EXH. CGP-1CT
DOCKET UE-24___
2023 PCA COMPLIANCE FILING
WITNESS: CARA G. PETERMAN

**BEFORE THE**
**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

| | |
|---|---|
| **In the Matter of the Petition of**<br><br>**PUGET SOUND ENERGY**<br><br>**For Approval of its 2023 Power Cost Adjustment Mechanism Report** | **Docket UE-24____** |

**PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF**

**CARA G. PETERMAN**

**ON BEHALF OF PUGET SOUND ENERGY**

**SHADED INFORMATION IS DESIGNATED AS CONFIDENTIAL PER WAC 480-07-160**

**REDACTED VERSION**

**APRIL 30, 2024**

**PUGET SOUND ENERGY**

**PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF**
**CARA G. PETERMAN**

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**PUGET SOUND ENERGY**

**PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF**
**CARA G. PETERMAN**

**LIST OF EXHIBITS**

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| Exh. CGP-2 | Professional Qualifications of Cara G. Peterman |
| Exh. CGP-3C | Excerpts of the Prefiled Direct Testimony of Daniel A. Doyle, 24000-05-PSE-Exh-DAD-1CT-2-15-24 |
| Exh. CGP-4 | Moody's Investors Service, *Puget Sound Energy, Inc.*, *Update to Credit Analysis* (Aug. 26, 2021) |

## PUGET SOUND ENERGY

## PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF CARA G. PETERMAN

## I. INTRODUCTION

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

A. My full name is Andrea Cara Gudger Peterman, and I generally prefer to go by Cara G. Peterman. My business address is 355 110th Avenue NE, Bellevue, Washington 98004. I am employed by Puget Sound Energy ("PSE") as Director, Chief Risk Officer and Corporate Treasurer.

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

A. Yes, I have. Please see Exh. CGP-2, which describes my education, relevant employment experience, and other professional qualifications.

**Q. What are your duties as Director, Chief Risk Officer and Corporate Treasurer for PSE?**

A. As Director, Chief Risk Officer and Corporate Treasurer for PSE, I have the responsibility for managing PSE's Enterprise Risk Management Program and Treasury functions. In Treasury, I have oversight of PSE's short-term debt program, I administer PSE's long-term debt portfolio, and oversee day-to-day management of PSE's cash position. I am also responsible for interfacing with credit rating agencies as well as with commercial and investment banks and debt investors. I am a member of the Qualified Plan's Committee, which oversees PSE's retirement, 401(k) and health and welfare plans. Finally, I am a board member and the Treasurer of the Puget Sound Energy Foundation.

**Q. Please summarize the contents of your testimony.**

A. This prefiled direct testimony is intended to support PSE's proposal for passing back the 2023 Power Cost Adjustment ("PCA") customer payable and recovering the estimated 2024 PCA customer receivable together once the PCA review is complete. In this testimony I will refer to PSE's proposal as the "Recovery Proposal". Specifically, this testimony describes the additional benefits to customers of the Recovery Proposal, beyond rate stability and gradualism[1], and highlights how the Recovery Proposal helps PSE maintain and restore cash flow stability and credit metric health, which is vital for company operations. This testimony is organized as follows:

(i) Discussion of the importance of cash flow stability to maintaining PSE's financial health;

(ii) Explanation of how the Clean Energy Transformation Act ("CETA") and other current events impact PSE's cash flow;

(iii) Descriptions of how cash flow can affect credit metrics and the importance of maintaining PSE's credit metrics, and

(iv) Summary of how the Recovery Proposal in this filing would alleviate cash flow and credit rating concerns.

[1] As presented in the Prefiled Direct Testimony of Susan E. Free, Exh. SEF-1T.

## II. PSE HAS FACED SIGNIFICANT CASH FLOW OBSTACLES IN RECENT YEARS

**Q. Why is cash flow so important to PSE?**

A. Cash flow is imperative to company operations. PSE requires cash to pay employees and vendors for all company activities, such as operations and maintenance expenses, power costs, gas costs, and capital expenditures, to make interest payments on its debt, pay taxes, etc.

**Q. Why is cash flow such a concern now?**

A. While PSE can generally be cash flow negative as PSE's capital expenditures exceeds cash flows from operations, with the passage of the CETA, the scale of the current and forecasted capital expenditures needed and the speed needed to invest in those expenditures is unprecedented and untenable without action by the Commission. For a more detailed discussion of PSE's projected capital expenditures over the next five years (2024-2028), please see Exh. CGP-3C, which is an excerpt from the Prefiled Direct Testimony of Daniel A. Doyle in PSE's most recent general rate case, Dockets UE-240004 and UG-240005. Cash flow will help fund the clean energy transition and any sizable unplanned or uncontrollable decrements to cash flow can put PSE's financial health, as measured by credit metrics and ratings, at risk.

Credit rating agencies have recognized the significant investments that CETA requires. For example, Moody's Investor Services ("Moody's") describes CETA as a "clean energy bill with aggressive carbon transition targets," further observing that, "[c]ompliance with the law will require significant investment and an overhaul of existing state electric infrastructure."[2]

**Q. What recent events have impacted cash stability?**

A. In January 2024 the Puget Sound region experienced some of the coldest temperatures in 33 years due to a prolonged polar vortex.[3] As a result, PSE set a new record for peak demand for gas and electricity. The incremental power cost to serve customers and keep the lights on during this five-day historic period of cold temperatures cost an additional $93.0 million from what PSE is currently recovering in rates for 2024.[4] Forecasted power cost increases for the remainder of 2024 are projected to increase *another* $34.5 million[5] as the region's water supply (and therefore hydro power), is lower than forecast, and PSE has to procure additional CETA-based resources to meet its approved Clean Energy Implementation Plan ("CEIP") targets. Please see the Prefiled Direct Testimony of Brennan D. Mueller, Exh. BDM-1CT. This increase of power cost expense of $127.5 million will be financed by incremental debt on the margin. After application of the PCA sharing bands, $90.3 million[6] of this imbalance will be assigned to customers and represents the 2024 PCA customer receivable.

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[2] Exh. CGP-4, Moody's Investors Service, *Puget Sound Energy, Inc.*, *Update to Credit Analysis* (Aug. 26, 2021).

[3] King 5 News, *Puget Sound Energy Addresses Energy Conservation Requests After Cold Snap* (Jan. 16, 2024) *available at* https://www.king5.com/article/news/local/puget-sound-energy-energy-conservation/281-1892b368-6bd2-4edf-b4d7-00f6792c6824.

[4] Exh. BDM-7C, cell F25.

[5] Exh. BDM-7C, cells G25 through Q25.

[6] Exh. BDM-7C, cell Q42.

**Q. How much will it cost PSE to finance this $127.5 million in increased power cost?**

A. Under the traditional timeline for recovering or passing back PCA deferrals, PSE will not fully recover the forecasted 2024 PCA customer receivable of $90.3 million until December 31, 2026 which is three years after the January 2024 event that has given rise to the majority of the estimated receivable. This means that PSE will have to carry the $127.5 million cost[7] for three years. PSE will finance the $127.5 million with short or long-term debt.

With current short-term interest rates at 5.6 percent, incremental interest expense could cost PSE an additional $15.8 million at current interest rates on an after-tax basis. This is an additional incremental loss of cash flow on top of the $127.5 million, as it is also not currently being recovered through rates. As discussed in more detail below, this will impact PSE's credit metrics.

**Q. Is anything else impacting PSE's cash flow?**

A. Yes, as Susan Free explains in her Prefiled Direct Testimony, Exh. SEF-1T,, PSE is currently recovering $76.4 million for the 2022 PCA customer receivable. However, the 2023 PCA customer payable of $22.2 million, under the conventional pass-back method, will decrease customer rates by $98.6 million (the switch of a $76.4 million inflow to an outflow of $22.2 million) and company cash flow by $93.7 million (taking into account revenue sensitive items from

[7] $37.3 million of this amount is a permanent loss of cash flow for the company due to the company share of the PCA under-recovery and $90.3 million of which will be recovered through the customer receivable once determined prudent.

which the company does not benefit from a cash flow perspective) in 2025. Therefore, the January 2024 cold weather event and subsequent higher forecasted power costs in 2024 ($127.5 million) and the pass back of the 2023 PCA customer payable will lead to two sequential years of cash flow loss of nearly $100 million or more.[8]

**Q. Why is this significant?**

A. This is significant because the increase in power cost in 2024 and the pass back of the 2023 PCA customer payable substantially reduce PSE's annual cash flow, it increases PSE's interest expense, increases PSE's debt, and therefore, will degrade PSE's credit metrics performance and financial health right at a time when PSE's financing needs due to CETA are increasing. I talk about the importance of credit metrics and financial health in the next section.

## III. CASH FLOW AFFECTS PSE's ABILITY TO MAINTAIN FINANCIAL HEALTH

**Q. How does PSE keep financing costs down?**

A. PSE keeps financing costs down by maintaining its current credit metrics and credit ratings. Credit metrics are measures used to assess an entity's financial strength, liquidity risk, and ability to service debts.

Credit *metrics* are an important factor when rating agencies assess a company's credit *rating*. A credit rating is designed to summarize credit risk, which is the

[8] See page 7, line 9 of Exh. SEF-3.

ability and willingness of an issuer of fixed income securities to fulfill its contractual financial obligations in full and on time. Ratings address the relative probability that an issuer or an issue will experience default, *i.e.*, the failure to pay either the required periodic payment or the principal when it matures under the terms of the security.

Table 1 below shows a list of credit metrics used by PSE's rating agencies. Key credit metrics emphasized the most by each rating agency are marked in bold:

**Table 1. PSE's Credit Metrics Used by Rating Agencies**

| **Rating Agency** | **Credit Metrics Evaluated in Determining Ratings** |
|---|---|
| S&P | • **FFO / End of Period Debt**<br>• Debt / EBITDA<br>• FFO / Interest Ratio<br>• EBITDA / Interest |
| Moody's | • **CFO Pre-WC / Debt**<br>• CFO Pre-WC less Dividends / Debt<br>• CFO Pre-WC + Interest / Interest<br>• Debt / Book Capitalization |
| Fitch | • **FFO Adjusted Leverage**<br>• Debt / EBITDA<br>• FFO Fixed Charge Coverage |

**Q. What does a credit rating agency do?**

A. The primary role of a credit rating agency is to provide an assessment of the creditworthiness of a company or a financial instrument to facilitate access to fixed income capital markets at the most efficient cost. All three credit rating agencies that assign credit ratings to PSE (Standard & Poor's ("S&P"), Moody's, and Fitch Ratings Inc. (“Fitch”)) use similar but slightly different calculations to compute credit metrics. Each credit agency applies discretionary adjustments to its calculations.

The agencies publish analyses of the issuers and issuances to communicate to the market with more detail the nuances of the current ratings, the analysis behind them, and the important factors driving the ratings and those factors that could change ratings. Ratings are expressed in a series of letters, numbers, and/or symbols to encapsulate the relative creditworthiness of the entity or issue.

**Q. How is a credit rating determined?**

A. The process begins with the preliminary credit assessment of the issuer. The primary analyst evaluates the creditworthiness as the first step and continually refines the evaluation as the process unfolds. The next step is meeting with the issuer’s management to assess their effect on credit quality and elicit more information that is not always accessible from securities filings and other public sources. The primary analyst conducts the meeting with the assistance of senior analysts on the team. They question and challenge management to understand their commitment to credit quality, their grasp of business operations and financial matters, and their views of future strategy, capital plans, and financial policies that could affect creditworthiness. After analyzing the credit profile and incorporating the insights gleaned from the management meeting and follow-up interactions, the ratings process culminates in a rating committee, where a company rating is determined,

**Q. Who uses credit ratings?**

A. Investors consult them when making investment decisions on choosing companies for investment and the price that they will demand to lend to or invest in a company. Ratings are valuable to investors because they are based on a consistent approach to assessing risk across time. Investors generally fall into two basic categories with distinct risk appetites. Fixed-income investors (*e.g.*, lenders or bondholders) extend capital to a company in exchange for a fixed return and the obligation to be repaid the original investment. Equity investors (*i.e.*, stockholders) receive only a residual return after all expenses are paid with no ability to demand a return of the investment. Fixed-income investors use ratings as one, very important consideration when deciding whether, and at what cost, to lend capital to a utility. Both fixed-income and equity investors use the credit analyses performed by rating agencies to help them understand the overall risk of an issuer.

**Q. How does loss of cash affect credit metrics?**

A. Credit metrics are a function of operating cash flow and debt that PSE must borrow to fund operations. Therefore, anything that decreases cash flow or increases borrowings beyond what is included in rates will have negative impacts on PSE's credit metrics. Examples include, but are not limited to, increasing power or gas costs, unexpected or unbudgeted increases in operations and maintenance expenses or capital expenses from inflation, storms/natural disasters, or other changes in project costs, changing regulatory policies or requirements, changes in building codes that increase costs, increases in interest rates that increase borrowing costs, etc. While rating agencies such as Moody's may be willing to accept a temporary cash dip due to power cost volatility, they are less willing to look through multiple years of significant cash volatility. Since PSE already has a two-year swing in its credit metrics due to the Purchased Gas Adjustment ("PGA") pass back in 2023-2024[9], this power cost volatility and multiple PCA over/under-recovery rate changes will compound and extend that volatility in the metrics, thereby making it hard for them to see through the volatility with discretionary adjustments.

**Q. How do credit ratings and actions affect a utility and its customers?**

A. Credit ratings directly affect the cost of capital needed for investment and, thereby, drive overall customer rates. Fixed-income investors and other creditors use ratings to assist them in determining the price they will charge the utility for the use of their money. The total price is the combination of the interest rate of the instrument and a credit spread to account for incremental risk an investor takes to invest in the company's bonds or equity above and beyond the risk-free rate, or U.S. Treasuries. There is an inverse relationship between debt cost and ratings: the higher the rating, the lower the cost. Equity investors (*i.e.*, stockholders) also use credit ratings as a risk guide to help them decide when and at what price they will offer their capital to a utility. The more risk they assess, the greater return they will require to compensate them for bearing that risk.

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[9] *See* Docket UG-230769.

**Q. Are the credit rating agencies already looking through PSE cash flow dips?**

A. Yes. As presented in my pre-filed direct testimony in PSE's current general rate case (UE-240004 and UG-240005), PSE's 2023 cash flow from operating activities, pre working capital compared to debt ("CFO Pre-WC/Debt") performance was higher than it otherwise should have been due to a short-term over-collection of the PGA expense. The solid orange line in Figure 1 below illustrates what credit metrics would have been for calendar years 2023 and 2024 with the PGA neutralized and the tightly dotted line represents the credit metrics as calculated with the impacts of the PGA over-collection. PSE's forecasted 2024 Moody's CFO Pre-WC / Debt metric [redacted] The PGA over-collection in 2023 and the subsequent one-year pass back in 2024 is causing the Moody's credit ratios to swing dramatically in calendar years 2023 and 2024. Although Moody's does not proactively adjust credit metrics for this swing in cash flow, Moody's will qualitatively acknowledge it in the annual credit assessments of PSE and typically "look through" this metric volatility due to the one-time nature of the event.

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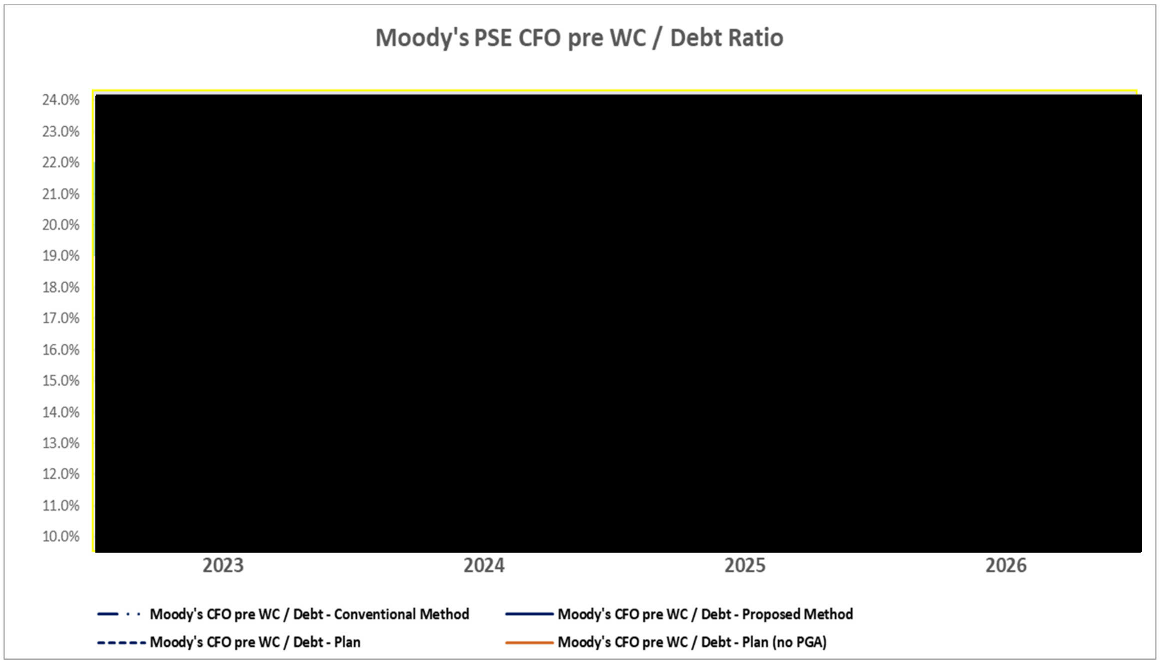
**Figure 1. Moody's PSE CFO Pre-Working Capital / Debt Forecast**




**Q. Why do cash flow considerations matter if PSE will eventually recover the cash related to the power cost under-recovery in January 2024?**

A. Cash flow considerations matter for at least two reasons.

First, rating agencies assess a company's financial strength on the business risk under which it operates. The rating agencies have been encouraged with SB 5295 and its efforts to reduce a utility's regulatory lag associated with recovery of expenditures and capital investments. However, as discussed by Susan Free, a typical recovery pattern for the 2024 PCA customer receivable would not incorporate the 2024 balance in rates until the earliest in October 2025, but more likely January 2026, given recent rate periods for the PCA. A three-year waiting period[10] to recover a receivable is a significant time in the eyes of credit rating

[10] Final recovery by December 2026 for an event that created significant cash flow need in January 2024.

SHADED INFORMATION IS DESIGNATED AS CONFIDENTIAL PER WAC 480-07-160 agencies and is detrimental to the focus on reducing regulatory lag for utilities. If the Commission chooses to adopt PSE's proposal, it will be seen as credit positive because the risk of cash flow recovery will have been shortened by a year or more, enabling PSE to move beyond the current year credit metric decrement from the 2024 PCA customer receivable.

Second, rating agencies, like Moody's, have been willing to look through one-time cost volatility items when metrics fall below downgrade thresholds when there is a credible story that this volatility is just a quick timing issue. However, when multiple cash flow volatility items pancake one year after the next, it becomes harder and harder to justify looking through credit metric weakness; credit rating agencies start to doubt the stability of cash flows and cash flow growth in the face of increasing cash flow volatility. As such, rating agencies may grow tired of credit metric under-performance and downgrade ratings or outlooks.

**Q. Please describe the forecasted credit metric impact from the Recovery Proposal.**

A. Figure 1 above illustrates the credit metric volatility associated with the PCA over and under-recoveries. First, as stated above, the orange line in Figure 1 is PSE's forecasted credit metric performance as presented in its most recent general rate case, without the impacts of the PGA over-collection. This view reflects the credit metric health of the business.

The next line to look at is the tightly dotted line. This represents PSE's forecasted credit metric performance with the PGA impacts of 2023 and 2024.

The next two lines represent the credit metric impacts from the two different PCA pass-back methods – the conventional method and the Recovery Proposal as discussed by Susan Free. The conventional method is represented by the line with a repeated long dash and two dots and the Recovery Proposal is represented by the solid blue line. One can see that the forecasted 2024 PCA under-recovery of $127.5 million causes additional credit metric deterioration in 2024 [redacted] basis points, taking the metric [redacted] in 2024. [redacted].

Under the conventional method, in which PSE passes back the 2023 PCA customer payable in 2025 and recovers the estimated 2024 PCA customer receivable in 2026, PSE's credit metric in 2025 is [redacted] compared to the [redacted] of the Plan (the orange line). It is not until the 2024 PCA customer receivable in 2026 when credit metric health recovers back to [redacted]. The forecasted 2024 PCA receivable is detrimental to PSE in 2024 and the Company does not recover until [redacted].

Under the Recovery Proposal, whereby the Company combines the 2023 PCA customer payable and the forecasted 2024 PCA customer receivable, PSE sees a small amount of credit metric mitigation (improvement from the conventional method) in 2024; the credit metric [redacted] rather than the [redacted] due to the fact that PSE's proposal has recovery (cash inflow) of the combined PCA deferral starting in October 2024. Then, PSE's credit metric performance [redacted] in 2025 before [redacted] in 2026. (PSE's credit metric performance does not perfectly align with the 2026 plan line due to the portion of the forecasted 2024 PCA receivable that PSE cannot pass on to customers as a result of the sharing bands.)

Looking at the graph, it is clear that the Recovery Proposal; (1) limits the decrement of the forecasted 2024 under-recovery to 2024 and [redacted] Under the conventional method, PSE's financial health [redacted].

## IV. PSE'S RECOVERY PROPOSAL IS BENEFICIAL FOR CUSTOMERS AND IMPORTANT FOR PSE'S FINANCIAL HEALTH

**Q. Why is PSE's Recovery Proposal beneficial?**

A. Susan Free discusses PSE's Recovery Proposal to net the 2023 PCA customer payable with the forecasted 2024 PCA customer receivable for recovery beginning October 1, 2024. She discusses the many reasons this proposal benefits customers. My testimony provides support for how PSE's Recovery Proposal will improve PSE's financial health and help mitigate the negative impacts from increased power costs in 2024. As discussed above, PSE is making significant capital expenditures to comply with CETA. As a result, cash needs are ballooning, and having stable cash flows and timely recovery of prudently incurred expenditures is imperative. Because credit rating agencies and investors are concerned with our financial health and timely recovery of expenditures, steps that the Commission can take to improve the timeliness of cash recovery will be seen as a credit positive.

**Q. How will PSE's Recovery Proposal help PSE?**

A. Approval of PSE's Recovery Proposal will help: (1) recover the cash loss in 2024 from the increase in power costs beginning October 2024; (2) improve the timeliness of cash recovery in 2025 associated with the estimated PCA 2024 customer receivable; and (3) provide more stability in PSE's credit metrics in 2025 and beyond. This faster restoration of credit metrics will help maintain PSE's current credit ratings and PSE's ability to finance the company at consistent performance levels. These three items would be seen as either credit neutral or credit positive, rather than credit negative.

Accordingly, based on the many benefits to PSE's customers and PSE, the Commission should approve PSE's Recovery Proposal as outlined by Susan Free in this proceeding.

## V. CONCLUSION

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

A. Yes.