.").

[5] *Id.*

if PSE elects to file an ERF within 12 months following the rate effective date of the compliance filing in PSE's 2017 general rate case.[6]

B. The 2017 Settlement Agreement and its Parameters for the ERF

Q. Is PSE's ERF consistent with the approach outlined in the 2017 Settlement Agreement?

A. This ERF is generally consistent with the approach outlined in the 2017 Settlement Agreement, except where the Company has made modifications to address concerns identified by Commission Staff, which are discussed in more detail later in my testimony.

Q. What are the guidelines agreed to in the 2017 Settlement Agreement?

A. The language of the 2017 Settlement Agreement and Exhibit I to the Settlement Agreement set forth the agreed-upon parameters for the current ERF. Exhibit I to the 2017 Settlement Agreement is provided as Exh. KJB-3. The parameters include the following:

- The ERF will be consistent with the process and procedures used by the Commission in Dockets UE-130137 & UG-130138.
- The ERF will be based on a CBR developed for a recently completed accounting period consistent with the approach defined in WAC 480-90-257 and WAC 480-100-257.
- The ERF will use only restating adjustments most recently approved by the

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[6] *Id.*

Commission with the following two exceptions:

(i) Use of end of period rate base is acceptable.

(ii) Annualization of any revenues that occurred after the test period and annualization of the underlying costs associated with those revenues to the extent not fully included in the test year results. This is necessary to maintain proper matching of the annualized revenue and expenses.

- The ERF will remove power costs, purchased gas, and gas pipeline cost recovery mechanism related revenues, rate base and expenses leaving only transmission, distribution and administration and general costs and rate base that will be used to determine the electric and natural gas revenue requirements to be considered in the expedited rate filing.
- The ERF shall maintain the rate of return established in the most recent general rate case except to update the interest rate on debt if needed.
- The ERF will not include changes to rate spread or rate design from the most recently filed general rate case.
- The ERF schedule would allow rates to take effect within 120 calendar days after filing.

Q. Please explain how PSE has incorporated the principles from the 2017 Settlement Agreement.

A. The Prefiled Direct Testimony of Susan E. Free, Exh. SEF-1T, describes in more detail the process by which PSE incorporated into this filing the principles from the 2017 Settlement Agreement and the requests by Commission Staff. She discusses how PSE prepared CBRs for this filing, the reflection of the commission basis results on an end of period basis, the annualization of revenues and underlying costs from the 2017 general rate case, and the segregation of costs to address only those costs to be included in an ERF. Additionally, as discussed later in my testimony, PSE incorporated the changes in the cost of debt, lowering the overall rate of return.

Q. Is PSE's rate base reflected at the end of the test period values?

A. Yes. As part of the 2017 Settlement Agreement, the settling parties agreed that rate base may be reflected at end of period ("EOP") values.

Q. Why is the use of EOP rate base appropriate in this ERF?

A. The use of EOP rate base is a tool the Commission continues to recognize as a useful means to address regulatory lag. EOP rate base requires no estimates or projections and instead is based on the actual plant values that are in service and providing benefits to customers. Reflecting rate base at EOP values provides a more representative picture of the plant and associated depreciation expense in place during the rate effective period than the use of AMAs, which requires the plant to have been in place prior to the start of the test year in order for the investment to be fully reflected in rates. In this particular ERF, the use of EOP rate base and depreciation expense[7] also provide the opportunity to annualize the benefits associated with plant related excess deferred tax reversals and have them

[7] End of period depreciation expense is a term used when adjusting depreciation expense to reflect the full year of depreciation expense for the end of period investments.

fully reflected in rates in a manner that complies with the consistency provisions of the IRS normalization rules. This is more fully explained in the Prefiled Direct Testimony of Matthew R. Marcelia, Exh. MRM-1T.

Q. Has the Commission supported the use of EOP rate base?

A. Yes. In Order 07 in Dockets UE-130137 and UG-130138, the Commission allowed the use of EOP rate base. In Order 08 in Dockets UE-111048 and UG-111049, the Commission stated that it is open to measuring rate base "at the end, or subsequent to the end of the test-year rather than the test-year average."[8] Additionally, in Avista's 2016 general rate case, the Commission identified end of period rate base as one available component of the "hybrid test year" process followed by the Commission,[9] and the Commission authorized the use of end of period rate base and depreciation expense for Avista in its 2017 general rate case.[10] Furthermore, in PSE's 2017 general rate case, the Commission reiterated that EOP rate base was among the tools the Commission has adopted to avoid the 27 month regulatory lag that often occurs through traditional AMA historical ratemaking.[11]

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[8] *See WUTC v. PSE,* Dockets UE-111048 & UG-111049, Order 08 ¶ 491 (May 7, 2011).

[9] *See WUTC v. Avista,* Dockets UE-160228 & UG-160229, Order 06 ¶ 82 (Dec. 15, 2016).

[10] *See WUTC v. Avista*, Dockets UE-170485 & UG-170486, Order 07 ¶ 203 (Apr. 26, 2018).

[11] *See WUTC v. PSE,* Dockets UE-170033 & UG-170034, Order 08 ¶ 326 (Dec. 5, 2017).

Q. Is the 2018 filing consistent with the ERF that PSE filed in 2013?

A. Yes. In general, this filing follows the approach utilized in the ERF filed and approved by this Commission in 2013. As discussed in more detail in the Prefiled Direct Testimony of Susan E. Free, Exh. SEF-1T, PSE has worked closely with Commission Staff to follow a format that Commission Staff prefers for this ERF, which has resulted in the same concepts from the 2013 ERF. In addition, there are two other changes associated with this ERF filing. First, for electric PSE has removed only the variable power costs rather than all production related costs, allowing the savings associated with fixed production costs to offset a portion of the ERF revenue deficiency. Second, PSE has used end of period depreciation to be consistent with the reflection of plant at end of period balances. This approach is consistent with the approach approved by the Commission in the recent Avista general rate case.[12]

Q. Why were all production costs intended to be excluded from the ERF?

A. ERF as originally envisioned excluded all production-related costs since they can be set in a power cost only case, and power costs are set on a forward-looking basis.

Q. Why is it appropriate for PSE to remove only the variable power costs rather than all production related costs?

A. Currently, PSE's overall fixed production costs are lower than the level

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[12] *See WUTC v. Avista*, Dockets UE-170485 & UG-170486, Order 07 ¶ 203 (Apr. 26, 2018).

established in the 2017 general rate case. Therefore, by removing only the variable costs and allowing the fixed production costs to stay in this proceeding, the overall revenue requirement request in this ERF filing is lower, providing customers the savings associated with the lower fixed production costs. The differences associated with variable costs are appropriately not included in this filing because i) there is a separate mechanism, the power cost adjustment ("PCA") mechanism, for addressing variable power cost differences; and ii) the PCA variable costs will continue to fluctuate over time and the differences associated with the ERF test year are well within the established bands of the PCA mechanism.

Q. Why is it appropriate for PSE to use EOP depreciation expense?

A. As discussed earlier, the use of EOP depreciation expense is necessary to match the rate base balances that are in service at June 30, 2018, with the level of depreciation expense associated with those assets. Adjusting depreciation expense to EOP provides PSE the opportunity to recover the return of its investment, that otherwise would not be fully reflected in rates. Additionally, as discussed earlier in my testimony, use of both EOP rate base and depreciation expense allows PSE to annualize the benefits associated with the excess deferred tax reversals while still meeting the consistency requirements of the IRS normalization rules.

C. Need for Rate Relief

Q. Why does PSE need rate relief so soon after setting rates in its 2017 general rate case?

A. This ERF request is primarily driven by the additional depreciation and amortization expense (approximately $60 million higher than 2017 general rate case levels for electric and $27 million higher for natural gas operations) associated with the more than $1.275 billion of non-production related plant placed in service since the end of the general rate case test year. A significant portion of the investment is in non-revenue producing plant, which creates earnings erosion until included in customers' rates. The following table provides an overview of the plant that has been added since September 30, 2016, the end of the general rate case test year.

TABLE 1 – Non-Production related[13] Plant Additions Since 2017 General Rate Case

Plant Type	Total Plant Additions (in millions)
Transmission & Distribution	$ 864.2
Technology	311.8
Facilities	85.5
Other	13.3
Total	$1,274.8

The depreciation and amortization expense associated with this additional plant is also significantly higher than levels established in the last general rate case and is the largest contributor to the revenue deficiency for both electric and natural gas.

[13] Since this ERF filing provides the net savings associated with fixed production costs, there are $112.1 million of production related plant additions included in this filing. These plant additions are more than offset by the incremental depreciation, and deferred taxes associated with those assets, therefore there is an overall net reduction in fixed production rate base of $249 million.

Q. Please describe the items driving the revenue deficiency.

A. The following provides an overview of the items driving the revenue deficiency:

(i) As discussed in more detail in the Prefiled Direct Testimony of Margaret F. Hopkins, Exh. MFH-1T, Information Technology ("IT") assets have become as foundational as the classic pipes and wires that deliver service to our customers. These systems must be kept current to ensure availability and security of the data contained in them. As a result, there is an increased pace of investment in PSE's IT infrastructure. Among the key IT initiatives completed since the last general rate case is the addition of two highly resilient modular data centers, a $65.2 million investment and the Snoqualmie business center that houses one of the two data centers, a $12.9 million investment. Ms. Hopkins' testimony provides an overview of PSE's IT strategy and an overview of the technology investments placed in service since the end of the test year for the 2017 general rate case.

PSE's IT investments contributed to the additional $27 million of amortization, of which $18.5 million is for electric and $8.6 million is for gas. Additionally, maintenance of the expanded IT infrastructure contributed $7 million toward the combined increase.

(ii) PSE has made investments to improve electric reliability at a rate that exceeds historical levels of plant replacement. As discussed in the Prefiled Direct Testimony of Catherine A. Koch, Exh. CAK-1T, PSE has invested over $505 million in electric transmission and distribution infrastructure since the 2017 general rate case test year. PSE's cable remediation program, which replaces cable that is prone to failure, accounts for nearly $84 million of the total increase in plant in service. Additionally, PSE invested nearly $80 million in substation improvements, completed its Pierce 230 transmission upgrades (approximately $41.8 million over 2017 general rate case levels), and invested over $55 million to improve reliability on its worst performing circuits. This increased level of electric investment contributed toward the $60 million increase in combined depreciation expense.

(iii) Similarly, on the gas side, PSE has invested over $386 million in gas infrastructure contributing to the increase in natural gas rate base of $98 million on which PSE earns a return and accrues depreciation expense. Since completion of the general rate case test year, PSE has invested more than $227 million in mains and services, with a significant portion of this work being driven by customer requests and external commitments. Additionally, the LNG upgrades ($27 million) and non-gas cost recovery mechanism eligible work (approximately $33 million) have contributed to the increased rate base. This investment is discussed in more detail in the testimony of Ms. Koch. It also contributed to the $60 million increase in combined depreciation expense discussed above.

(iv) The inclusion of $31 million of excess deferred income tax[14] reversals along with the impacts associated with the lower cost of debt ($8 million) have only partially offset the cost and rate base increases discussed above.

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[14] The Prefiled Direct Testimony of Matthew R. Marcelia, Exh. MRM-1T, discusses the annualized 2018 Excess Deferred Income Tax reversals that result from the Tax Cut and Jobs Act that are included in this ERF.

(v) Other changes in operation and maintenance ("O&M") expense and revenues have generally offset each other since PSE last set rates.

Table 2 below provides an overview of the drivers of the overall revenue deficiency:

Table 2 – Overview of Deficiency

	Deficiency (Surplus)	Electric	Gas	Combined
1	**Revenue Requirement Deficiency**			
2	Depreciation	$ 40.9	$ 18.8	$ 59.7
3	Amortization	18.5	8.6	27.1
4	A&G - Maintenance	4.7	2.6	7.3
5	Change in O&M	(6.7)	9.8	3.1
6	Change in Rate Base	(4.9)	7.5	2.6
7	ARAM	(23.5)	(7.4)	(30.9)
8	Change in Rate of Return	(5.6)	(2.0)	(7.6)
9	Other	(4.5)	(0.4)	(4.9)
10	Deficiency (Surplus)	$ 18.9	$ 37.5	$ 56.4

Q. PSE's capital spending is a primary driver of the ERF deficiency. Please explain why this level of capital spending is necessary.

A. As supported in the testimonies of Ms. Koch and Ms. Hopkins, PSE's investments are driven by our mission to provide safe, dependable and efficient service for our customers. PSE's investments in IT infrastructure are inextricably linked to advancing, securing, and enabling the day-to-day operation of our gas and electric service. PSE's investments in transmission and distribution system improvements are necessary to maintain and improve reliability and safety for our customers, and to meet requests made by customers and the communities in which we provide service.

Q. For electric operations, the June 30, 2018 CBR shows that PSE earned above its authorized rate of return[15] for the period. Why is PSE seeking rate relief?

A. The CBR by itself is not representative of PSE's current earnings profile nor does it fully reflect the continued earnings erosion that will occur in calendar year 2018 and beyond, absent rate relief. Since the CBR was not intended to be used as the basis for setting rates, it merely provides a point in time earnings snapshot based purely on historical results and does not reflect whether PSE's rates are currently fair, just, reasonable, or sufficient. For example, the CBR in this case uses a test period that still includes six months of calendar year 2017 results, a period in which PSE did over earn prior to resetting rates in December 2017. Thus, the CBR in this case includes only six months of the rates and expenses established in the 2017 general rate case. Even so, the CBR reflects a decrease in earnings of 30 basis points when compared to the calendar 2017 CBR results, which demonstrates that earnings have been decreasing since rates were set in the 2017 general rate case in December 2017. Earnings will decrease even further once the revenues and expenses authorized in the general rate case are fully reflected, as demonstrated in Exh. SEF-3.[16]

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[15] PSE's authorized rate of return for the period is the blended rate of 7.68 percent, which represents six months at the previously authorized 7.77 percent rate of return and six months at the currently authorized 7.60 percent rate of return.

[16] *See* Exhibit SEF-3, Line 36, Ref 3.02, Column G.

Q. What are the limitations of relying solely on the results of the CBR?

A. One key limitation is that the CBR rules do not allow for the annualizing of pricing (revenue) or expenses. Annualizing adjustments, such as the restatement of revenues and wages that update the test year results to provide the full effect of a test year change, are common adjustments in a general rate case, yet they are not permitted for CBR purposes. As a result, known and measurable changes that occurred part way through the test year are not fully reflected in the CBR reporting and therefore, do not fully reflect PSE's earnings going forward.

Q. How does the ERF address these limitations?

A. The ERF addresses these limitations using annualizing adjustments to the CBR, which annualize revenues and associated expenses from the general rate case.[17] Once these annualized adjustments are made to the CBR, it is clear that PSE is earning below its requested rate of return of 7.49 percent. This under earning is present even when considering the benefits associated with the deferred tax reversals under the average rate assumption method ("ARAM"), a methodology that is necessitated by the consistency requirements of the IRS normalization

[17] It should be noted that the ERF does not include all restating adjustments that would be included in a rate case but includes only those restating adjustments approved in the general rate case that are not fully reflected in the ERF test year results. As discussed later in my testimony, the exclusion of any new annualizing adjustments as well as the exclusion of proforma adjustments are one of the trade-offs the company accepts in exchange for the shorter adjudication period.

provisions. These deferred tax reversals[18] are providing some earnings relief in the near term, as discussed further in Mr. Marcelia's testimony.

Q. PSE's electric rates were increased as a result of the 2017 general rate case. Shouldn't that result in PSE continuing to over-earn as it did in 2017 rather than experience earnings erosion?

A. No. Although PSE's general rate case did result in an overall revenue increase of $20 million over previous rates, the rate increase was based on the additional costs associated with new amortizations of previously deferred costs and the new, higher depreciation rates that were approved in that case. In the general rate case these costs were included as pro forma adjustments and the actual increased expense levels did not commence until approved in the rate case. In total, these pro forma adjustments added $72.2 million[19] in costs that PSE began to incur on December 19, 2017, the rate effective date of the general rate case. Therefore, although revenues were increased by $20 million, PSE's authorized expenses increased by $72.2 million, which overall will result in lower earnings rather than increased earnings on a going forward basis.

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[18] The deferred tax reversals for the January through June 2018 period are $7.6 million for electric and $2.6 million for natural gas.

[19] The new amortizations associated with i) storm expense ($9.8 million); ii) the White River regulatory asset ($5.1 million); iii) environmental remediation amortization ($1.4 million); and iv) deferred payment processing expenses ($3.1 million) as well as the new depreciation rates which increased depreciation expense by ($52.8 million) far exceed the $20 million increase to electric revenues received in the 2017 general rate case.

Q. Are increased customer growth and achieved savings expected to offset PSE's needed level of future investment?

A. No. The earnings erosion that PSE is currently experiencing is not a temporary matter. For the foreseeable future, PSE must continue to invest in both its IT and transmission and distribution infrastructure to maintain the security, safety, and reliability of these systems. Absent rate relief, PSE will see its earnings continue to erode. Exhibit KJB-4 provides a comparison of the five-year compound growth rate for O&M, depreciation and amortization expenses and customer counts for the 2012 through 2017 period. This table clearly demonstrates that the growth in customers does not offset the growth in depreciation and amortization expenses.

Q. How does an ERF with end of period rate base help to address PSE's demonstrated earnings erosion?

A. As discussed earlier, an ERF with end of period rate base will partially address earnings erosion as it shortens the time frame between when the investment has been placed in service and when the investment is included in rates. Investments recovered in a general rate case often have up to 27 months of lag. Additionally, investments made during the general rate case test year are only partially included in rates due to the average of monthly averages convention that is typically used in a general rate case. Use of an ERF with end of period rate base still results in regulatory lag, but the lag is shorter—between eight and twenty months, depending on the month the investment was made.

Q. How does the increased spending in technology investments affect the earnings erosion and further support the need for an ERF with end of period rate base and depreciation?

A. As discussed in Ms. Hopkins' testimony, as utilities continue to rely more on technology solutions to meet evolving customer needs and growing security risks, IT assets have become as fundamental to the provision of utility service as the classic pipes and wire infrastructure investments. Security and reliability of the IT systems are critical and of growing importance in this day of increased cyber-security threats as well as the NERC/CIP[20] compliance requirements. However, the regulatory lag associated with these assets has a far greater impact on earnings erosion than the typical transmission and distribution ("T&D") expenditures, due to the shorter lives of the IT assets and the associated impact on PSE's depreciation and amortization expenses. The typical T&D investment life ranges between 30 to 50 years, which means the annual depreciation on those assets range between two and three percent per year. However, technology investments typically have a depreciable life of ten years or less and in many circumstances only a three to five-year life. Therefore, the impact of the typical 27-month regulatory lag is far greater on these short-lived assets and creates significant earnings erosion if not addressed. To illustrate the issue, the following chart provides a comparison of the under-recovery of depreciation expense associated with a $1 million investment.

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[20] North American Electric Reliability Corporation-Critical Infrastructure Protection.

$1 Million Investment		
	T&D Asset	IT Asset
Asset Life	30 yrs	5 yrs
Annual Depn Rate	3%	20%
Annual Depn expense impact	$33,333	$200,000
Depreciation Exp. incurred but not recovered in rates:		
Traditional AMA (27 months)	75,000	450,000
EOP Rate base	41,667	250,000
ERF with EOP rate base	25,000	150,000
% of delayed recovery		
Traditional AMA	8%	45%
EOP rate base	4%	25%
ERF with EOP rate base	3%	15%

As can be seen, under traditional ratemaking, where there is typically a minimum 27-month lag, the recovery lost through regulatory lag is approximately eight percent for a T&D investment, however, in the case of a technology related asset, the regulatory lag is approximately a 45 percent delay in recovery of the assets, six times as much lag as the lag associated with a T&D investment. The chart above shows that even utilizing end of period rate base through a general rate case setting results in a delay in recovery of 25 percent of the technology related asset. Only by utilizing the ERF with end of period rate base and depreciation expense does the regulatory lag associated with the IT investment get reduced to 15 percent, which is still double the regulatory lag associated with a typical T&D investment under traditional ratemaking.

D. Timing of ERF Proceeding

Q. What is the timing of the proposed rate change?

A. The settling parties in PSE's 2017 Settlement Agreement agreed to a schedule for the ERF that would allow rates to become effective within 120 days after the filing date. To facilitate this expedited timeline, PSE requests that the Commission immediately suspend the filing and set a prehearing conference date.

Exh. KJB-5 provides a proposed procedural schedule consistent with the timing agreed to by the settling parties in the 2017 general rate case. This schedule is also aligned with the procedural schedule utilized in the 2013 ERF.

Q. Why is the 120-day time frame reasonable?

A. The ERF is intended to be a limited update to rates that can be completed on an abbreviated schedule. Since the filing includes only the standard restating ratemaking adjustments, uses existing methodologies previously approved by the Commission and excludes proforma adjustments, the review can be accomplished on an expedited basis.

Q. What has PSE done to facilitate the 120-day time frame?

A. In recognition of the Commission's order accepting the 2017 Settlement Agreement, PSE has taken a number of steps to facilitate the parties' review and to limit the need for discovery[21]. In addition to providing the detailed workpapers to all parties, which transparently lay out each adjustment, PSE has:

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[21] *See WUTC v. PSE,* Dockets UE-170033 & UG-170034, Order 8 ¶ 221 (Dec. 5, 2017).

- Included with the workpapers the monthly detail of PSE's income statements and the detail of property additions by FERC account since the conclusion of the 2017 general rate case. This additional information has been included with the filing to facilitate review by the parties of the actual test year results of operation and provides information well beyond what is typically included in a rate filing.

- PSE has included testimony to support capital projects greater than $10 million[22] that have been placed in service since the last general rate case and are included in the ERF test year results. Additionally, the testimonies of both Ms. Koch and Ms. Hopkins include exhibits detailing the Operations and IT projects over $100,000 completed since the test year. These exhibits, when combined with the major projects discussed in testimony, account for over 75 percent[23] of PSE's investments since the general rate case. This level of supporting documentation for actual test year balances is well beyond the information typically included with initial documentation in a general rate case filing, further supporting the expedited schedule.

- Ms. Free's testimony provides a detailed explanation demonstrating that each adjustment is simply an update of the adjustment included in the

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[22] $10 million threshold for capital projects represents approximately 0.2 percent of PSE's electric net plant in service and 0.4 percent of PSE's natural gas net plant in service.

[23] $989 million of $1,246 million non-production related capital additions.

2017 general rate case and calculated consistent with the methodology approved in the general rate case.

III. SUMMARY OF REQUESTED RATE RELIEF

Q. Please summarize PSE's rate request in this case.

A. PSE requests a rate increase for electric customers of $18.9 million, which is an average 0.9 percent increase over the electric rates set in Docket UE-180282. PSE requests a rate increase for natural gas customers of $21.7 million, which is an average 2.7 percent increase over the natural gas rates set in Docket UG-180283.

Q. What rate of return was used to determine the revenue deficiency?

A. PSE used a rate of return of 7.49 percent to determine the revenue deficiency. The 7.49 percent is based on the authorized rate of return of 7.60 percent as determined in Order 08 in Dockets UE-170033 and UG-170034, updated to reflect a lower cost of debt. Both the capital structure and the return on equity component are unchanged from the levels approved in the 2017 general rate case.

Q. Please explain the change in the cost of debt since the 2017 general rate case.

A. The changes to PSE's cost of debt reflect the recent issuance of $600 million of senior notes, the proceeds of which were used (i) to refinance $250 million of 2067 junior subordinated notes, (ii) to redeem $200 million of senior notes that matured in June 2018, (iii) to pay down short-term debt, and (iv) for general corporate purposes. These changes result in a reduction of PSE's weighted cost of debt by 11 basis points and result in a revised overall cost of capital of 7.49 percent. PSE has incorporated this updated overall cost of capital into this filing for purposes of calculating the ERF revenue deficiency. Finally, although capital structure is not typically changed in an ERF it is worth noting that the above debt transactions do not alter PSE's expected total overall debt percentage from amounts authorized in the 2017 general rate case.

IV. INTRODUCTION OF COMPANY WITNESSES

Q. Would you please introduce the other PSE witnesses and describe the topics they will present?

A. Yes. The following witnesses are presenting testimony in support of PSE's ERF:

- Ms. Susan E. Free presents the ERF electric and natural gas revenue requirement and underlying commission basis reports for the 12 months ending June 30, 2018.
- Mr. Jon A. Piliaris presents: (i) the calculation of the revenues at present rates used to derive the revenue deficiencies using weather normalized billing determinant; (ii) the proposed rate spread and rate design for the recovery of the portion of the revenue deficiencies requested in this filing; and (iii) the corresponding updates to the allowed revenue per customer calculations used in the decoupling mechanism.
- Ms. Cathy A. Koch provides testimony demonstrating the prudence of the electric and natural gas transmission and distribution projects for which PSE is seeking cost recovery in the ERF.
- Ms. Margaret F. Hopkins testifies regarding PSE's information and technology strategy and supports the IT expenditures PSE has made since the 2017 general rate case.

- Mr. Doug Loreen testifies regarding the Bellingham Service Center, South King Renovations and the Snoqualmie Business Center.
- Mr. Matthew R. Marcelia testifies regarding the Tax Cuts and Jobs Act (Tax Reform) and the Financial Transparency and Improvement Program.

V. CONCLUSION

Q. Does this conclude your testimony?

A. Yes, it does.