

**Exh. CRM-1T
Dockets UE-180899/UG-180900
Witness: Chris R. McGuire**

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.

Respondent.

**DOCKETS UE-180899 and
UG-180900
(Consolidated)**

TESTIMONY OF

Chris R. McGuire

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Testimony in Support of Settlement

January 30, 2019

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1 I. INTRODUCTION

2

3 Q. Please state your name and business address.

4 A. My name is Chris R. McGuire. My business address is The Richard Hemstad Building,
5 1300 S. Evergreen Park Drive S.W., Olympia, WA 98504.

6

7 Q. Who employs you and in what capacity?

8 A. I work in the Regulatory Services Division of the Washington Utilities and
9 Transportation Commission (“Commission”) as Assistant Director of Energy Regulation.
10 I have worked at the Commission since May 2012, and in my current position since April
11 2018.

12

13 Q. Would you please state your educational and professional background?

14 A. I graduated from the University of Washington in 2002 with a Bachelor of Science
15 degree in Cell and Molecular Biology. I graduated from the University of Colorado in
16 2010 with a Master of Business Administration and a Master of Science in
17 Environmental Studies. Prior to my employment with the Commission, I held various
18 research and analytical positions at the University of Washington, the University of
19 Colorado and the National Renewable Energy Laboratory.

1 Reform”). The Settling Parties agree to a March 1, 2019, effective date for the agreed-
2 upon tariff revisions.

3 The Settlement also includes a 2.66 percent increase in low-income assistance for
4 natural gas customers, and limits the rate increase for natural gas transportation
5 customers to 2.9 percent. It allows PSE to defer depreciation expense and cost of capital
6 related to certain investments in advanced metering infrastructure (“AMI”). Additionally,
7 the Settlement requires that PSE not remotely disconnect customers for nonpayment
8 while the Commission is considering rules pertaining to remote disconnection.

9
10 **Q. Does the Settlement include any additional agreements beyond those mentioned**
11 **above?**

12 A. Yes. The Settlement provides for a number of additional agreements that focus on
13 preserving parties’ abilities to contest certain issues in future proceedings. Those issues
14 are discussed in more detail below but, in short, the Settlement provides that (1) a
15 prudence determination has not been made with respect to AMI, and all costs related to
16 AMI are expressly removed from all revenue requirement calculations in this proceeding,
17 (2) because the revenue requirement calculation is a black box and, accordingly, the plant
18 in service used to calculate depreciation and rate base remains unspecified, parties
19 reserve the right to undertake a prudence review of any and all investments transferred to
20 plant since PSE’s 2017 general rate case, and (3) there is no agreement on the proper
21 accounting and ratemaking treatment of the “interim” reversals of protected-plus EDIT
22 for the period January 1, 2018, through February 28, 2019.

1 Finally, the Settling Parties agree that no terms of the Settlement shall be
2 considered precedential. Importantly, support of this Settlement should not be construed
3 as support for expedited rate filings (ERFs), generally, or support for the specific
4 conceptual framework and methodological detail of the filing in this case.
5

6 **Q. Please summarize why Staff supports the Settlement.**

7 A. The Settlement arrives at a fair and reasonable outcome that is the result of substantial
8 compromise. This Settlement provides PSE with significant and justified revenue support
9 for its natural gas operations within a 120-day procedural window while avoiding a rate
10 increase for electric customers. The Settlement also resolves one of the remaining Tax
11 Reform items by beginning to pass back to customers protected-plus EDIT. Further, an
12 increase to natural gas low-income funding will help to mitigate the impact of the natural
13 gas rate increase for the most vulnerable of PSE's customers.

14 The Settlement also takes a balanced approach with respect to PSE's AMI
15 investments. It is important to Staff for parties to be able to conduct a thorough business
16 case analysis and prudence evaluation of investments in AMI in a full adjudication and
17 with full discovery availability. The Settlement preserves parties' abilities to review, and
18 if necessary challenge, the Company's recovery of those investments by explicitly
19 removing all rate impacts associated with AMI from the revenue requirement calculation
20 and by providing that parties may undertake a prudence evaluation of AMI in a future
21 proceeding. In turn, the Settlement allows PSE to defer for later consideration for
22 recovery depreciation expense for ongoing AMI investments as well as the cost of capital
23 for AMI in service during the test year in this case.

1 IV. SETTLEMENT AGREEMENT

2
3 a. *Black Box Settlement*

4
5 Q. Why is this a “black box” settlement?

6 A. Although there is agreement that the overall settlement package produces a fair and
7 reasonable outcome, the parties do not have agreement on which adjustments are
8 included or excluded in the final revenue requirement calculations.

9 Moreover, a number of the parties to this case, including Staff, contend that the
10 expedited nature of this case (and for ERFs more generally) ensures that the level of
11 review is substantially shallower than it would be for a general rate case. This creates
12 material challenges for reviewing the prudence of plant investments, which requires
13 analysis of project cost data, assessments of the company’s management of contracts, a
14 review of decision-making documentation, and a deep understanding of the underlying
15 business cases. Importantly, because utilities frequently fail to adequately support their
16 investments in their initial filings, parties often have to obtain much of the evidence for a
17 prudence determination through the discovery process, which is severely constrained in
18 an ERF.

19 Because a comprehensive prudence review is not possible in an abbreviated
20 adjudication, the Settling Parties agreed that a black-box settlement was a practical way
21 to preserve parties’ abilities to conduct in a future proceeding a more thorough review of
22 plant investments that were included in this ERF.

1 **Q. Does the Settlement memorialize this understanding?**

2 A. Yes. Beyond indicating that this is a black box settlement, the Settlement Agreement
3 reserves the right for the Settling Parties to undertake a prudence review of any and all
4 plant investments that were not incorporated in rates in PSE's 2017 general rate case. In
5 other words, no individual transfer to plant is assumed to be included in the revenue
6 requirements agreed to in this Settlement.

7

8 **Q. Given that the Settlement is a black box, what rate base and authorized rate of**
9 **return will PSE use for reporting purposes?**

10 A. For reporting purposes, PSE will use the rate base and rate of return approved in the 2017
11 general rate case, except the rate of return was updated for changes to cost of debt.
12 Therefore, PSE will use a rate of return of 7.49 percent for reporting purposes.

13

14 ***b. Revenue Requirement***

15

16 **Q. What do the Settling Parties agree to in terms of electric and natural gas revenue**
17 **requirements?**

18 A. For PSE's electric operations, the Settling Parties agree to no change in revenues relative
19 to revenues produced at current rates. For PSE's natural gas operations, the Settling
20 Parties agree to an increase of \$21.5 million in revenues relative to revenues produced at
21 current rates. The revenue calculations for both electric and natural gas operations
22 include the effect of passing back to customers protected-plus EDIT.

23

1 **Q. Why is no change to electric rates reasonable?**

2 A. PSE's filing requested an increase in electric revenue of \$18.9 million. In this Settlement,
3 PSE agreed to accept no increase in electric rates in consideration of the broader
4 settlement package, thereby foregoing its claim to a revenue deficiency. This settlement
5 term provides electric ratepayers with relief from a potential rate increase.

6

7 **Q. Why is a \$21.5 million increase to natural gas revenues reasonable?**

8 A. In its filing, PSE presented a natural gas revenue deficiency of \$37.4 million. However,
9 in order to avoid triggering the Commission's rules with respect to general rate cases (i.e.
10 in order to propose an expedited schedule), PSE constrained its request to a revenue
11 increase of less than three percent. Therefore, the \$21.7 million in requested additional
12 revenue is only a portion of PSE's represented revenue deficiency.

13 Parties attempting to assess whether PSE's request of \$21.7 million was excessive
14 would need to begin with an assessment of the \$37.4 million represented deficiency.
15 Through its review of the materials supporting the \$37.4 million revenue deficiency
16 representation, Staff concluded that the Company's initial request for an increase in gas
17 revenues was justified. Therefore, the agreement to provide PSE with \$21.5 million in
18 additional revenue is reasonable.⁵

19

20 **Q. Do these revenue calculations include the pass-back of any Tax Reform items?**

21 A. Yes. The revenue calculations in the Company's as-filed request and in the Settlement
22 agreement both include the effect of passing back to customers protected-plus EDIT. The

⁵ The agreed-upon increase of \$21.5 million is slightly different from the Company's initially requested \$21.7 million due to implementation of the settlement terms regarding natural gas transportation customers.

1 grossed-up, annualized EDIT amounts embedded in these calculations are \$25.9 million
2 for electric operations and \$6.1 million for gas operations. I discuss Tax Reform items in
3 more detail in Section IV(b), below.
4

5 **Q. Does the Settlement resolve this proceeding in an expedited manner?**

6 A. Yes. PSE filed this ERF on November 7, 2018, so the statutory suspension deadline for
7 resolving this case is September 9, 2019. Because the last date on the procedural schedule
8 (the due date simultaneous post-hearing briefs) is April 10, 2019, this proceeding would
9 have likely lasted into May 2019, and possibly much longer. This Settlement allows rates
10 to become effective on March 1, 2019, which is less than 120 days after the filing date.

11 Parties to the 2017 Multi-Party Settlement agreed to support (or at least not
12 oppose) a 120-day procedural schedule for this ERF. The March 1, 2019, rate effective
13 date in this ERF Settlement allows full resolution of this case in 114 days.

14
15 ***c. Tax Reform Items***

16
17 **Q. What Tax Reform items are at issue in this case?**

18 A. PSE's filing included a proposal to begin passing back to customers one specific element
19 of the Tax Cuts and Jobs Act, namely protected-plus EDIT.
20

21 **Q. What is "protected-plus" EDIT?**

22 A. First, it's important to understand that in the context of Tax Reform, "excess deferred
23 income taxes," or EDIT, is simply the portion of deferred income taxes that were

1 collected over the years from ratepayers but are no longer owed to the Internal Revenue
2 Service (“IRS”). Because utilities can claim accelerated depreciation for tax purposes
3 (which decreases taxable income in the in years and increases taxable income in the out
4 years), they can, in effect, “defer” payment of taxes to the IRS. Given that depreciation
5 expense is calculated in a straight-line manner for ratemaking purposes (to allocate plant
6 costs equitably across the generations of customers benefitting from the plant), taxes are
7 not deferred from the perspective of the ratepayer. Stated more simply, companies collect
8 taxes from ratepayers even though some of those taxes are not immediately owed to the
9 IRS. The taxes that have been collected from ratepayers that are owed to the IRS, but
10 have not yet been paid to the IRS, are booked by the company as a deferred tax liability.

11 If the corporate tax rate were to have remained constant at 35 percent, the full
12 deferred tax liability would have eventually been paid to the IRS. However, after the
13 corporate tax rate was reduced to 21 percent, a significant portion of that liability was no
14 longer owed to the IRS over any time horizon. The amount that the Company has
15 collected from ratepayers that is no longer owed to the IRS is called “excess” deferred
16 income taxes.

17 EDIT can be divided up into two basic categories: protected and unprotected.
18 Protected EDIT arises from the differences between tax and regulatory depreciation for
19 utility plant. Unprotected EDIT arises from those same differences for everything else.
20 As discussed below, the tax code and the Internal Revenue Service’s rules require special
21 treatment for protected EDIT. However, due to technical issues associated with many
22 companies’ plant accounting software, certain plant-related unprotected EDIT is
23 indistinguishable from protected EDIT. Because there is no practical way of identifying

1 what plant-related EDIT is protected versus unprotected, the plant-related unprotected
2 EDIT is left lumped in with the protected EDIT.

3 The term “protected-plus” EDIT is meant to indicate that although IRS
4 normalization rules only apply to protected EDIT, the EDIT balances utilities are
5 subjecting to IRS normalization rules contain protected EDIT *plus* some amount of
6 unprotected EDIT. Because “protected-plus” EDIT captures all EDIT associated with
7 utility plant, the term “plant-related” EDIT can be used interchangeably with “protected-
8 plus” EDIT.

9
10 **Q. How will the protected-plus EDIT flow back to ratepayers?**

11 A. The Settlement provides for protected-plus EDIT to be passed back to ratepayers through
12 a separate tariff schedule, Schedule 141X.

13
14 **Q. How are the specific protected-plus EDIT amounts calculated?**

15 A. The IRS requires that protected EDIT be passed back to ratepayers no faster than the
16 underlying deferred tax liability would “reverse” under the Average Rate Assumption
17 Method (ARAM). Therefore, the protected-plus EDIT calculations are made consistent
18 with ARAM. The grossed-up, annualized EDIT reversals consistent with ARAM are
19 \$25.9 million for electric operations and \$6.1 million for gas operations. These amounts
20 are based on EDIT reversals in the 2018 period.

21
22 **Q. Does this completely resolve all issues related to protected-plus EDIT?**

23 A. No, it does not. Although annualized, protected-plus EDIT will begin flowing back to
24 customers on March 1, 2019, there is disagreement among the parties regarding the

1 proper accounting and ratemaking treatment of protected-plus EDIT reversals that
2 occurred between January 1, 2018, and February 28, 2019. This time period represents
3 the “interim” period where the new tax law was in effect, but protected-plus EDIT
4 reversals were not yet captured in customer rates. There is also disagreement on whether
5 the entire EDIT amount on the Company’s books on January 1, 2018, is owed back to
6 customers dollar-for-dollar.

7 Although the disagreement is significant, the Settling Parties agree that ratepayers
8 can begin receiving the full annualized benefit of protected-plus EDIT on March 1, 2019.
9 The disposition of the interim reversals and the proper ratemaking treatment thereof will
10 be subject to adjudication in PSE’s next general rate case.

11
12 **Q. Are there other Tax Reform items that have yet to be resolved for PSE?**

13 A. Yes, besides the interim protected-plus EDIT reversals discussed above, there are two
14 categories of issues remaining: (1) unprotected EDIT and (2) the interim over-collection
15 of tax expense for the period January 1, 2018, to April 30, 2018. These issues are
16 identified in PSE’s petition for an accounting order in Dockets UE-171225 and UG-
17 171226. The Settling Parties agree that these two additional Tax Reform items will be
18 addressed in PSE’s next general rate case.

19
20 *d. Advanced Metering Infrastructure*

21
22 **Q. Did PSE’s rate request include recovery of its investment in advanced metering**
23 **infrastructure (AMI)?**

1 A. Yes, it did. Embedded in the electric test year results of operations was more than \$44
2 million in AMI net plant in service, and embedded in the natural gas test year results of
3 operations was more than \$16 million in AMI net plant in service.

4
5 **Q. How does the Settlement address these investments?**

6 A. The Settlement includes two basic agreements with respect to AMI: (1) the revenue
7 requirements agreed to in this case explicitly remove all plant in service related to AMI,
8 and (2) PSE is allowed to defer, for future consideration by the Commission, depreciation
9 expense associated with AMI and a return on test year AMI plant in service.

10

11 **Q. What is the purpose of removing all plant in service related to AMI from the**
12 **revenue requirement calculations?**

13 A. It was important to Staff to preserve parties' abilities to review the prudence of
14 investments in AMI in a full adjudication. Explicit removal of all AMI plant in service
15 from the revenue requirement calculations ensures those investments have not received
16 implicit approval through inclusion in rates and, thus, allows parties to challenge
17 recovery of AMI if those investments are shown to be imprudent in a future proceeding.

18 It is important to recognize that AMI presents unique challenges with respect to a
19 prudence review, especially given that the business case for AMI depends on the promise
20 of benefits that are to a degree unknown and dependent upon future action on the part of
21 the utility, well beyond when AMI is placed in service. Therefore, a definitive
22 determination of prudence cannot be made at a single point in time; rather, a review of
23 prudence of AMI will be an ongoing effort to ensure that the utility is held accountable

1 for continuously pursuing AMI benefits for ratepayers. For that reason, Staff believes
2 AMI is a compelling candidate for performance-based regulation.

3
4 **Q. Please explain the agreement to allow the Company to defer depreciation expense**
5 **associated with AMI and return on test year plant in service.**

6 A. First, it's important to clearly delineate between the two sub-components: (1) deferral of
7 depreciation expense and (2) deferral of return on test year plant in service.

8 First, regarding the deferral of depreciation expense, the Settling Parties agreed to
9 an AMI deferral mechanism that is similar to what the Commission granted Avista in
10 Dockets UE-170327 and UG-170328.⁶ The Settlement allows PSE to defer its book
11 depreciation expense on its AMI investments beginning March 1, 2019. This book
12 depreciation expense includes depreciation expense associated with all AMI investments,
13 including AMI investments beyond the test year. The Company will book this
14 depreciation expense in FERC Account 182.3. This account will not accrue a carrying
15 charge.

16 Second, regarding deferral of return on test year plant in service, the parties
17 agreed that the Company may defer its return at its weighted average cost of capital. PSE
18 will book this deferred return on capital to FERC Account 186. This account will not
19 accrue a carrying charge.

20

⁶ *Avista Corporation*, Petition for an Accounting Order Authorizing Deferred Accounting Treatment related to Advanced Metering Infrastructure and Approval of Depreciation Rate, Dockets UE-170327 and UG-170328, Order 01 (September 14, 2017).

1 **Q. What is the purpose of these AMI deferrals?**

2 A. Given the removal of AMI from the revenue requirement calculations, the Company will
3 not be recovering depreciation expense associated with those investments, and will not be
4 earning a return on the AMI plant in service. Absent the agreement to remove AMI from
5 the revenue requirement calculations, return of and on those investments would be baked
6 into rates for the portion of the Company's AMI platform that has been placed in service
7 as of the test year. Allowing the Company to defer AMI depreciation and return on test
8 year plant in service allows the Company an opportunity to recover those costs in a future
9 proceeding. Allowing the Company to defer depreciation expense on the AMI
10 investments placed in service after the test year also allows for consistent regulatory
11 treatment for investor-owned utilities investing in AMI.

12
13 **Q. Is there agreement that PSE should be allowed to recover these AMI deferral
14 accounts in full?**

15 A. No, there is not. This Settlement allows PSE to defer AMI depreciation and cost of
16 capital for future consideration by the Commission. The recovery of any cost associated
17 with AMI is dependent upon a finding of prudence. In the event PSE's investments in
18 AMI are determined to be imprudent, recovery of these deferred amounts will be
19 challenged.

20 Further, parties may have differing perspectives on the ultimate recoverability of
21 the deferred return on AMI plant in service at the full weighted average cost of capital.
22 Indeed, the booking of the deferred cost of capital to FERC Account 186 implies that the
23 recovery of this deferral is more uncertain. However, the Settling parties agreed that the

1 issue of to what extent (or whether) the Company should be allowed recovery of the full
2 balance on this account can be taken up in a future proceeding.

3
4 ***e. Low Income Funding***

5
6 **Q. Does the Settlement include increased support for low-income customers?**

7 A. Yes. The Settlement provides for a 2.66 percent (approximately \$130,000) increase in
8 annual natural gas low-income Home Energy Lifeline Program (“HELP”) funding. The
9 2.66 percent increase in HELP funding aligns with the 2.66 percent revenue increase to
10 residential natural gas customers.

11 Annual electric HELP funding will remain unchanged.

12
13 ***f. Gas Transportation Customers***

14
15 **Q. Please explain what was at issue with respect to gas transportation customers.**

16 A. Although PSE requested an overall natural gas revenue increase of less than three
17 percent, certain natural gas transportation customers would have experienced an increase
18 of substantially more than three percent. This Settlement does not address whether
19 increases of more than three percent for certain sub-classes of customers should trigger
20 the Commission’s rules with respect to general rate proceedings, pursuant to WAC 480-
21 07-505(1)(b).⁷

⁷ WAC 480-07-505(1)(b) states that “the commission will initiate a general rate proceeding in response to a filing by a public service company ... requesting to change its rates if ... [t]ariffs would be restructured such that the gross revenue provided by any one customer class would increase by three percent or more.”

1 **Q. How does the Settlement resolve this issue?**

2 A. This Settlement limits rate increases to 2.90 percent for the following individual
3 schedules: 31, 31T, 41, 41T, 61, 85, 85T, 86, 86T, 87, and 87T.

4

5 ***g. Remote Disconnections***

6

7 **Q. Please explain what was at issue with respect to remote disconnections.**

8 A. Parties were concerned that the Company may remotely disconnect customers for
9 nonpayment before the Commission completes rules with respect to remote
10 disconnections. The Commission is currently considering rules pertaining to remote
11 disconnections in Docket U-180525.

12

13 **Q. How does the Settlement resolve this issue?**

14 A. The Settling Parties agree that PSE will not remotely disconnect customers for
15 nonpayment pending adoption by the Commission of rules pertaining to remote
16 disconnections, provided the rules are established by January 1, 2020. Staff anticipates
17 that revised rules will be adopted well before January 1, 2020.

18

19 ***h. ERF Issues***

20

21 **Q. Do the Settling Parties agree that the methodology and conceptual framework used**
22 **by PSE represent a consensus approach to ERFs?**

1 A. No, they do not. It goes without saying that there are objections to ERFs altogether.
2 However, in the event that the Commission allows ERFs, and parties must respond to
3 them, there is no established policy framework or agreed-upon methodological approach
4 to guide a company's filing or a party's review of that filing.

5 One of Staff's central objectives for this case was to avoid contentious litigation
6 with respect to ERFs. Staff remains concerned that without a policy framework for ERFs,
7 and without a methodological approach informed by some form of thoughtful
8 deliberation among the parties, ERFs will continue to be the source of angst and
9 contention. Staff's hope is that the Commission will undertake a review of, and develop
10 policy guidance for, ERFs through a process that enables a productive exchange of ideas.

11
12 **Q. Are there terms in the Settlement regarding the precedence of this ERF?**

13 A. Yes. The Settlement Agreement simply states that the Settling Parties agree that this
14 Settlement establishes no precedent for future ERFs.

15
16 **Q. Do you have a recommendation for the Commission regarding ERFs?**

17 A. Yes. Staff recommends that the Commission take up the issue of ERFs in its broader
18 Inquiry into the Adequacy of the Current Regulatory Framework in Docket U-180907. If
19 the Commission determines ERFs are a useful regulatory tool for addressing an identified
20 policy problem, Staff believes there would be substantial value in the Commission
21 establishing a policy framework for ERFs through a policy and interpretive statement.

22 Through a policy statement, the Commission could put structure to a fairly
23 nebulous concept and provide guidance on a number of outstanding questions. Most

1 critically, parties need Commission guidance on the *purpose* of ERFs in terms of the
2 policy problem they help to solve. Having clarity on the purpose of ERFs will allow us to
3 contemplate whether ERFs effectively and efficiently fulfill that purpose and under what
4 circumstances ERFs should be used.

5
6 **Q. What are some of the questions about ERFs that should be addressed in the Inquiry**
7 **into the Adequacy of the Current Regulatory Framework in Docket U-180907?**

8 A. Besides the question of what is the policy purpose of ERFs, there are a number of
9 questions without an agreed-upon answer. Under what conditions is an ERF appropriate?
10 What is the appropriate basis for determining whether a company's current rate remains
11 just and reasonable? Should an ERF use a completely new test year, or should an ERF
12 use the test year from a recently completed general rate case and merely extend the pro
13 forma period? Should it include all investments or just major investments? Should it
14 exclude revenue-producing plant? How should plant additions be treated in an ERF if
15 parties do not have the time to perform a thorough prudence review? Should ERF rates be
16 subject to refund if prudence determinations for investments cannot be completed? How
17 should expenses be handled in an ERF? Should they update to actuals or should they
18 remain locked to the previous general rate case?

19 This is not by any means a comprehensive list of questions but, rather, a sample
20 that I hope will help to demonstrate the need for policy guidance on this issue.

- 1 • Other Tax Reform Items – Besides the interim reversals for protected-plus EDIT
2 discussed above, there are two remaining unresolved Tax Reform issues: (1)
3 unprotected (non-plant) EDIT and (2) the interim over-collection of taxes for the
4 period January 1, 2018, to April 30, 2018. These issues are identified in PSE’s
5 petition for an accounting order in Dockets UE-171225 and UG-171226. These
6 two remaining Tax Reform items represent liabilities owed to customers and will
7 be addressed in PSE’s next general rate case.

8
9 **Q. Does this conclude your testimony?**

10 **A. Yes, it does.**