

EXHIBIT NO. ___(DAD-1T)
DOCKET NO. UE-121373
DOCKET NO. UE-121697/UG-121705
DOCKET NO. UE-130137/130138
WITNESS: DANIEL A. DOYLE

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

For Approval of a Power Purchase
Agreement for Acquisition of Coal
Transition Power, as Defined in
RCW 80.80.010, and the Recovery of
Related Acquisition Costs

DOCKET NO. 121373

In the Matter of the Petition of

PUGET SOUND ENERGY, INC. and
NW ENERGY COALITION

For an Order Authorizing PSE to Implement
Electric and Natural Gas Decoupling
Mechanisms and to Record Accounting
Entries Associated with the Mechanisms

DOCKET NOS. UE-121697 and UG-
121705 (Consolidated)

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

DOCKET NOS. UE-130137 and UG-
130138 (Consolidated)

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
DANIEL A. DOYLE
ON BEHALF OF PUGET SOUND ENERGY, INC.**

*In Support of the Multiparty Settlement
Re: Coal Transition PPA and other Pending Dockets*

MAY 8, 2013

PUGET SOUND ENERGY, INC.
PREFILED REBUTTAL TESTIMONY
(NONCONFIDENTIAL) OF DANIEL A. DOYLE

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1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF**
3 **DANIEL A. DOYLE**

4 **I. INTRODUCTION**

5 **Q. Please state your name and business address.**

6 A. My name is Daniel A. Doyle. I am employed as Senior Vice President and Chief
7 Financial Officer for Puget Sound Energy, Inc. (“PSE”). My business address is
8 10885 NE Fourth Street, Bellevue, WA 98009-9734.

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

11 A. Yes, I have. It is Exhibit No. ___(DAD-2).

12 **Q. What is the purpose of your rebuttal testimony?**

13 A. This prefiled rebuttal testimony also responds to arguments made in the following
14 testimonies:

15 (i) the Prefiled Response Testimony of Mr. Stephen G. Hill,
16 Exhibit No. ___(SGH-1T), on behalf of the Public Counsel
17 Section of the Washington Attorney General’s Office
18 (“Public Counsel”);

19 (ii) the Prefiled Response Testimony of Mr. Michael P.
20 Gorman, Exhibit No. ___(MPG-1T), on behalf of the
21 Industrial Customers of Northwest Utilities (“ICNU”); and

22 (iii) the Prefiled Response Testimony of Mr. Kevin G. Higgins,
23 Exhibit No. ___(KGH-1T), on behalf of The Kroger Co.
24 (“Kroger”) on behalf of its Fred Meyer Stores and Quality
25 Food Centers divisions.

1 **II. THE DETERMINATION OF PSE'S AUTHORIZED**
2 **COST OF CAPITAL IS OUTSIDE THE**
3 **SCOPE OF THIS PROCEEDING**

4 **A. The Determination of PSE's Authorized Return on Equity for PSE is**
5 **Outside the Scope of This Proceeding**

6 **Q. How do you respond to testimony from Public Counsel and ICNU proposing**
7 **reductions in PSE's authorized return on equity in this proceeding?**

8 A. As discussed in more detail below, the determination of PSE's authorized return
9 on equity is outside the scope of this proceeding. The Commission made a
10 determination on PSE's return on equity one year ago in PSE's general rate case.
11 Further, the recommended reductions to PSE return on equity proposed by Public
12 Counsel and ICNU are not supported by evidence, and the witnesses proposing
13 such adjustments admit their proposals are not based on complete capital studies
14 or analyses.

15 **Q. Has Public Counsel advocated for a reduction in PSE's authorized return on**
16 **equity in this proceeding?**

17 A. Yes. Although Public Counsel does not expressly identify a recommended
18 reduction in PSE's authorized return on equity, the testimony suggests that Public
19 Counsel is advocating for a thirty basis point reduction in PSE's authorized return
20 on equity—from 9.80 percent to 9.50 percent—due to alleged changes in capital
21 markets, without any formal justification.

1 **Q. How does PSE calculate Public Counsel's suggested reduction in authorized**
2 **return on equity due to alleged changes in capital markets?**

3 A. Because Public Counsel does not expressly state what its suggested reduction in
4 authorized return on equity is, Public Counsel's suggested reduction must be
5 deduced from other statements in the testimony.

6 First, Public Counsel advocates that the Commission reduce PSE's authorized
7 return on equity by fifty basis points if the Commission were to adopt PSE's
8 decoupling proposal. Hill, Exh. No. ___(SGH-1T), at page 12, lines 3-5. If
9 adopted, this proposed reduction would reduce PSE's authorized return on equity
10 from 9.8 percent to 9.3 percent.

11 Public Counsel then suggests that

12 [t]aking those factors into account as well as my own recent
13 estimate of the cost of equity capital for BBB-rated electric
14 utilities, an equity return of 9.0 percent would be reasonable for
15 [PSE] under a decoupling ratemaking scenario.

16 Hill, Exh. No. ___(SGH-1T), at page 12, lines 8-10. This suggests a reduction
17 from the suggested authorized return on equity from 9.3 percent to 9.0 percent —
18 or a thirty basis point reduction—due to alleged changes in capital markets.

19 **Q. Has Public Counsel presented a return on equity study in this proceeding?**

20 A. No. Public Counsel admits that it has not undertaken a return on equity study in
21 this proceeding that would support the proposed 30 basis point reduction in PSE's
22 authorized return on equity. Hill, Exh. No. ___(SGH-1T), at page 10, lines 15-16.

1 Public Counsel points to declines in corporate bond yields and suggests that
2 capital costs are now lower than when the Commission adopted PSE's authorized
3 return on equity of 9.80 percent. Hill, Exh. No. ___(SGH-1T), at page 8, line 13,
4 through page 9, line 14. Public Counsel fails to provide any evidence, however,
5 of any positive or negative correlation between corporate bond yields and
6 authorized utility returns on equity or how the spread between the two changes
7 over time.

8 Public Counsel also suggests that cost of capital testimony in a rate proceeding
9 involving Southwestern Electric Power Company before the Public Utilities
10 Commission of Texas is instructive. Hill, Exh. No. ___(SGH-1T), at page 10,
11 line 16, through page 11, line 11. In that proceeding, witness for Public Counsel
12 suggests that an appropriate range of authorized returns on equity for BBB-rated
13 electric utilities would be within a range from 8.50 percent to 9.50 percent. The
14 Public Utilities Commission of Texas, however, has yet to issue an order in the
15 Southwestern Electric Power Company rate proceeding. Moreover, Public
16 Counsel fails to disclose that other evidence presented in Southwestern Electric
17 Power Company would support an authorized return on equity within a range of
18 10.5 percent and 11.5 percent.

19 More fundamentally, Public Counsel's references regarding Southwestern Electric
20 Power Company rate proceeding are irrelevant. Public Counsel neither presents
21 evidence that Southwestern Electric Power Company has a risk profile similar to
22 PSE nor provides detail regarding Southwestern Electric Power Company's
23 customer base and service territory. Moreover, the use of a single utility as a

1 reference significantly departs from the appropriateness, and time-honored
2 tradition, of considering peer groups when assessing cost of capital.

3 **Q. Has ICNU advocated for a reduction in PSE’s authorized return on equity in**
4 **this proceeding?**

5 A. Yes. ICNU is advocating for a fifty basis point reduction in PSE’s authorized
6 return on equity, from 9.80 percent to 9.30 percent. ICNU suggests that “the
7 decline in utility bond yields suggests that PSE’s current capital cost should be
8 much lower today than it was at the time the final order in the last rate case was
9 issued.” Gorman, Exh. No. ___(MPG-1T), at page 12, lines 12-13. ICNU fails to
10 provide any evidence, however, of any positive or negative correlation between
11 utility bond yields and authorized utility returns on equity.

12 **Q. Has ICNU presented a return on equity study in this proceeding?**

13 A. Yes. ICNU presented a return on equity study as Exhibit No. ___(MPG-3). In
14 that study, ICNU relied upon a constant growth discounted cash flow (“DCF”)
15 model, a sustainable growth DCF, a multi-stage growth DCF, risk premium, and
16 capital asset pricing model. The results of ICNU’s return on equity study are
17 provided in Table 1 below.

18 **Table 1. ICNU Return on Equity Results**

Model	Low	High	Mean	Median	Source
Constant Growth DCF	5.70%	11.37%	9.10%	9.29%	Exh. No. ___(MPG-10)
Sustainable Growth DCF	7.21%	9.69%	8.42%	8.38%	Exh. No. ___(MPG-13)
Multi-Stage Growth DCF	7.55%	10.18%	9.01%	9.03%	Exh. No. ___(MPG-15)
Risk Premium	9.09%	9.44%	N/A	N/A	Exh. No. ___(MPG-1T)
CAPM	N/A	N/A	8.40%	N/A	Exh. No. ___(MPG-22)

1 **Q. Is PSE presenting a return on equity study in this proceeding?**

2 A. No. The scope of this proceeding is to consider whether a proposed global
3 settlement of five dockets is consistent with the public interest, and the
4 determination of the cost of capital, including the authorized return on equity for
5 PSE, is outside the scope of this proceeding. Additionally, even if PSE's
6 authorized return on equity were properly within the scope of this proceeding—
7 which it is not—PSE had only seven business days to prepare this rebuttal
8 testimony. PSE simply could not analyze ICNU's return on equity study within
9 the time allowed and prepare a study responding to ICNU's study. Therefore,
10 PSE is not presenting a return on equity study in this proceeding.

11 **Q. Does PSE have any comments regarding ICNU's return on equity study?**

12 A. Yes. ICNU's recommended return on equity in this proceeding (9.30 percent)
13 does not materially differ from ICNU's recommended return on equity in PSE's
14 2011 general rate proceeding (9.50 percent), in which this Commission authorized
15 a return on equity of 9.80 percent. Given the similarities in ICNU's suggested
16 returns on equity in the two proceedings, no compelling evidence exists to
17 warrant a reduction in PSE's authorized return on equity.

18 Moreover, the ICNU testimony fails to provide a complete picture because ICNU
19 has failed to provide evidence regarding the authorized returns on equity and
20 capital structure of those operating utilities contained within the holding
21 companies presented in ICNU's proposed proxy group. PSE researched those
22 authorized returns on equity and capital structures using the SNL Energy

1 databases. According to the SNL Energy database, the average authorized return
2 on equity for the operating utilities within ICNU's proposed proxy group is
3 10.08%, and the average capital structure for the operating utilities within ICNU's
4 proposed proxy group contains 48.80% equity. Please see Exhibit No. ___(DAD-
5 3) for a copy of the results of the research. Thus, each of the average authorized
6 return on equity and the average authorized capital structure of the operating
7 utilities in ICNU's proposed proxy group is substantially higher than that
8 advocated for PSE in this proceeding.

9 Finally, the cost of capital reductions proposed by Public Counsel and ICNU
10 ignore that fact that we are in unprecedented economic times where, in efforts to
11 improve economic growth, the Federal Reserve has engaged in expansionary
12 policies that have reduced interest rates to historic lows. The three or four-year
13 term of the proposed settlement and the pre-established K-factors protect
14 customers from the impacts of the inevitable increase in interest rates and capital
15 costs that will ultimately come when the Federal Reserve relaxes these
16 expansionary policies.

17 **B. The Determination of PSE's Authorized Cost of Debt for PSE is**
18 **Outside the Scope of This Proceeding**

19 **Q. Has Public Counsel made a recommendation with respect to PSE's cost of**
20 **debt?**

21 A. Yes. Public Counsel suggests that PSE's embedded debt cost is likely to decline
22 in the near-term. Hill, Exh. No. ___(SGH-1T), at page 14, line 8, through
23 page 16, line 10. Public Counsel acknowledges, however, that projections in

1 future interest rates are inherently subjective and that “it is certainly possible that
2 the U.S. economy could heat up and interest rates could rise as rapidly as [PSE]
3 currently projects” Hill, Exh. No. ____ (SGH-1T), at page 16, lines 1-2.
4 Thus, Public Counsel highlights the speculative nature in making prospective
5 adjustments to costs of debt capital and equity returns.

6 **Q. Does Public Counsel suggest what PSE’s cost of debt should be?**

7 A. No. Public Counsel fails to provide any suggested reduction in PSE’s authorized
8 cost of debt. Perplexingly, Public Counsel suggests that its opinion that costs of
9 debt are likely to continue to decline “provides further justification for the
10 Commission by reduce PSE’s allowed ROE to 9.0 percent” Hill, Exh.
11 No. ____ (SGH-1T) at page 16, lines 6-10. Public Counsel fails to provide any
12 evidence or rationale that would support a reduction in an authorized return on
13 equity due to alleged projections of reductions in cost of debt.

14 **Q. Has ICNU made a recommendation with respect to PSE’s cost of debt?**

15 A. Yes. ICNU has identified five PSE debt issuances that will mature and be
16 refinanced during the maximum four-years of the rate case stay-out period and
17 recommends that the Commission

18 request [PSE] to present supporting documentation on how it
19 intends to replace the maturing debt issuances and update its
20 embedded cost of long-term debt. In addition, the Commission
21 should direct the Company to update its cost of short-term debt.

22 Gorman, Exh. No. ____ (MPG-1T), at page 11, lines 17-20.

1 **Q. How does PSE respond to the recommendations of Public Counsel and**
2 **ICNU?**

3 A. As stated above, the scope of this proceeding is to consider whether a proposed
4 global settlement of five dockets is consistent with the public interest, and the
5 determination of the cost of capital, including the cost of long-term and short-term
6 debt for PSE, is outside the scope of this proceeding. Additionally, it is
7 impossible for PSE—or any party to this proceeding—to project likely changes in
8 interest rates during the four-year period. The proposals by these parties do not
9 comport with the rigorous studies and analyses upon which this Commission has
10 historically relied when making cost of capital determinations. Therefore, any
11 adjustment to the cost of either the long-term or short-term debt of PSE would be
12 speculative and inappropriate.

13 **C. Public Counsel Incorrectly Assumes that Decoupling Requires a**
14 **Lower Allowed Return on Equity**

15 **Q. Do parties in this proceeding suggest that the Commission reduce PSE's**
16 **authorized return on equity if the decoupling mechanism proposal?**

17 A. Yes, although as I discuss below, there is no evidence supporting their suggested
18 adjustments. Public Counsel asserts that, if the Commission were to adopt the
19 decoupling mechanism proposal, the Commission should reduce PSE's authorized
20 return on equity by 50 basis points. Hill, Exh. No. ___(SGH-1T), at page 11,
21 lines 16-18. Witness for Public Counsel asserts that this 50 basis point reduction
22 is supported by testimony on behalf of another party in a proceeding that occurred

1 seven years ago. Hill Exh. No. ____ (SGH-1T), at page 11, lines 14-18. Public
2 Counsel fails to provide similar testimony in this proceeding.

3 ICNU also asserts that, if the Commission were to adopt PSE's decoupling
4 mechanism proposal, the Commission should reduce PSE's authorized return on
5 equity. Gorman, Exh. No. ____ (MPG-1T), at page 27, lines 3-5. ICNU
6 recommends a 25 basis point reduction. Gorman, Exh. No. ____ (MPG-1T), at
7 page 28, lines 13-14. Like Public Counsel, ICNU fails to provide analysis in this
8 proceeding that such a reduction is warranted and instead relies on previous
9 testimony of its witness from other proceedings. Gorman, Exh. No. ____ (MPG-
10 1T), at page 28, lines 13-15.

11 Finally, Kroger asserts that, if the Commission were to adopt PSE's decoupling
12 mechanism proposal, the Commission should reduce PSE's authorized return on
13 equity by 25 basis points. Higgins, Exh. No. ____ (KCH-1T), at page 20, lines 12-
14 14.

15 **Q. Have other jurisdictions implemented reductions in authorized returns on**
16 **equity in connection with the adoption of proposed decoupling mechanism?**

17 A. Although a few jurisdictions have implemented reductions in authorized returns
18 on equity in connection with the adoption of proposed decoupling mechanism, a
19 comprehensive survey of jurisdictions conducted by Pamela Lesh Morgan, shows
20 that the vast majority of jurisdictions have not reduced authorized returns on
21 equity due to the implementation of a proposed decoupling mechanism. Table 2

1 below provides the results of the comprehensive analysis conducted by Ms.
2 Morgan.

3 **Table 2. Commission Decisions on Authorized Returns on Equity**
4 **in Light of Implementation of Decoupling Mechanisms**

Reduction in Return on Equity	Number of Decisions	Result of Settlement
None	56	28
10 basis points	9	4
25 basis points	3	1
50 basis points	4	0
Total	72	33

5 Pamela Lesh Morgan, “A Decade of Decoupling for US Energy Utilities: Rate
6 Impacts, Designs, and Observations,” at page 15 (2012) (available at
7 <http://switchboard.nrdc.org/blogs/rcavanagh/decouplingreportMorganfinal.pdf>).

8 As demonstrated by Table 2 above, the large majority (80 percent) of decisions
9 adopting decoupling make no reduction to the authorized returns on equity.

10 Among those decisions that did include a reduction in the authorized return on
11 equity, the majority have reductions (10 basis points) that are smaller than the
12 25 basis point reduction advocated by ICNU and Kroger and significantly smaller
13 than the 50 basis point reduction advocated by Public Counsel.

14 **Q. Have Public Counsel, ICNU, or Kroger provided evidence that the proposed**
15 **decoupling mechanism will reduce PSE’s business risk?**

16 A. No. Neither Public Counsel, ICNU, nor Kroger has provided evidence that the
17 proposed decoupling mechanism will reduce PSE’s business risk. Indeed, no
18 empirical evidence exists that quantifies how, if at all, decoupling changes a

1 utility's business risk. Indeed, an empirical study conducted by The Brattle
2 Group found that decoupling may actually *increase* a utility's overall business
3 risk to some extent. Joseph B. Wharton, *et al.*, "The Impact of Decoupling on the
4 Cost of Capital – An Empirical Investigation" (Mar. 2011) (available at
5 <http://www.brattle.com/documents/UploadLibrary/Upload922.pdf>). Given the
6 dearth of empirical evidence regarding the effect of decoupling mechanisms on
7 business risk, the reductions proposed by Public Counsel, ICNU, and Kroger are
8 arbitrary and wholly without support.

9 **III. THE DETERMINATION OF PSE'S AUTHORIZED**
10 **CAPITAL STRUCTURE IS OUTSIDE THE**
11 **SCOPE OF THIS PROCEEDING**

12 **A. Public Counsel's Proposal to Adjust PSE's Capital Structure is**
13 **Misplaced**

14 **Q. Does Public Counsel make a proposal to adjust PSE's authorized capital**
15 **structure?**

16 A. Yes. Public Counsel suggests that the Commission adjust PSE's authorized
17 capital structure as a purported "alternative means to address the lower risk
18 imparted by decoupling" Hill, Exh. No. ___(SGH-1T), at page 17, lines 9-
19 10; *see also* Hill, Exh. No. ___(SGH-1T), at page 16, line 11, through page 18,
20 line 11.

1 **Q. Does Public Counsel provide a rationale to support the proposed adjustment**
2 **PSE's authorized capital structure?**

3 A, No. Public Counsel's proposed adjustment to PSE's authorized capital structure
4 is a results-driven adjustment offered in lieu of Public Counsel's proposed
5 reduction in PSE's authorized return on equity. In other words, Public Counsel
6 offers the proposal as a means by which the Commission could adopt Public
7 Counsel's proposal but keep PSE's authorized return on equity at 9.8 percent by
8 adjusting PSE's authorized capital structure to include 37.5 percent common
9 equity and 62.5 percent debt. Mathematically, this achieves the same result as
10 reducing PSE's authorized return on equity to 9.0 percent but keeping PSE's
11 authorized capital structure at 48.0 percent common equity and 52.0 percent debt
12 ratio.

13 In other words, Public Counsel's suggested adjustment to PSE's authorized
14 capital structure is no different than Public Counsel's suggested adjustment to
15 PSE's authorized return on equity, which, as discussed above, is without support.
16 Moreover, this proposed adjustment is entirely results-driven and fails to
17 acknowledge how the adjustment (i) reflects the actual capital structure
18 supporting regulated activities or (ii) satisfies the balance of safety and economy
19 required by Commission orders. A capital structure with 37.5 percent equity
20 would (i) be inconsistent with the direction taken by the Commission for more
21 than a decade, encouraging the PSE to increase its equity level; (ii) contain
22 significantly less equity than the 44 percent minimum contained within the

1 merger commitments approved by this Commission; and (iii) likely affect the risk
2 and credit profile of PSE significantly.

3 **B. PSE's Capital Structure for the Twelve Months Ending December 31,**
4 **2012, Contained 48.65 Percent Equity and Not 46.6 Percent Equity as**
5 **Suggested by ICNU**

6 **Q. How do you respond to ICNU's assertion that PSE's actual common equity**
7 **ratio has been approximately 46 percent for the last two years?**

8 A. ICNU's calculation fails to adjust for the impact of unrealized non-cash mark-to-
9 market accounting gains or losses on PSE's capitalization. If ICNU were to make
10 this adjustment alone, then the result would be a capital structure with an equity
11 component of 48.65 percent for the twelve months ending December 31, 2011.

12 **Q. Please explain how ICNU calculates PSE's capital structure.**

13 A. ICNU calculates a capital structure based on information "recorded on [PSE's]
14 FERC Form 1 over the period March 31, 2011 through December 31, 2012."
15 Gorman, Exh. No. ___(MPG-1T), at page 8, lines 9-10. From this information,
16 ICNU concludes that "[d]uring this time period, PSE increased its common equity
17 ratio from 45.7 percent at year-end 2011, up to 46.07 percent at year-end 2012."
18 Gorman, Exh. No. ___(MPG-1T), at page 8, lines 10-11.

19 **Q. Why is it appropriate to adjust for the impact of unrealized non-cash mark-**
20 **to-market accounting gains or losses on PSE's capitalization?**

21 A. It is necessary to adjust for the impact of unrealized non-cash mark-to-market
22 accounting gains or losses on PSE's capitalization as well as adjustments for non-
23 regulated subsidiary retained earnings and pension accounting for the same

1 reasons discussed below as to why it is necessary to adjust returns on equity to
2 calculate an operating return on equity.

3 As discussed below, the Commission's established practice for the recovery of
4 commodity costs is to reflect in rates the actual commodity costs PSE has, or
5 expects, to incur. Therefore, unrealized non-cash mark-to-market accounting
6 gains or losses from marking derivatives to market as required by generally
7 accepted accounting principles are not, and should not, be reflected in rates.

8 **Q. What was PSE's capital structure for the twelve months ending**
9 **December 31, 2011?**

10 A. As shown below in Table 3 below, PSE's capital structure for the twelve months
11 ending December 31, 2011, contained an equity component of 48.65 percent.
12 This equity component contained in this capital structure slightly exceeds the
13 equity component of 48 percent authorized in PSE's last rate proceeding.

14 **Table 3. PSE Capital Structure**
15 **(for the twelve months ending December 31, 2011)**

Description	Amount^a	Ratio
Short-Term Debt	\$159,106,118	4.39%
Long-Term Debt	\$3,509,682,195	49.12%
Common Stock	\$3,476,036,691	48.65%
Total	\$7,144,825,004	100.00%

^aAverage of Month-End Balances

16 This is the same capital structure presented in Exhibit No. ___(KJB-7) at page 3.

1 **Q. What was PSE’s capital structure for the twelve months ending**
2 **December 31, 2012?**

3 A. As shown below in Table 4 below, PSE’s capital structure for the twelve months
4 ending December 31, 2012, contained an equity component of 48.65 percent.

5 **Table 4. PSE Capital Structure**
6 **(for the twelve months ending December 31, 2012)**

Description	Amount^a	Ratio
Short-Term Debt	\$94,047,784	1.26%
Long-Term Debt	\$3,773,845,605	50.44%
Common Stock	\$3,613,954,006	48.30%
Total	\$7,481,847,395	100.00%

^aAverage of Month-End Balances

7 This equity component contained in this capital structure slightly exceeds the
8 equity component of 48 percent authorized in PSE’s last rate proceeding.

9 **Q. Is there a “mismatch” between the common equity presented on page 3 of**
10 **Exhibit No. ___(KJB-7) and the common equity presented on page 8 of the**
11 **same exhibit, as ICNU claims?**

12 A. The common equity presented on page 3 of Exhibit No. ___(KJB-7) is different
13 from the common equity presented on page 8 of the same exhibit. Specifically,
14 the common equity presented on page 3 of Exhibit No. ___(KJB-7) is \$3,476
15 million of common equity at year-end 2011, and the common equity presented on
16 page 8 of Exhibit No. ___(KJB-7) is \$3,220 million of common equity at year-
17 end 2011.

1 The differences between these two common equity amounts, however, explicitly
2 illustrate the importance of the adjustments made by PSE—and accepted by this
3 Commission—in calculating the appropriate capital structure for ratemaking
4 purposes. The amounts presented on page 3 of Exhibit No. ___(KJB-7) have
5 been adjusted to reflect the appropriate capital structure for ratemaking purposes,
6 whereas the amounts presented on page 8 of Exhibit No. ___(KJB-7) are in FERC
7 accounts and have not been so adjusted. As pointed out by ICNU, the difference
8 between these two amounts (\$255.8 million) is material and largely accounts for
9 the differences between the capital structures presented by PSE and ICNU.

10 **IV. ICNU MISINTERPRETS CERTAIN INFORMATION**
11 **REGARDING PUGET ENERGY AND PSE**

12 **A. ICNU Incorrectly Asserts that PSE’s Operating Return on Equity in**
13 **Calendar Year 2012 Was 10.75 Percent**

14 **Q. How do you respond to ICNU’s claim that PSE’s return on equity in**
15 **calendar year 2012 was 10.75 percent?**

16 A. PSE disagrees with ICNU’s calculation of the return on equity. ICNU’s
17 calculation fails to make the following adjustments to the calculated return on
18 equity necessary to reflect the regulated nature of PSE’s operations:

- 19 • ICNU’s calculation fails to exclude unrealized non-cash
20 mark-to-market accounting gains and losses on derivative
21 instruments, after tax, from earnings.
- 22 • ICNU’s calculation fails to remove the impacts of
23 accumulated other comprehensive income (“OCI”),
24 subsidiary retained earnings, pension accounting and
25 retained earnings of derivative instruments.

- ICNU's calculation fails to remove the accumulated retained earnings from unregulated activities, such as Puget Western ("PWI").
- ICNU's calculation fails to adjust average common equity for the impact of the average of monthly averages.

If ICNU were to make these three adjustments, then the result would be a return on equity of 7.7 percent in calendar year 2012.

Q. How does ICNU calculate the 10.75 percent return on equity?

A. ICNU calculated a return on equity of 10.75 percent, based on earnings of \$356,170,000, and an average common equity of \$3,313,180,000. Gorman, Exh. No. ___(MPG-1T), at page 4, Table 1. ICNU's calculation is similar to the return on equity of 10.8 percent calculated in accordance with U.S. Generally Accepted Accounting Principles ("GAAP") which is different from established regulatory methodology.

Q. Why is it appropriate to make the four adjustments listed above to the return on equity?

A. These four adjustments are necessary to calculate PSE's operating return on equity, which is an annualized non-GAAP financial measure. PSE uses the operating return on equity because it is a better indicator of the utility's operating performance and PSE's earnings from regulated operations.

The Commission's established practice for the recovery of commodity costs is to reflect in rates the actual commodity costs PSE has, or expects, to incur. These costs are recovered through the Purchased Gas Adjustment ("PGA") and Power Cost Adjustment ("PCA") mechanisms, with general rates set to reflect the

1 expected level of electric energy costs in a base rate. Unrealized non-cash mark-
2 to-market accounting gains or losses from marking derivatives to market (as
3 required by GAAP) are not, and should not, be reflected in rates. As a result, the
4 impact of these unrealized non-cash mark-to-market accounting gains or losses on
5 PSE's capitalization, generally reflected in OCI, must also be removed for
6 ratemaking purposes. Additionally, it is appropriate to remove the accumulated
7 retained earnings of PWI from PSE's consolidated capital structure because those
8 accumulated retained earnings were generated from unregulated activities. This
9 treatment is consistent with PSE's past practices in general rate proceedings and is
10 consistent with capital structures included in Commission Basis Reports. Failure
11 to adjust for these items would result in an inconsistency between (i) the balance
12 sheet impacts of these items and (ii) the cost recovery of these items.

13 **Q. What was PSE's return on equity in calendar year 2012?**

14 A. As shown below in Table 5 below, PSE's operating return on equity in calendar
15 year 2012 was 7.7 percent. This operating return on equity is 210 basis points
16 lower than the 9.80 percent return on equity authorized in PSE's last rate
17 proceeding.

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Table 5. PSE Earned Return on Equity (Thousands)

	Earnings	Average Common Equity	Return on Equity
Return on Equity -- GAAP	\$356,170	\$3,313,183	10.8%
Less/Plus: Unrealized gains and losses on derivative instruments, after-tax	(77,428)	—	*
Other Equity Adjustments	—	268,610	*
Impact of Average of Monthly Averages (AMA)	—	32,131	*
AMA Regulated Return on Equity	\$278,742	\$3,613,924	7.7%

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**B. ICNU’s Concern Regarding the Dividend Payout Ratio of PSE is
Misplaced**

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**Q. Is ICNU’s expressed concern regarding the dividend payout ratio of PSE
misplaced?**

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A. Yes. ICNU expresses concern that “PSE was paying out approximately 80% of its earnings” and that “its payout ratio to its holding company was . . . relatively high.” Gorman, Exh. No. ___(MPG-1T), at page 8, lines 19-23. PSE makes these distributions to Puget Energy, Inc. (“Puget Energy”) in large part to service debt obligations at the Puget Energy level. Puget Energy has used these funds to finance, reduce and refinance its debt obligations. It would be improper to suggest that this payout ratio yielded an extraordinary benefit to Puget Energy shareholders. Indeed, average dividends paid from Puget Energy to shareholders over the past three years are lower than average dividends to Puget Energy shareholders over the past decade. In other words, the equity investors today are receiving less in dividends than were shareholders prior to the merger.

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1 **Q. Please describe the credit facilities at Puget Energy?**

2 A. At the time of the merger in February 2009, Puget Energy entered into a
3 \$1.225 billion five-year term-loan and a \$1.0 billion five-year capital expenditure
4 credit facility for funding capital expenditures. On February 10, 2012, Puget
5 Energy entered into a \$1 billion five-year revolving¹ senior secured credit facility.
6 Puget Energy used initial borrowings under this five-year revolving facility to
7 repay debt outstanding under the term loan and capital expenditure credit facility,
8 and Puget Energy terminated those agreements.

9 On June 15, 2012, Puget Energy issued \$450 million of senior secured notes,
10 which mature on July 15, 2022, and have an interest rate of 5.625 percent. Puget
11 Energy used net proceeds from this note offering to pay down \$425 million of the
12 \$859 million balance outstanding on the five-year revolving facility.

13 As of December 31, 2012, Puget Energy had a \$434 million balance outstanding
14 on the five-year revolving facility. In February 2013, Puget Energy reduced the
15 size of five-year revolving facility from \$1 billion to \$800 million. (The five-year
16 revolving facility also has an accordion feature that, upon the banks' approval,
17 would increase the size of the facility to \$1.3 billion.) These refinancings were
18 made in line with the merger commitments approved by this Commission that
19 required PSE to refinance the term loan with intermediate or long-term debt.

¹ As a revolving facility, amounts borrowed may be repaid without a reduction in the size of the facility.

1 **Q. What has Puget Energy’s dividend to shareholders been since the merger?**

2 A. As shown below in Table 6 below, Puget Energy’s annual average dividends to
3 shareholders since the merger has been \$98.334 million per year:

4 **Table 6. Puget Energy Dividend**
5 **(since merger in 2009)**
6 **(Thousands)**

Year	Dividend
2009 (post-merger)*	\$82,991
2010	\$104,311
2011	\$117,441
2012	\$88,594
Average	\$98,334

7 * February 6, 2009, through December 31, 2009

8 This average annual dividend to shareholders is less than the ten-year average
9 annual Puget Energy dividend of \$108.773 million to shareholders, as shown in
10 Table 7 below.

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**Table 7. Puget Energy Dividend
(Calendar Years 2003-2012)
(Thousands)**

Year	Dividend
2003	\$93,965
2004	\$99,386
2005	\$100,172
2006	\$116,094
2007	\$116,914
2008	\$129,677
2009 (pre-merger)*	\$38,188
2009 (post-merger)**	\$82,991
2010	\$104,311
2011	\$117,441
2012	\$88,594
Average	\$108,773

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* January 1, 2009, through February 5, 2009
** February 6, 2009, through December 31, 2009

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Given the relative reduction in annual average Puget Energy dividends to shareholders since the merger and considering the growth of PSE over this period, any potential implication that Puget Energy is paying extraordinary dividends to shareholders is patently false. Indeed, the Puget Energy dividends in calendar year 2012 were the smallest dividends in over a decade.

1 **C. ICNU Erroneously Suggests that PSE's Pension Expense is Not**
2 **Indicative of Current Contribution Levels**

3 **Q. Is ICNU correct that the recovery of PSE's pension contributions in rates is**
4 **not indicative of current contribution levels?**

5 A. No. ICNU incorrectly asserts that PSE's pension recovery is not indicative of
6 current contribution levels. Specifically, ICNU suggests as follows:

7 the 2009 and 2010 contribution levels are significantly higher than the
8 2011 and 2012 amounts. The four-year average amount during the 2009
9 through 2012 period of \$17.8 million is over 50% higher than the current
10 2012 level. As a result, the amount proposed by PSE is overstated and is
11 not indicative of the current contribution levels.

12 Gorman, Exh. No. ___(MPG-1T), at page 14, lines 10-14.

13 **Q. What time period does ICNU reference in testimony regarding pension**
14 **contributions?**

15 A. ICNU uses 12-month periods ending June 30, 2009 – 2012, consistent with the
16 ERF test period, to analyze pension contributions. This is an important distinction
17 because pension contributions in 2011 were low and as a result, skew the numbers
18 for the last two periods.

19 **Q. What is PSE's projected pension contributions for test year ending June**
20 **2013?**

21 A. PSE's total pension contribution from July 1, 2012 to June 30, 2103 is projected to
22 be \$21.6 million, which is based on (i) the additional \$11.4 million contributed in
23 the second half of calendar year 2012; (ii) the pension contribution of \$5.1 million
24 made in the first quarter of 2013; and (iii) the pension contribution of \$5.1 million

1 scheduled for the second quarter of 2013. This additional test year illustrates that
 2 PSE's pension contributions are in line with the historical average. Similarly,
 3 PSE's pension contributions in calendar year 2012 was \$22.8 million, which is
 4 also in line with the average annual pension contributions since July 1, 2008, as
 5 shown in Table 8 below.

6 **Table 8. PSE Pension Contributions**
 7 **(Thousands)**

Year	Pension Contributions
7/1/2008 - 6/30/2009	\$30,500
7/1/2009 - 6/30/2010	\$24,400
7/1/2010 - 6/30/2011	\$5,000
7/1/2011 - 6/30/2012	\$11,400
7/1/2012 - 6/30/2013*	\$21,600
Average	\$18,580

* PSE's pension contributions for the period July 1, 2012, through March 31, 2013, were \$16,500,000, and PSE has a pension contribution of \$5,100,000 scheduled for June 2013.

8 **Q. Is the 4-year average contribution used in the ERF proceeding representative**
 9 **of current of pension contributions?**

10 A. Yes. As presented above, the average is representative of the pension
 11 contributions made in 2012. As discussed in the Prefiled Direct Testimony of
 12 Katherine J. Barnard, Exhibit No. ___(KJB-11T), the use of the 4-year average is
 13 consistent with the methodology adopted in recent general rate cases, including
 14 PSE's 2011 general rate case. Therefore, ICNU's adjustment should be rejected.

V. CONCLUSION

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Q. Does this conclude your prefiled rebuttal testimony?

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A. Yes.