**EXHIBIT NO. \_\_\_(SEF-1T)
DOCKET NO. UG‑15\_\_\_\_
WITNESS:  SUSAN E. FREE**

**BEFORE THE**

**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

|  |  |
| --- | --- |
| **In the Matter of the Petition of****PUGET SOUND ENERGY, INC.** **for (i) Approval of a Special Contract for Liquefied Natural Gas Fuel Service with Totem Ocean Trailer Express, Inc. and (ii) a Declaratory Order Approving the Methodology for Allocating Costs Between Regulated and Non-regulated Liquefied Natural Gas Services** | **DOCKET NO. UG-15\_\_\_\_** |

**PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
SUSAN E. FREE
ON BEHALF OF PUGET SOUND ENERGY, INC.**

**AUGUST 11, 2015**

**PUGET SOUND ENERGY, INC.**

**PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
SUSAN E. FREE**

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**PUGET SOUND ENERGY, INC.**

**PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
SUSAN E. FREE**

# I. INTRODUCTION

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

A. My name is Susan E. Free. My business address is 10885 NE 4th Street, P.O. Box 97034, Bellevue WA 98009-9734. I am employed by Puget Sound Energy, Inc. (“PSE”) as the Manager of Revenue Requirement.

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

A. Yes, I have. It is Exhibit No. \_\_\_(SEF-2).

**Q. What are some of your duties as Manager of Revenue Requirement?**

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

**Q. What is the nature of your prefiled direct testimony in this proceeding?**

A. This prefiled direct testimony describes the proposed accounting and cost flow methodology for the treatment being requested for both the regulated and non-regulated portion of the Tacoma Liquefied Natural Gas Facility (the “Tacoma LNG Facility”). This prefiled direct testimony is being offered to obtain approval of a defined allocation methodology for the Tacoma LNG Facility that will be followed consistently over time.

# II. OVERVIEW OF THE REQUESTED REGULATORY TREATMENT FOR THE REGULATED AND NON-REGULATED PORTIONS OF THE TACOMA LNG FACILITY

**Q. Please provide an overview of the requested regulatory treatment for the regulated and non-regulated portions of the Tacoma LNG Facility.**

A. Please see the Prefiled Direct Testimony of Mr. Roger Garratt, Exhibit No. \_\_\_(RG-1CT), for a description of the overall structure of the Tacoma LNG Facility. PSE is requesting that its existing, Commission-approved cost allocation methodology be deemed appropriate for accounting for its investment in and operation of the Tacoma LNG Facility that will be divided between regulated and non-regulated operations. The capacity of the Tacoma LNG Facility necessary to serve PSE’s natural gas customers (“core customers”) as a peaking resource along with the capacity necessary to serve Totem Ocean Trailer Express, Inc. (“TOTE”) under the LNG Fuel Supply Agreement, dated October 27, 2014, between PSE and TOTE (the “TOTE Special Contract”) would be regulated and the remaining capacity of the facility would be non-regulated. This prefiled direct testimony addresses how the costs of the Tacoma LNG Facility will be allocated between the regulated operations and non-regulated operations.

**Q. Does this prefiled direct testimony address the cost flow and allocation methodology of the natural gas distribution upgrades?**

A. No. The Prefiled Direct Testimony of Larry E. Anderson, Exhibit No. \_\_\_(LEA-1T), provides an overview of the natural gas distribution upgrades and the factors that result in the need for this investment.

The non-regulated portion of the Tacoma LNG Facility will utilize distribution service. For non-regulated bundled fuel sales, the non-regulated business will provide distribution revenues back to regulated operations. For non-regulated tolling fuel sales, the tolling customer will take distribution service on a tariffed rate, and that revenue will be recognized by regulated operations. Please see the Prefiled Direct Testimony of Roger Garratt, Exhibit No. \_\_\_(RG-1CT), for a discussion of the recognition of natural gas distribution system revenues associated with non-regulated fuel sales from the Tacoma LNG Facility.

Additionally, as discussed in the Prefiled Direct Testimony of Larry E. Anderson, Exhibit No. \_\_\_(LEA-1T), the natural gas distribution upgrade is sized to serve the vaporization and return flow of natural gas back to PSE’s system during peak events to serve PSE’s core customers. Because the natural gas distribution upgrade, as designed, would occur with or without the non-regulated fuel sales, it is 100% assignable to regulated operations and requires no allocation to non-regulated operations.

# III. PROPOSED ACCOUNTING AND COST ALLOCATION

## A. Overview of the Existing, Commission-Approved Cost Allocation Methodology

**Q. Does PSE currently follow a cost allocation methodology to allocate common costs between electric and gas and non-utility operations?**

A. Yes. PSE’s existing, Commission-approved cost allocation methodology was first approved in Docket No. UE-960195 (i.e., the merger between Puget Sound Power & Light Company and Washington Natural Gas Company) and also received approval in Docket No. U-072375 (i.e., the merger into Puget Holdings LLC). This existing, Commission-approved cost allocation methodology is sufficient for use in allocating costs between the regulated and non-regulated operations of the Tacoma LNG Facility.

**Q. Please provide an overview of PSE’s existing, Commission-approved cost allocation methodology.**

A. Please see Exhibit No. \_\_\_(SEF-3) for a copy of PSE’s Controller’s Training Manual Section CTM-8, which provides background and the detail of PSE’s existing, Commission-approved cost allocation methodology. As an overview, allocations are currently performed using the following three methods shown in the order of preference:

1. direct charging;

2. allocation using causal relationships; and

3. allocation using a general allocation factor.

**Q. Please describe direct charging.**

A. Direct charging is the preferred method for assignment of costs. When a cost can be uniquely identified to regulated or non-regulated activities, PSE will charge that cost to an account for that specific business area.

For example, PSE would direct charge an employee’s time spent negotiating non-regulated fuel sales contracts to the non-regulated operations of the Tacoma LNG Facility. In such a case, the PSE employee would directly charge his or her time to non-regulated operations, and the total amount charged to non-regulated operations would include appropriate labor and corporate overheads.

Similarly, employees dedicated to the Tacoma LNG Facility will directly charge their time to a specific function of the Tacoma LNG Facility, when possible. For example, when employees dedicated to the Tacoma LNG Facility perform maintenance or make repairs to specific areas of the facility, such as vaporization or storage equipment, they would charge time and materials to work orders that are allocated based on the vaporization or storage allocators that have been developed. These order charges would, in turn, be loaded with the appropriate labor and corporate overheads. Likewise, for time spent that cannot be attributed to a specific function, PSE will use the total capital allocator, which is a general allocator, to allocate their labor and related labor and corporate overheads.

**Q. Please describe allocations using causal relationships.**

A. The second method of allocation is using an allocator based on the relationship of the underlying driver of the cost being allocated. An example of an allocation based on the cause of the cost would be the allocation of the costs associated with storage. These costs would be allocated based on the total gallons of storage available to each consumer (PSE and TOTE storage would be allocated to regulated operations, while the remaining storage would be allocated to non-regulated operations).

**Q. Please describe allocations using general allocation factors.**

A. The third type of allocation relates to Tacoma LNG Facility costs that are common to both regulated and nonregulated services but cannot practically be allocated using the first two methods of allocation. This method of allocation will be based on the assumption that PSE incurred the common costs to support both regulated and non-regulated services, and the assignment of these costs would be in relationship to the directly incurred costs.

## B. Allocation Factors for the Tacoma LNG Facility

**Q. What allocators will PSE use to allocate Tacoma LNG Facility costs and capital?**

A. Please see Exhibit No. \_\_\_(SEF-4) for the allocation factors developed for the Tacoma LNG Facility to allocate Tacoma LNG Facility costs and capital. Please see the Prefiled Direct Testimony of Roger Garratt, Exhibit No. \_\_\_(RG-1CT), and supporting materials thereto, for the development and support of the capital allocation factors. Please see the Prefiled Direct Testimony of Clay Riding, Exhibit No. \_\_\_(CR-1HCT), and supporting materials thereto, for the development and support of the operations and maintenance (“O&M”) allocation factors.

The allocation factors presented in Exhibit No. \_\_\_(SEF-4) were estimated based off of the modeling assumptions used in the first year of operations assuming 19% utilization of non-regulated capacity which is PSE’s current base case projection of subscription for that year and is derived from the analyses conducted by Concentric Energy Advisors, Inc. (“Concentric”). Please see the Prefiled Direct Testimony of Melissa F. Bartos, Exhibit No. \_\_\_(MFB-1T), and the supporting exhibits thereto, for a discussion of the Concentric analyses.

### 1. Tacoma LNG Facility Expenses and Capital Costs to be Directly Assigned

**Q. Based on the existing, Commission-approved cost allocation methodology, what Tacoma LNG Facility revenue, expense, and capital cost categories will be directly assigned?**

A. PSE will directly assign the following Tacoma LNG Facility revenue, expense, and capital cost categories:

* Bunkering O&M and capital;
* Vaporization O&M and capital;
* Revenue;
* Gas Costs;
* Non-Regulated Fuel Sales Distribution Revenues and Expenses;
* Certain Labor, along with Labor and Corporate Overheads;
* Certain Maintenance Expenses;
* Depreciation Expense;
* Regulated Interest Expense;
* Revenue Sensitive Fees & Taxes; and
* Federal Income Tax.

Please see Exhibit No. \_\_\_(SEF-5) for the Tacoma LNG Facility revenue, expense, and capital cost categories that PSE will directly assign.

**Q. Will the capital and O&M costs allocated pursuant to the bunkering allocation factor always be allocated 100% to TOTE fuel sales?**

A. Yes. The capital and O&M costs allocated pursuant to the bunkering allocation factorwill be fully assigned to TOTEfuel sales. However, to the extent that PSE makes non-regulated fuel sales to marine customers using bunkering facilities, PSE will credit TOTE fuel sales on a pro rata basis for such use. For example, if PSE were to make non-regulated fuel sales utilizing the bunkering facilities in amounts that equal the fuel sales volume made to TOTE (such that TOTE’s utilization of the bunkering facilities equal 50% of the total volumes), then PSE will transfer marine customer revenue to TOTE fuel sales in an amount sufficient to credit TOTE for that 50% of usage.

### 2. Tacoma LNG Facility Causal Allocation Factors

**Q. Based on the existing, Commission-approved cost allocation methodology, what causal allocators will PSE use for the Tacoma LNG Facility?**

A. PSE will use the following causal allocators for the Tacoma LNG Facility revenues, expenses, and capital costs:

* Liquefaction Capacity;
* LNG Volumes;
* Annual Capacity;
* Wharfage; and
* Storage.

Please see Exhibit No. \_\_\_(SEF-6) for further detail on these causal allocators. The allocation factors presented in Exhibit No. \_\_\_(SEF-6) were estimated based on the modeling assumptions used in the first year of operations assuming 19% utilization of non-regulated capacity which is PSE’s current base case projection of subscription for that year.

**Q. To what Tacoma LNG Facility revenue, expense, and capital cost categories will PSE apply the causal allocation factors identified in Exhibit No. \_\_\_(SEF-6)?**

A. PSE will apply the causal allocation factors identified in Exhibit No. \_\_\_(SEF-6) to the following Tacoma LNG Facility revenue, expense, and capital cost categories:

**Table 1. Tacoma LNG Facility Revenue, Expense, And Capital Cost
Categories to be Allocated Using Causal Allocation Factors**

|  |  |
| --- | --- |
| **Category** | **Causal Allocation Factors** |
| Fixed Power Costs | Annual Capacity  |
| Variable Power Costs | LNG Volumes |
| Wharfage | Wharfage |
| Plant Consumables | LNG Volumes |
| Liquefaction Capital and O&M | Liquefaction Capacity |
| Storage Capital | Storage |

### 3. Tacoma LNG Facility General Allocation Factors

**Q. Based on the existing, Commission-approved cost allocation methodology, what General Allocators will PSE use for the Tacoma LNG Facility?**

A. Certain capital and O&M expenses associated with the Tacoma LNG Facility cannot utilize the first two preferred allocation methodologies of direct and causal allocations. Therefore, PSE will use the following general allocators for the Tacoma LNG Facility:

* Common Capital;
* Truck Loading; and
* Total Capital.

Please see Exhibit No. \_\_\_(SEF-7C) for additional detail on these general allocation factors. The allocation factors presented in Exhibit No. \_\_\_(SEF-7C) were estimated based off of the modeling assumptions used in the first year of operations assuming 19% utilization of non-regulated capacity which is PSE’s current base case projection of subscription for that year.

**Q. To what Tacoma LNG Facility revenue, expense, and capital cost categories will PSE apply the general allocation factors identified in Exhibit No. \_\_\_(SEF-7C)?**

A. PSE will apply the generalallocation factors identified in Exhibit No. \_\_\_(SEF-7C) to the following Tacoma LNG Facility revenue, expense, and capital cost categories:

**Table 2. Tacoma LNG Facility Revenue, Expense, And Capital Cost
Categories to be Allocated Using General Allocation Factors**

| **Category** | **General Allocation Factors** |
| --- | --- |
| Capital Costs common to all Tacoma LNG Facility functions | Common Capital |
| Staff Expenses, Labor and Labor Overheads that cannot be directly assigned or causally allocated | Total Capital |
| Maintenance Expenses that cannot be directly assigned or causally allocated | Total Capital |
| Incremental Insurance Expense | Total Capital |
| Lease Expense | Total Capital |
| Property Tax Expense[[1]](#footnote-2) | Total Capital |
| Truck Loading O&M and Capital | Truck Loading |

## C. Allowance for Funds Used During Construction

**Q. How will PSE allocate Allowance for Funds Used During Construction associated with the Tacoma LNG Facility?**

A. The portions of the Tacoma LNG Facility capital expenditures for the regulated operations will receive Allowance for Funds Used During Construction (“AFUDC”) based on PSE’s full authorized cost of capital of 7.77%.

For purposes of Generally Accepted Accounting Principles (“GAAP”), however, the portion of the Tacoma LNG Facility recorded to non-utility plant will receive capitalized interest based on the cost of debt only and not the full weighted average cost of capital which includes equity. PSE’s currently authorized cost of debt is 5.90%.

In order to achieve the GAAP level of capitalized interest on non-utility property, PSE will first apply AFUDC based on the full 7.77% cost of capital to all LNG capital orders. This full AFUDC will be allocated between regulated and non-regulated operations following the allocation methods previously discussed. Then, PSE will record the GAAP-required offsetting reduction to the non-regulated capital expenditures on a separate capital order that will be directly assigned to non-regulated fuel sales operations and will be calculated to reduce the AFUDC on non-utility plant to a level that equals the 5.90% cost of debt.

## D. Corporate Overheads

**Q. Will PSE apply corporate overheads to the Tacoma LNG Facility? If so, how will PSE allocate corporate overheads between regulated and non-regulated operations?**

A. Yes. PSE will apply corporate overheads to the Tacoma LNG Facility. PSE’s existing,Commission-approved cost allocation methodology provides for appropriate allocation of corporate overheads between regulated and non-regulated operations.

Along with labor overheads discussed earlier in this prefiled direct testimony, PSE’s corporate overheads applicable to service from the Tacoma LNG Facility will include an allocation for corporate support services that are applied to all labor associated with non-regulated fuel sales operations. Therefore, any labor and costs directly charged or allocated to non-regulated fuel sales operations will be loaded with these corporate overheads.

Under PSE’s existing,Commission-approved costs allocation methodology, the labor associated with corporate employees receives a corporate overhead rate that includes the costs of supporting employees in PSE’s corporate location. Alternatively, the labor associated with employees directly located at a subsidiary or non-utility location receives a corporate overhead rate that does not include certain of the corporate costs that do not apply to remotely located employees. Please see Exhibit No. \_\_\_(SEF-8) for an example of the current corporate overhead rates for PSE’s non-regulated subsidiary and holding company.

Corporate employee labor is charged 14.7% corporate overheads, and site-specific labor is charged 3% corporate overheads. The work papers supporting the Prefiled Direct Testimony of Roger Garratt, Exhibit No. \_\_\_(RG-1CT), and the Prefiled Direct Testimony of Clay Riding, Exhibit No. \_\_\_(CR-1HCT), assume a corporate overhead rate of 10%. The 10% corporate overhead rate was used for modeling purposes to simulate the impact of the use of two corporate overhead rates that depend on the type of employees charging or allocating time to LNG functions.

Additionally, the total capital costs assigned to the non-fuel sales operations will contain standard capital overheads, such as construction support, materials, and fleet overheads. These methods for applying corporate overheads to capital and O&M costs ensure that the non-regulated fuel sales operations are being appropriately burdened with a fair share of support services and are not being subsidized by regulated operations.

## E. Working Capital

**Q. Will PSE allocate working capital to the non-regulated fuel sales operations?**

A. Yes. PSE will allocate working capital to the non-regulated fuel sales operations. The Commission-approved calculation of combined working capital employed by PSE assigns a portion of working capital to non-utility, which is excluded from PSE’s rate base. The amount of working capital that is assigned to non-utility is based on the balances in non-operating accounts, such as non-utility plant and construction work in progress. Accordingly, no change needs to be made to the method for allocating working capital because the increased balances in non-utility plant will serve to increase the portion of working capital that is allocated to non-utility.

The Commission-approved calculation is a highly detailed calculation. PSE did not model the impact of the non-regulated fuel sales operations of the Tacoma LNG Facility to the non-operating working capital at the same level of detail. In the interest of simplicity, PSE’s model assumes working capital allocated to non-regulated fuel sales operations is equal to one month’s expense of non-regulated fuel sales expenses.

# IV. ILLUSTRATIVE IMPACTS ON REGULATED AND NON-REGULATED OPERATIONS OF THE TACOMA LNG FACILITY, BASED ON DIFFERING LEVELS OFSUBSCRIPTION OF NON-REGULATED FUEL SALES CAPACITY

**Q. Will the allocation of the initial investment of the Tacoma LNG Facility to non-regulated fuel sales operations change?**

A. Although the allocation methodology for allocating the initial investment of the Tacoma LNG Facility to non-regulated fuel sales operations will not change , the value of the allocation factors may not be the same as the estimates included in this prefiled direct testimony. As discussed in the Prefiled Direct Testimony of Roger Garratt, Exhibit No. \_\_\_(RG-1CT), the Tacoma LNG Facility investment allocated to non-regulated fuel sales operations will remain assigned to non-regulated fuel sales operations, regardless of the level of subscription of non-regulated fuel sales capacity. However, it is not until PSE places the Tacoma LNG Facility in service that PSE will determine the actual value of the capital allocation factors because all costs in all capital categories will then be known.

**Q. Will the value of the allocation factors change depending on the level of subscription of the non-regulated service?**

A. Yes, depending on the allocator. The LNG Volumes, Annual Capacity and Wharfage causal allocators in Exhibit No. \_\_\_(SEF-6) will have different values depending on the level of non-regulated sales over time and will be recalculated on a periodic basis. The exhibits referenced below present illustrative impacts on regulated and non-regulated operations of the Tacoma LNG Facility, based on differing levels of subscription of non-regulated fuel sales capacity. Changes in the value of these specific allocation factors can be seen under each of the different scenarios. The support for the calculation of these factors is included in the work papers supporting the Prefiled Direct Testimony of Roger Garratt, Exhibit No. \_\_\_(RG-1CT), and the Prefiled Direct Testimony of Clay Riding, Exhibit No. \_\_\_(CR-1HCT):

(i) non-regulated fuel sales capacity is 0% subscribed in the first year of operations (see Exhibit No. \_\_\_(SEF-9C);

(ii) non-regulated fuel sales capacity is 19% subscribed in the first year of operations (see Exhibit No. \_\_\_(SEF-10C); and

(iii) non-regulated fuel sales capacity is 100% subscribed in the first year of operations (see Exhibit No. \_\_\_(SEF-11C).

**Q. Please provide an overview of the examples presented in your exhibits.**

A. Using Exhibit No. \_\_\_(SEF-10C) as an example, all amounts shown on page 1 in column G represent an example of the revenues, expenses, rate base, and net assets that have been directly assigned or allocated above the line to peak shaving and TOTE fuel sales operations. Amounts shown in column I represent an example of the revenues, costs, and net non-utility plant directly assigned or allocated below the line to the non-regulated fuel sales operations.

**Revenue**

Line 5 represents the revenue to be received from the TOTE Special Contract (but does not include revenue collected from TOTE for service across PSE’s distribution system). Line 3 represents the revenue received from PSE core customers to cover the cost of service associated with peak shaving operations. Please see the work papers supporting the Prefiled Direct Testimony of Roger Garratt, Exhibit No. \_\_\_(RG-1CT), and the Prefiled Direct Testimony of Clay Riding, Exhibit No. \_\_\_(CR-1HCT), for the determination of the amount of revenue assigned to TOTE and PSE core customers. Neither of these amounts include the revenue to recover the natural gas distribution upgrades. These amounts are considered to be directly assigned because they will be the result of PSE customer bills from base rates or special contracts.

Exhibit No. \_\_\_(SEF-10C) assumes that the non-regulated fuel sales capacity is 19% subscribed during the first year of operations, which is PSE’s current base case projection of subscription for that year. Included on line 4 is the amount of distribution revenues received from non-regulated fuel sales operations. The determination of this amount is supported in the work papers supporting the Prefiled Direct Testimony of Roger Garratt, Exhibit No. \_\_\_(RG-1CT), and the Prefiled Direct Testimony of Clay Riding, Exhibit No. \_\_\_(CR-1HCT). This amount is considered to be directly assigned because it will be based on revenues received by PSE from non-regulated fuel sales operations pursuant to or based on distribution service tariffed rate.

The offsetting distribution expense recorded for amounts paid for natural gas distribution service and charged to non-regulated operations is reflected on line 23. Line 6 represents the contracted, directly assignable revenue received by PSE from non-regulated fuel sales operations.

**Expenses, Rate Base, and Net Assets**

The remaining expense, rate base and net assets have been directly assigned or allocated as discussed throughout this testimony and are supported by the work papers supporting the Prefiled Direct Testimony of Roger Garratt, Exhibit No. \_\_\_(RG-1CT), and the Prefiled Direct Testimony of Clay Riding, Exhibit No. \_\_\_(CR-1HCT).

**Q. How do Exhibit No. \_\_\_(SEF-9C) and Exhibit No. \_\_\_(SEF-11C) compare to Exhibit No. \_\_\_(SEF-10C)?**

A. When the subscribed amount of non-regulated fuel sales capacity changes, the total variable project costs, certain fixed costs, and revenues and expenses from non-regulated fuel sales operations change. Exhibit No. \_\_\_(SEF-9C) and Exhibit No. \_\_\_(SEF-11C) reflect the resulting revenue, costs, and rate base that would be recognized by the regulated and non-regulated operations assuming 0% and 100% non-regulated sales, respectively in the first year of operations based on the workpapers supporting the Prefiled Direct Testimony of Roger Garratt, Exhibit No. \_\_\_(RG-1CT).

# V. CONCLUSION

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

A. Yes, it does.

1. The total capital allocator will be applied to the actual and estimated tax bills received from Pierce County where the parcels or tax code areas for which the Tacoma LNG Facility assets reside. [↑](#footnote-ref-2)