Exhibit No. DCG-1T
Docket UE-161123
Witness: David C. Gomez

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY,** **Respondent.**	**DOCKET UE-161123**

TESTIMONY OF

David C. Gomez

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Calculation of Microsoft's Retail Wheeling Transition Payment

July 27, 2015

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is David C. Gomez. My business address is the Richard Hemstad Building, 1300 S. Evergreen Park Drive S.W., Olympia, Washington 98504.

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

A. I am employed by the Washington Utilities and Transportation Commission ("Commission") as the Assistant Power Supply Manager in the Energy Section of the Regulatory Services Division. I attained this position on July 1, 2012. Prior to my current position, I was the Deputy Assistant Director in the Solid Waste and Water Section of the Regulatory Services Division.

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

A. I have been employed by the Commission since May 2007.

Q. Please state your educational and professional background.

A. I hold a Bachelor of Arts degree in Business from Hamline University and a Masters of Business Administration degree from the University of Saint Thomas; both universities are located in Saint Paul, Minnesota.

Before joining the Commission, my relevant professional experience consisted of 25 years in a variety of fields, including management, contracting, supply chain, procurement, operations and engineering. I hold professional certifications from the Institute for Supply Management (ISM); APICS - The Association for Operations Management; Universal Public Procurement Council (UPPC); and QAI Global Institute (Software Testing).

Q. What are your duties with the Commission?

A. I perform accounting and financial analysis of regulated utility companies, as well as legislative and policy analysis. I presented testimony on behalf of Commission Staff in Docket UE-121373, regarding the Coal Transition Power Purchase Agreement between Puget Sound Energy, Inc. and TransAlta Centralia Generation LLC; Dockets UE-130043 and UE-140762, PacifiCorp's 2013 and 2014 general rate cases; Docket UE-130617, Puget Sound Energy's 2013 Power Cost Only Rate Case (PCORC); and Dockets UE-140188, UE-150204 and UE-160228, Avista's last three general rate cases. I have provided Staff recommendations to the Commission at numerous open meetings, and worked on various Commission rulemakings.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. What is the scope of your testimony in this proceeding?

A. My testimony evaluates the methodology and approach used by Puget Sound Energy (PSE or Company) to arrive at Microsoft's proposed transition payment of approximately $23.7 million.[1] Specifically, I address in my testimony the sufficiency

[1] *See generally* Piliaris, Confidential Exhibit No. __ (JAP-03(C)).

of this payment to hold PSE's remaining ratepayers harmless as a result of Microsoft no longer taking power supply service from the Company. I respond directly to the pre-filed direct testimony of Company witness Jon A. Piliaris and Mr. Gary S. Saleba representing Microsoft.

Q. Please provide a summary of your findings regarding the sufficiency of Microsoft's proposed transition payment.

A. The approximately $23.7 million payment agreed to by Microsoft and the Company[2] is sufficient to protect existing ratepayers from having to make up Microsoft's share of its allocated power costs. Microsoft's allocation of its share of power costs reflects its Schedule 40 cost of service and includes: generation assets; long-term fuel or purchased power agreements; deferred costs; and other prudent investments to which PSE has commitments. In calculating Microsoft's transition payment, PSE also recognizes the estimated offsetting system-wide benefits conveyed to remaining ratepayers associated with Microsoft's departure.

Q. Briefly describe the basic methodology PSE employs to calculate Microsoft's transition payment.

A. In his direct testimony, Mr. Gary Saleba summarizes the Company's approach:

> "…PSE proposes to collect the net present value (NPV) of the difference between (a) the power supply revenues PSE would have collected from Microsoft if Microsoft continued to purchase power supply service from PSE and (b) the amount of reduced power supply expenses that are realized by not having to provide Microsoft with this power supply service. This NPV is aggregated over the first five years

[2] Saleba, Exh. No. __ (GSS-1T), at 2:1-4.

> after Microsoft begins purchasing power supply from a non-PSE source."[3]

The description provided by Mr. Saleba of PSE's methodology is generally referred to as the "revenues lost approach."[4]

Q. Is the revenues lost approach a reasonable one for calculating a payment like the one Microsoft would make here?

A. Yes. The Federal Energy Regulatory Commission (FERC) adopted the revenues lost approach in its landmark Order 888, citing in its decision its finding that the method is the "fairest and most efficient way to balance the competing interests of those involved."[5] The approach is simple and produces reasonable estimates of a departing customer's share of power costs.

III. PSE'S APPLICATION OF THE REVENUES LOST METHODOLOGY

Q. Can you describe the Company's application of the revenues lost methodology in this case?

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[3] Saleba, Exh. No. __ (GSS-1T), at 5:8-17.

[4] *Stranded Cost Estimates for a Restructured Electric Industry in North Carolina*, Research Triangle Institute (RTI), August 1999 – "FERC's Revenues Lost approach defines stranded costs as the difference between a stream of lost revenues from a departing customer and the cost stream of that same "stranded" power sold elsewhere at competitive wholesale market rates."

[5] *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*; Order 888, FERC Stats. & Regs. ¶ 31,036, 61 Fed.Reg. 21,540, 21,658 (FERC May 10, 1996).

A. Yes. As described by Mr. Piliaris in his direct testimony, the starting point for the projection of power-related revenue associated with serving Microsoft is the Schedule 40 allocated baseline rate from its 2014 Power Cost Only Rate Case (PCORC) effective on December 1, 2014.[6] This baseline rate is composed of both fixed and variable components and is expressed in a dollar per MWh basis to enable its use in the Power Cost Adjustment (PCA) mechanism. PSE's revenue stream estimate for Microsoft is calculated by simply multiplying the PCA baseline allocated to Schedule 40 service with the annual forecasted load.

To arrive at a baseline rate for each year after Microsoft's exit, PSE escalated certain variable components of the baseline rate in line with its forecasts of power prices at Mid-C and gas prices from Sumas. The remaining embedded variable costs and all fixed costs are held constant.

Separate from the calculation of the revenue requirement above, PSE calculates the offsetting benefit of no longer having to serve Microsoft.[7] The Company performs this calculation using two separate iterations of its Portfolio Screening Model III (PSM III), one with and one without Microsoft's load. Examining PSE's underlying calculations in its PSM III model reveals that the benefit of Microsoft's departure result from both reducing the size and timing of the acquisition of new plant and the forecasted market value of the energy no longer required to serve Microsoft.

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[6] Piliaris, Exh. No. __ (JAP-1CT), at 4:11-16.

[7] PSE's estimates of energy and capacity payments is equivalent to the Competitive Market Value Estimates or CMVE in the FERC methodology. While the term used under the FERC methodology implies mitigation of departing load through estimates of the value of the departing load if sold in a market, PSE's calculation accomplishes the same objective.

PSE then takes the NPV of the difference between these two calculations over a 17-year period which coincides with the Company's Integrated Resource Planning horizon.[8]

Q. Is the Company's application of the revenues lost methodology appropriate in this case?

A. Yes. PSE's approach remains faithful to the basic FERC methodology. The fundamental issues around PSE's approach relate not to the methodology itself but to the assumptions and variables made by the Company which, when incorporated into PSE's revenues lost model in Mr. Piliaris' confidential Exhibit No. __ (JAP-03(C)), can have a material effect on results. That other parties in this case, including Microsoft, advocate for a different set of assumptions and variables to apply to the revenues lost methodology offered by PSE does not itself indict the functionality of this approach in arriving at a reasonable estimate of Microsoft's obligation upon departure.

Q. Company witness Mr. Piliaris offers two alternate methodologies for calculating Microsoft's transition payment; one based on its "peak credit" methodology and another based on the fixed portion of PSE's Power Cost Adjustment (PCA) baseline rate. How do these approaches compare with PSE's application of the revenues lost methodology?

[8] Under the FERC methodology, this time span is referred to as the "reasonable expectation period".

A. Unlike the revenues lost methodology, the two alternate methods offered by Mr. Piliaris make no attempt to quantify the system-wide energy and capacity benefits associated with Microsoft's departure. Instead, these two methodologies rely on the assumption that some level of benefits will be conveyed to remaining ratepayers by the fifth year of PSE's analysis.[9] In addition, the alternate methodologies offered by PSE utilize only a portion of the PCA baseline rate as opposed to its revenues lost approach which uses the entire baseline.

Q. Why do you think the use of the entire baseline rate in conjunction with the revenues lost methodology produces better estimates of Microsoft's departing obligation?

A. Using the entire baseline rate avoids controversy over which power costs to include and not include. Further, the revenues lost methodology, which uses PSE's entire baseline rate, enables the appropriate matching of the Company's calculation of estimated energy and capacity benefits associated with Microsoft's departure against the corresponding annual revenue requirement related to its power supply service under Schedule 40. Using the approved PCA baseline rate as a starting point is also logical as its method for calculation has been around since 2001 and is well known to the Commission and the parties in this case.

[9] Piliaris, Exh. No. __ (JAP-1CT), at 13:13-14:15.

Q. Does Microsoft offer any other methodology besides FERC's revenues lost?

A. No. Mr. Saleba's testimony does not include a proposal for a different methodology besides the revenues lost approach PSE used to calculate Microsoft's transition payment. Instead, Mr. Saleba challenges two assumptions PSE made in applying the FERC revenues lost methodology; the five-year period after Microsoft's departure the Company used to determine the amount of the transition payment to be paid and the market value of the energy used to offset the revenue stream estimate.[10] In Mr. Saleba's view, the Company's application of the revenues lost methodology results in a transition payment that "… is in excess of the amount needed to hold PSE's remaining customers harmless."[11]

Q. Why do you believe that PSE's use of a five-year period is appropriate as opposed to a longer period as proposed by Mr. Saleba?

A. A five-year period is appropriate for two principal reasons. First, relying on long-range estimates of market prices for power and gas conveys an unacceptable amount of risk to remaining customers. Quoting from the Bonneville Power Administration's Power Market Price Study in its current BP-18 Rate Proceeding:

> "Uncertainty regarding the price of natural gas is fundamental in evaluating electricity market price risk. As noted, when natural gas-fired generators deliver the marginal unit of electricity, as they frequently do in the Pacific Northwest, the price of natural gas largely determines the market price of electricity. Furthermore, as natural gas is an energy commodity, the price of natural gas is expected to

[10] In his direct testimony Mr. Saleba argues for a higher market value estimate which includes capacity. *See* Saleba, Exh. No. __ (GSS-1T); at Page 8:6-Page 9:3.
[11] Saleba, Exh. No. __ (GSS-1T), at Page 5:23-6:3.

fluctuate, and that volatility is an important source of market uncertainty." [12]

One only needs to examine the 33 percent spread in PSE's 20-year levelized gas price forecasts over a two-year period (2014-2016) to confirm this uncertainty in real terms.

Second, Mr. Piliaris states in his direct testimony that the Company's revenues lost methodology relies on assumptions from its 2015 Integrated Resource Plan (IRP).[13] As mentioned previously in my testimony, PSE's relies on its PSM III model to determine the capacity benefit resulting from Microsoft's departure. It also uses PSM III, along with its underlying assumptions, in the preparation of its IRP. PSM III applies these assumptions to select the optimum, cost effective mix of PSE's future resource acquisitions. The Commission's 2015 IRP acknowledgment letter to PSE expressed some reservation around the assumptions the Company used in its IRP to arrive at the timing and specific type of future electric resources additions. This level of uncertainty within the Company's resource acquisition planning horizon lends further support for the five-year period proposed by PSE as opposed to the 15-year period offered by Mr. Saleba.

Q. Mr. Saleba also challenges the value of reduce power supply purchases resulting from Microsoft's departure in PSE's model. Do you agree that the energy benefit calculated by PSE is too low?

[12] Power Market Price Study and Documentation, BP-18-E-BPA-04, November 2016, at 16:10-16.
[13] Piliaris, Exh. No. __ (JAP-1CT), at: 1-4.

A. No. Mr. Saleba attempts to assign a capacity value to the market power prices calculated through PSM III. While these amounts do only account for the market price of energy without capacity, the capacity benefit associated with Microsoft's departure is already accounted for in PSE's model. Including Mr. Saleba's proposed adjustment overstates capacity benefits.

Q. Should PSE's application of FERC's revenues lost methodology establish a precedent for the calculation of future transition payments associated with departing customers?

A. No. While the FERC revenues lost methodology is one way to calculate a transition payment there are other approaches as well, which, when applied correctly, can also yield reasonable results. For example, some methods differ by whether they measure stranded costs before or after a customer's exit,[14] whether they are based on estimates or on actual market valuations of assets, and whether they look at a utility's individual generation assets or employ a more aggregate, "top-down" approach like the revenues lost methodology used in this case. Another approach is to be less prescriptive of the methodology employed, as is the Commission's current practice in how regulated utilities calculate their avoided cost.

At this juncture, Staff does not know whether retail wheeling is a one-time event or will others follow. Certainly if expansion of retail wheeling were to occur, policies around how transition payments are to be calculated are needed. The goal of these policies should be to: 1) ensure remaining customers are no worse or better off

[14] The principal advantage of an ex-ante estimate is that it creates an incentive for parties to settle stranded cost claims without resorting to litigation. Ex-post methods can provide greater certainty that the amount of transition payment covers a departing customer's obligation.

as a result of departing customer no longer taking power supply service, 2) require the utility to mitigate the impacts associated with a customer's departure, 3) provide certainty for the departing customer, and 4) encourage parties to reach agreement and avoid litigation.

Q. Does this conclude your testimony?

A. Yes.