EXH. CGP-1CT
DOCKETS UE-240004/UG-240005
2024 PSE GENERAL RATE CASE
WITNESS: CARA G. PETERMAN

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, Respondent.	Docket UE-240004 Docket UG-240005

PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF

CARA G. PETERMAN

ON BEHALF OF PUGET SOUND ENERGY

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

REDACTED VERSION

FEBRUARY 15, 2024

PUGET SOUND ENERGY

PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF
CARA G. PETERMAN

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I. INTRODUCTION

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

A. My full name is Andrea Cara Gudger Peterman, and I generally prefer to go by Cara G. Peterman. My business address is Puget Sound Energy, P.O. Box 97034, Bellevue, Washington 98009-9734. I am employed by Puget Sound Energy ("PSE") as Corporate Treasurer.

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

A. Yes, I have. Please see the First Exhibit to the Prefiled Direct Testimony of Cara G. Peterman, Exh. CGP-2, which describes my education, relevant employment experience, and other professional qualifications.

Q. What are your duties as Corporate Treasurer for PSE?

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

Q. What is the purpose of this prefiled direct testimony and how is it organized?

A. Section II of this prefiled direct testimony presents

(i) PSE's actual capital structure and cost of capital for the test year, which commenced July 1, 2022, and ended June 30, 2023;

(ii) PSE's projected capital structure and cost of capital for each of calendar years 2023 and 2024; and

(iii) PSE's proposed capital structure and cost of capital for the first and second years of the proposed multiyear rate plan period.

Section III describes the methodology used to calculate the short-term debt, long-term debt, and equity cost rates presented in this prefiled direct testimony.

Section IV discusses the importance of supporting and growing cash flow so that PSE can access financial markets on reasonable terms to finance the investments necessary to achieve the state's decarbonization goals codified in the Clean Energy Transformation Act ("CETA").

Section V describes the efforts that PSE has taken to manage its cost of capital.

Section VI confirms PSE's compliance with regulatory commitments the organization has made with respect to financial matters.

Finally, Section VII provides the conclusion of this prefiled direct testimony.

II. PSE'S CAPITAL STRUCTURE REQUEST

A. PSE's Capital Structure and Cost of Capital Authorized by the Commission in the 2022 Multiyear Rate Plan Proceeding

Q. Please provide PSE's capital structure and cost of capital authorized by the Commission in Dockets UE-220066 et al. (the "2022 Multiyear Rate Plan Proceeding").

A. Table 1 below presents the capital structure and cost of capital authorized for PSE by the Commission in the 2022 Multiyear Rate Plan Proceeding.

Table 1. PSE's Capital Structure and Cost of Capital Authorized by the Commission in the 2022 Multiyear Rate Plan Proceeding

Capital Source	Capitalization Ratios	Cost Rate	Weighted Cost Rate
Short- and Long-Term Debt	51.00%	5.00%	2.55%
Common Equity	49.00%	9.40%	4.61%
Total Capital	**100.00%**		**7.16%**

B. PSE's Actual Capital Structure and Cost of Capital for the Test Year and PSE's Projected Capital Structure and Cost of Capital for Calendar Years 2023 and 2024

Q. Please provide PSE's actual capital structure and cost of capital for the test year (July 1, 2022, through June 30, 2023) and PSE's projected capital structure and cost of capital for each of calendar years 2023 and 2024.

A. Table 2 below presents PSE's actual capital structure and cost of capital for the test year (July 1, 2022, through June 30, 2023) and PSE's projected capital structure and cost of capital for each of calendar years 2023 and 2024.

Table 2. PSE's Actual Capital Structure and Cost of Capital for the Test Year (July 1, 2022 – June 30, 2023) and Projected Capital Structure for Each of Calendar Years 2023 and 2024

Test Year (July 1, 2022, through June 30, 2023)

Capital Source	Capitalization Ratios	Cost Rate	Weighted Cost Rate*
Short-Term Debt	1.23%	4.58%	0.09%
Long-Term Debt	49.70%	5.07%	2.54%
Common Equity	49.07%	9.40%	4.61%
Total Capital	**100.00%**		**7.24%**

Calendar Year 2023

Capital Source	Capitalization Ratios	Cost Rate	Weighted Cost Rate*
Short-Term Debt	0.61%	5.89%	0.07%
Long-Term Debt	50.07%	5.07%	2.56%
Common Equity	49.32%	9.40%	4.64%
Total Capital	**100.00%**		**7.27%**

Table 2. PSE's Actual Capital Structure and Cost of Capital for the Test Year (July 1, 2022 – June 30, 2023) and Projected Capital Structure for Each of Calendar Years 2023 and 2024

Calendar Year 2024

Capital Source	Capitalization Ratios	Cost Rate	Weighted Cost Rate*
Short-Term Debt	1.26%	6.04%	0.11%
Long-Term Debt	49.74%	5.20%	2.61%
Common Equity	49.00%	9.40%	4.61%
Total Capital	**100.00%**		**7.33%**

* Weighted short-term debt rate includes 0.03% of commitment and amortization fees. Weighted long-term debt rate includes 0.02% of amortization of reacquired debt.

For additional information regarding PSE's actual capital structure and cost of capital for the test year (July 1, 2022 – June 30, 2023) and PSE's projected capital structure for each of calendar years 2023 and 2024, please see the following exhibits:

(i) The Second Exhibit to the Prefiled Direct Testimony of Cara G. Peterman, Exh. CGP-3, at 1-2, provides PSE's actual capital structure and cost of capital for the test year (July 1, 2022, through June 30, 2023).

(ii) The Third Exhibit to the Prefiled Direct Testimony of Cara G. Peterman, Exh. CGP-4, at 1-2, provides PSE's projected capital structure and cost of capital for calendar year 2023.[1]

(iii) The Fourth Exhibit to the Prefiled Direct Testimony of Cara G. Peterman, Exh. CGP-5C, at 1-2, provides PSE's

[1] Please note that PSE has labeled the data for calendar year 2023 as *projected* because PSE will not have audited financial figures by the time this case is filed.

projected capital structure and cost of capital for calendar year 2024.

Q. Why is PSE's actual weighted average cost of capital ("WACC") in the test year and projected WACC for calendar years 2023 and 2024 higher than the WACC approved for PSE by the Commission for the 2022 Multiyear Rate Plan Proceeding?

A. PSE's actual WACC for the test year and projected WACCs for calendar years 2023 and 2024 are higher than the WACC approved for PSE by the Commission in the 2022 Multiyear Rate Plan Proceeding because interest rates have risen more than forecasted in the 2022 Multiyear Rate Plan Proceeding.

Q. What is the impact of higher interest rates?

A. When interest rates increase, so does the interest expense incurred by PSE to finance investments and operations with debt. Because PSE's authorized WACC of 7.16 percent will remain fixed in rates through, at least, the end of calendar year 2024, PSE will bear increases in interest rates above those forecasted in the 2022 Multiyear Rate Plan Proceeding as interest expense. For example, the weighted average cost of debt in 2023 was approximately 8 basis points higher than the weighted average cost of debt authorized in the 2022 Multiyear Rate Plan Proceeding, and PSE projects that the weighted average cost of debt in 2024 will be approximately 17 basis points higher than the weighted average cost of debt authorized in the 2022 Multiyear Rate Plan Proceeding. These increased costs of debt represent, in the aggregate, a projected increase in interest expense of approximately $21 million over the course of the current two-year multi-year rate plan. This increase in unrecovered interest expense exacerbates the cash flow problems currently faced by PSE.

C. PSE's Proposed Capital Structure and Cost of Capital for the Proposed Multiyear Rate Plan Period

Q. What capital structure does PSE propose for ratemaking purposes for the multiyear rate plan period?

A. PSE's shareholders are planning to make significant contributions in equity capital over the course of the next five years to support investments necessary to continue to maintain safe, reliable, and affordable service and to meet the state's decarbonization goals set forth in CETA. PSE proposes that the Commission approve an increase to PSE's authorized equity ratio in each of the two years of the multiyear rate plan period:

(i) an increase in the authorized equity ratio to 50.0 percent for the first year of the proposed multiyear rate plan period (an increase of 1.0 percent from the authorized equity ratio of 49.0 percent currently used in rates), and

(ii) an increase in the authorized equity ratio to 51.0 percent for the second year of the proposed multiyear rate plan period (an increase of 1.0 percent from the proposed authorized equity ratio of 50.0 percent proposed for the first year of the proposed multiyear rate plan period).

Q. Does PSE anticipate that its actual equity ratio will reflect the equity ratios that PSE proposes that the Commission adopt for the multiyear rate plan period?

A. No. Due to the size of PSE's financing needs to support resource acquisition activities to meet the state's decarbonization goals reflected in CETA, PSE's investors will make equity investments simply to maintain the existing actual equity ratio of 49.0 percent. If PSE were to be required to achieve actual equity ratios identical to the equity ratios proposed by PSE in this proceeding, then PSE's investors would need to invest approximately $200 million of additional equity. Allowing the use of a hypothetical capital structure in this proceeding would relieve incremental financing pressure under what are projected to be unprecedented financing conditions. As discussed in Section IV of this prefiled direct testimony, an increase in cash flow from the increased equity ratio is important to support the health of PSE's credit metrics over the course of the proposed multiyear rate plan period and the years thereafter. Please see the Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-1CT, for a discussion of PSE's proposed capital structure.

Q. What return on equity does PSE propose for ratemaking purposes for the multiyear rate plan period?

A. As discussed in the Prefiled Direct Testimony of Ann E. Bulkley, Exh. AEB-1T, and in the Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-1CT, PSE proposes that the Commission approve an increase to PSE's authorized return on equity in each of the two years of the multiyear rate plan period:

(i) an increase in the authorized return on equity to 9.95 percent for the first year of the proposed multiyear rate plan period (an increase of 0.55 percentage points from the authorized return on equity of 9.40 percent currently used in rates), and

(ii) an increase in the authorized return on equity to 10.50 percent for the second year of the proposed multiyear rate plan period (an increase of 0.55 percentage points from the proposed authorized return on equity of 9.95 percent proposed for the first year of the proposed multiyear rate plan period).

Q. What cost of debt does PSE propose for ratemaking purposes for the multiyear rate plan period?

A. PSE proposes that the Commission approve the following authorized costs of short-term debt for the multiyear rate plan period:

(i) an authorized cost of short-term debt of 5.07 percent for the first year of the proposed multiyear rate plan period (an increase of 0.07 percentage points from the authorized cost of debt of 5.00 percent currently used in rates), and

(ii) an authorized cost of short-term debt of 4.08 percent for the second year of the proposed multiyear rate plan period (a decrease of 0.99 percentage points from the authorized cost of short-term debt of 5.07 percent proposed for the first year of the proposed multiyear rate plan period).

PSE proposes that the Commission approve the following authorized costs of long-term debt for the multiyear rate plan period:

(i) an authorized cost of long-term debt of 5.27 percent for the first year of the proposed multiyear rate plan period (an increase of 0.27 percentage points from the authorized cost of debt of 5.00 percent currently used in rates), and

(ii) an authorized cost of long-term debt of 5.36 percent for the second year of the proposed multiyear rate plan period (an increase of 0.09 percentage points from the authorized cost of short-term debt of 5.27 percent proposed for the first year of the proposed multiyear rate plan period).

Q. Please present PSE's proposed capital structure and cost of capital for the first year of the multiyear rate plan period.

A. Table 3 below presents PSE's proposed capital structure and cost of capital for the first year of the multiyear rate plan period.

Table 3. PSE's Proposed Capital Structure and Cost of Capital for the First Year of the Multiyear Rate Plan Period

Capital Source	Capitalization Ratios	Cost Rate	Weighted Cost Rate*
Short-Term Debt	1.81%	5.07%	0.11%
Long-Term Debt	48.19%	5.27%	2.56%
Common Equity	50.00%	9.95%	4.98%
Total Capital	**100.00%**		**7.65%**

* Weighted short-term debt rate includes 0.02% of commitment and amortization fees. Weighted long-term debt rate includes 0.02% of amortization of reacquired debt.

Please see the Fifth Exhibit to the Prefiled Direct Testimony of Cara G. Peterman, Exh. CGP-6C, for PSE's proposed capital structure and cost of capital for the first year of the multiyear rate plan period

Q. Please present PSE's proposed capital structure and cost of capital for the second year of the multiyear rate plan period.

A. Table 4 below presents PSE's proposed capital structure and cost of capital for the second year of the multiyear rate plan period.

Table 4. PSE's Proposed Cost of Capital and Capital Structure for the Second Year of the Multiyear Rate Period

Capital Source	Capitalization Ratios	Cost Rate	Weighted Cost Rate*
Short-Term Debt	1.19%	4.08%	0.06%
Long-Term Debt	47.81%	5.36%	2.57%
Common Equity	51.00%	10.50%	5.36%
Total Capital	**100.00%**		**7.99%**

* Weighted short-term debt rate includes 0.01% of commitment and amortization fees. Weighted long-term debt rate includes 0.01% of amortization of reacquired debt.

Please see the Sixth Exhibit to the Prefiled Direct Testimony of Cara G. Peterman, Exh. CGP-7C, for PSE's proposed capital structure and cost of capital for the second year of the multiyear rate plan period.

III. METHODOLOGIES USED TO CALCULATE PSE'S WEIGHTED-AVERAGE COST OF CAPITAL

A. Methodology Used to Calculate Short-Term Debt Cost Rates

Q. Please describe PSE's short-term credit facilities.

A. PSE currently has an $800 million unsecured revolving credit facility, which matures in May 2027. PSE has the option to renew the facility in two one-year extensions before it expires. The credit facility has an accordion feature, which would allow PSE, if needed, to increase the committed amount to $1.4 billion with the banking group's approval.

PSE uses the $800 million unsecured revolving credit facility for general corporate funding needs, to support the issuance of commercial paper and hedging activities through borrowings, or the issuance of standby letters of credit. This credit facility provides the necessary liquidity to fund utility operational requirements, including the variability in funding needs.

Q. Is the structure of the unsecured revolving credit facility consistent with the short-term credit facilities considered in the 2022 Multiyear Rate Plan Proceeding?

A. Yes. Although PSE renewed the credit facility in May 2022, the structure (including term, pricing, and financial covenant) of the unsecured revolving credit facility is consistent with the short-term credit facilities considered in the 2022 Multiyear Rate Plan Proceeding.

Q. What methodology has PSE used in this proceeding to calculate the cost rate for short-term debt?

A. To calculate the cost rate for short-term debt for the test year, PSE calculated total interest expense for short-term borrowing, such as commercial paper or credit facility loans, for the applicable period. PSE then divided this total interest expense by the total weighted average short-term debt balance for the applicable period to determine the weighted average short-term debt cost rate for the applicable period. PSE also included cost rates for commitment fees (including letter of credit fees) and the amortization of short-term debt issue costs for the applicable periods. Each of these calculations is identified in line items in each of Exh. CGP-3 through Exh. CGP-7C.

Q. Please elaborate on PSE's projected use of commercial paper and credit agreement loans to finance short-term borrowing needs.

A. PSE meets its short-term borrowing needs by using both commercial paper and short-term credit facilities. PSE's decision to use commercial paper or short-term credit facilities depends on pricing and availability at the time of borrowing. Although commercial paper has recently been the lower cost option for short-term financings, the tier 2 commercial paper market can become difficult to access in a cost-effective manner, particularly in times of macroeconomic stress.

Accordingly, PSE realizes that it cannot rely solely on commercial paper to fund short-term liquidity needs. Therefore, PSE has projected commercial paper issuances and costs, along with borrowing under its credit agreements, in short-term debt costs for each applicable period.

Q. How has PSE calculated its projected cost of short-term debt during each rate year of the proposed multiyear rate plan period?

A. To calculate the projected cost of short-term debt during each rate year of the proposed multiyear rate plan period, PSE determined the spread between its short-term borrowing costs and the Secured Overnight Financing Rate ("SOFR").[2] PSE then applied that spread to Moody's projected monthly SOFRs during the applicable rate years of the multiyear rate plan period.

Q. Is the presentation of the cost of short-term debt in this proceeding consistent with PSE's presentation of the cost of short-term debt in past rate proceedings?

A. Yes. PSE's presentation of the cost of short-term debt in this proceeding is consistent with PSE's past rate proceedings, including the 2022 Multiyear Rate Plan Proceeding.

B. Methodology Used to Calculate Long-Term Debt Cost Rates

Q. Please describe PSE's long-term debt.

A. As of December 31, 2023, PSE has over $5.2 billion of long-term debt in:

[2] *See* Federal Reserve Bank of New York, *Secured Overnight Financing Rate Data*, https://www.newyorkfed.org/markets/reference-rates/sofr.

(i) bonds and notes issued pursuant to PSE's electric and natural gas mortgage indentures, which hold a lien on substantially all utility properties owned by PSE; and

(ii) pollution control bonds

Table 5 below presents a summary of PSE's existing long-term debt as of December 31, 2023.

Table 5. PSE's Long-Term Debt (as of December 31, 2023)
(Dollars in Thousands)

Series	Type	Due	Amounts
7.15%	First Mortgage Bond	2025	15,000
7.20%	First Mortgage Bond	2025	2,000
7.02%	Senior Secured Note	2027	300,000
7.00%	Senior Secured Note	2029	100,000
3.90%	Pollution Control Bond	2031	138,460
4.00%	Pollution Control Bond	2031	23,400
5.48%	Senior Secured Note	2035	250,000
6.72%	Senior Secured Note	2036	250,000
6.27%	Senior Secured Note	2037	300,000
5.76%	Senior Secured Note	2039	350,000
5.80%	Senior Secured Note	2040	325,000
5.76%	Senior Secured Note	2040	250,000
4.43%	Senior Secured Note	2041	250,000
5.64%	Senior Secured Note	2041	300,000
4.30%	Senior Secured Note	2045	425,000
4.22%	Senior Secured Note	2048	600,000
3.25%	Senior Secured Note	2049	450,000
4.70%	Senior Secured Note	2051	45,000
2.89%	Senior Secured Note	2051	450,000
5.448%	Senior Secured Note	2050	400,000
	Debt discount, issuance cost, and other		(39,813)
Total PSE Long-Term Debt			**$5,184,047**

Q. Are any of PSE's outstanding issues of long-term debt identified in Table 5 callable as of December 31, 2023?

A. Yes. Certain of PSE's outstanding issues of long-term debt identified in Table 5 above are callable, subject to a make-whole penalty. Please see the Seventh Exhibit to the Prefiled Direct Testimony of Cara G. Peterman, Exh. CGP-8, for a list of PSE's outstanding issues of long-term debt that are callable as of December 31, 2023.

Q. Would it be cost-effective for PSE to call these issues of long-term debt?

A. Not at this time. To call these issues of long-term debt early, PSE must pay any required make-whole penalty in place to protect debtholders from early termination. PSE will continue to monitor call premium economics as a matter of standard operating protocols.

Q. How has PSE calculated the cost of long-term debt in this proceeding?

A. To calculate the cost of long-term debt, PSE calculated the yield-to-maturity, or cost rate, of each debt issue using the issue date, maturity date, net proceeds to PSE, and coupon rate of that security. PSE then used the proportional share that each issue's principal amount represents of the total amount of long-term debt outstanding to weigh these cost rates.

Q. Did PSE break out amortization costs on reacquired debt from its cost rate calculation for short- and long-term debt consistent with prior cases?

A. Yes. PSE broke out amortization costs on reacquired debt from its cost rate calculation for short- and long-term debt consistent with prior cases. The calculation of the amortization costs on reacquired debt is identified in line items in each of Exh. CGP-3 through Exh. CGP-7C.

Q. Did PSE have any new issues of long-term debt during the test year?

A. Yes. PSE issued a 30-year, $400 million senior secured debt instrument in May 2023 at an interest rate of 5.448 percent. Please see Section V of this prefiled direct testimony for further discussion on the May 2023 bond issuance.

C. Methodology Used to Calculate Cost Rates for Equity

Q. What is the currently authorized return on equity ("ROE") that is applied during the test year (July 1, 2022, through June 30, 2023) and calendar years 2023 and 2024?

A. The authorized ROE during the test year, as well as calendar years 2023 and 2024, is 9.4 percent.

Q. What ROE is PSE requesting for the MYRP?

A. As discussed in the Prefiled Direct Testimony of Ann E. Bulkley, Exh. AEB-1T, and the Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-1CT, PSE proposes a return on equity of 9.95 percent for the first year of the multiyear rate plan period and 10.50 percent for the second year of the multiyear rate plan period. Please see the Prefiled Direct Testimony of Ann E. Bulkley, AEB-1T, for the methodologies used in proposing these returns on equity for the multiyear rate plan periods.

Q. Has PSE Witness Bulkley projected a different return on equity for each of the two years of the proposed multiyear rate plan period?

A. No. PSE Witness Bulkley has not projected a different return on equity for each of the two years of the proposed multiyear rate plan period. As discussed in the Prefiled Direct Testimony of Ann E. Bulkley, Exh. AEB-1, the analyses performed by PSE indicates that a return on equity of 10.50 percent is appropriate to allow PSE to attract capital on reasonable terms throughout the two-year multiyear rate period. As discussed in the Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-1CT, PSE is requesting a stepped increase in the return on equity over the two years of the multiyear rate plan period in recognition of the Commission's preference for gradualism.

IV. THE IMPORTANCE OF CASH FLOW AND CREDIT RATINGS IN ACHIEVING THE CLEAN ENERGY TRANSITION

A. The Success of the Clean Energy Transformation Act Depends on PSE's Ability to Finance the Transition and Maintain its Financial Health

Q. Please describe the major CETA requirements that PSE will need to address over the next decades.

A. The state's decarbonization goals codified in CETA requires that PSE's meet 100 percent of its retail electric load with carbon-neutral electricity by 2030 and 100 percent of its retail electric load with carbon-free electricity by 2045. As discussed in the Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-1CT, meeting these objectives will require PSE to make substantial capital investments over the next two decades in clean energy resources, transmission facilities that will bring clean energy to load centers, and improvements to the distribution infrastructure that brings power to customers' homes and places of business. As PSE Witness Doyle notes, these investments are *incremental* to the investments that PSE plans to make to maintain safe and reliable operations of the existing utility system, which is and will remain a steadfast organizational priority.

Q. What concerns does PSE have as it plans further investments in the clean energy transition?

A. PSE has concerns about its ability to finance both the traditional needs of the utility (i.e., investments in operations, maintenance, and capital requirements of the existing electric and gas systems) and the need to support the clean energy transition. To be successful, it is of utmost importance that PSE be able to secure the necessary debt and equity financing, when needed and at terms and costs that are reasonable. Access to capital at reasonable costs is one of the most critical issues to be addressed in this case.

Q. Why is access to capital one of the most important issues in this case?

A. PSE needs competitive access to external financing sources to be able to achieve the state's decarbonization goals codified in CETA. Even prior to passage of CETA, PSE is cash flow negative – meaning the costs that PSE recovers through rates and the return of and on rate base are not sufficient to cover all of the funding needs of the business (operations and maintenance expenses, capital expenditures, working capital, regulatory liabilities, etc.). As a result, PSE must finance the rest of the needs of the business with incremental funding via debt (i.e., short- and long-term debt) and equity.

PSE must issue debt to make these investments in clean energy projects possible, and PSE's financial health must be strong enough to encourage debt investors to buy PSE commercial paper and/or bonds at reasonable rates. If PSE does not have access to these external financing sources at reasonable costs, PSE will have to pay fixed income investors more to compensate them for putting money at risk. This will harm customers financially in the form of higher rates, as the cost of financing on prudent investments is borne by customers.

Q. Do equity investors share these concerns, or are they limited to fixed income investors?

A. Issues pertaining to PSE's financial health concern equity investors as well. Just like debt investors, equity investors seek to deploy capital (equity) in investments that will earn a rate of return commensurate with the market and business risks of the organizations in which they invest. These investors expect and require the rate of return to be comparable to returns an investor can receive in a similar company with similar risk and similar financial health.

B. Credit Metrics Are a Key Method of Measuring a Company's Financial Health

Q. How do potential investors assess PSE's financial health?

A. Investors assess the financial health of all businesses based on a variety of quantitative financial metrics and qualitative factors. Some of the most important financial metrics are credit metrics. Ratings agencies calculate credit metrics, and credit metrics are designed to evaluate a company's fitness for investment today and into the future.

Q. What are credit metrics, and how do they inform credit ratings?

A. Credit metrics are measures used to assess an entity's financial strength, liquidity risk, and ability to service debt. Rating agencies use credit metrics, presented as percentages or coverage ratios, using a company's published financial statements. The most commonly referenced credit metrics are

- Funds from Operation ("FFO"),
- Cash Flow from Operation pre-Working Capital ("CFO pre WC"),
- Earnings Before Interest/Taxes/Depreciation & Amortization ("EBITDA"), and
- Interest and Total Debt.

All three credit rating agencies that assign credit ratings to PSE (i.e., Standard & Poor's ("S&P"), Moody's Investor Services ("Moody's"), and Fitch Ratings Inc. ("Fitch")) use similar but slightly different calculations to compute credit metrics. Each credit agency applies discretionary adjustments to its calculations.

Credit *metrics* are an important factor when rating agencies assess a company's credit *rating*. Table 6 below shows a list of credit metrics used by PSE's rating agencies. Key credit metrics emphasized the most by each rating agency are marked in bold below.

Table 6. PSE's Credit Metrics Used by Rating Agencies

Rating Agency	Credit Metrics Evaluated in Determining Ratings
S&P	• **FFO / End of Period Debt** • Debt / EBITDA • FFO / Interest Ratio • EBITDA / Interest
Moody's	• **CFO Pre-WC / Debt** • CFO Pre-WC less Dividends / Debt • CFO Pre-WC + Interest / Interest • Debt / Book Capitalization

Fitch	• **FFO Adjusted Leverage** • Debt / EBITDA • FFO Fixed Charge Coverage

Please see the Prefiled Direct Testimony of Todd A. Shipman, Exh. TAS-1T, for further discussion about financial health, credit ratings, and rating agencies.

Q. Do rating agencies consider qualitative factors in addition to quantitative metrics when determining a company's credit ratings?

A. Yes. Although rating agencies tend to be quite focused on quantitative metrics, they also place a great deal of emphasis on various qualitative factors, such as business, regulatory, legislative, and climate conditions within which a company operates. These considerations are important because they influence the company's future financial performance. For example, rating agencies will assess regulators' willingness to support the financial health of jurisdictional utilities. If support is strong, then a rating agency will have more confidence in the future financial performance of the utility. Please see the Prefiled Direct Testimony of Todd A. Shipman, Exh. TAS-1T, for further discussion of the consideration of qualitative factors by ratings agencies.

Q. What effects do power purchase agreements have on PSE's credit metrics?

A. Acquiring resources via power purchase agreements ("PPAs") affect credit metrics. S&P, one of the ratings agencies that fixed income investors rely on to assess PSE's financial health, considers PPAs to be comparable to incremental debt and therefore, “imputes” additional debt in excess of short-term debt and the long-term debt mechanisms, which strains PSE’s credit metrics used by S&P.

For example, PSE’s business plan projects that PSE will enter into many PPAs with independent power producers to meet the state’s decarbonization goals codified in CETA. PSE forecasts that the imputed debt amount would rise from a current level of around $450 million in 2023 to almost $1 billion by 2028. S&P adds this increased imputed debt number to the total debt in S&P’s ratio calculation, which weighs down PSE’s S&P FFO/debt metric by around 140 bps. In short, both owned generation resources and PPAs impact PSE’s credit metric performance.

C. PSE’s Recent Credit Metric Performance Indicates Declining Creditworthiness

Q. What are PSE’s current credit ratings at the time of this filing?

A. Table 7 below presents PSE’s current credit ratings at the time of this filing.

Table 7. PSE’s Current Credit Ratings

Security	S&P	Moody’s	Fitch
Corporate Credit/Issuer Rating	BBB*	Baa1	BBB+
Senior Secured Debt	A-	A2	A
Commercial Paper	A-2	P-2	F-2
Outlook	Stable	Stable	Stable

* As mentioned in the Prefiled Direct Testimony of Todd A. Shipman, Exh. TAS-1T, PSE’s stand-alone credit profile (SACP) is BBB+, which is comparable to Moody’s and Fitch’s ratings for PSE.

Q. What is PSE's current and recent performance on each of the key credit metrics?

A. Similar to the discussion in the Prefiled Direct Testimony of Todd A. Shipman, Exh. TAS-1T, this discussion will focus on key credit metrics of S&P and Moody's. The key credit metrics of S&P and Moody's are more comparable because both calculate ratios as a percentage of "FFO" or "CFO pre WC" over total debt, whereas Fitch's calculates its key credit metric, adjusted leverage, inversely (when compared to S&P and Moody's). These differences in calculation methodologies make it difficult to compare Fitch's credit metrics to S&P and Moody's metrics. Accordingly, this discussion excludes Fitch's credit metrics, but it should be noted that the key credit metric performance themes discussed below for S&P and Moody's hold true for Fitch's credit metrics as well.

Table 8 below provides the recent historical performance of PSE's key credit metrics and benchmark range targeted by PSE.

Table 8. PSE S&P and Moody's Recent Key Credit Metrics Performance

							Projections*	
1	S&P							
		2018	2019	2020	2021	2022	2023	2024
2	FFO	$1,079	$1,068	$1,073	$1,152	$1,047	[redacted]	[redacted]
3	Debt	4,853	5,091	5,283	5,820	5,873	[redacted]	[redacted]
4	FFO to Debt Ratio	22.2%	21.0%	20.3%	19.8%	17.8%	[redacted]	[redacted]
5	Moody's						Projections*	
		2018	2019	2020	2021	2022	2023	2024
6	CFO pre WC	$928	$731	$898	$900	$880	[redacted]	[redacted]
7	Debt	4,578	4,828	4,957	5,268	5,483	[redacted]	[redacted]
8	CFO Pre-WC/Debt	20.3%	15.1%	18.1%	17.1%	16.1%	[redacted]	[redacted]

* Based on PSE's current plan

As indicated in Table 8 above, PSE's credit metric performance (as indicated on lines 4 and 8 of Table 8) has declined significantly from 2018 due to stagnation in FFO and CFO pre-WC. At the same time, PSE has had to increase borrowings to fund the capital and expense needs of the business. Rows 2 and 6 of Table 8 reflect the stagnation of cash flow. Rows 3 and 7 of Table 8 show the increase of $900 million–$1.10 billion in debt from 2018 to 2022. Again, it is important to note that each rating agency has different formulas to calculate cash flow and debt. As a result, the S&P and Moody's cash flow and debt values will never match.

The stagnation in cash flow and increase in debt is causing PSE's credit metrics to decline substantially. S&P FFO to debt has declined 440 basis points from 2018 to 2022, and Moody's CFO pre-WC has declined 420 basis points from

20.3 percent to 16.1 percent. In fact, the key credit metrics for Moody's have been below the bottom of the allowable range for Baa1 of 19 percent from 2019 to 2022.

Q. What has caused the stagnation in cash flows and the increase in debt?

A. Cash flow (or funds from operations) have largely stagnated for two reasons: (1) the passage of the Tax Cuts and Jobs Act ("TCJA") in 2017, which was implemented in 2018, and (2) the outcome of the rate proceeding in Dockets UE-190529 et al. (the "2019 General Rate Case").

Q. What impact did the TCJA have on PSE cash flow?

A. As described in the Prefiled Direct Testimony of Matthew R. Marcelia, Exh. MRM-1T, the TCJA negatively affected PSE cash flows primarily due to a loss of bonus depreciation and a reduction in the corporate tax rate from 35 percent to 21 percent. The elimination of bonus depreciation, amortization of excess deferred taxes, and change in the corporate tax rate have combined to result in an average annual decrease in PSE's available cash flow of approximately $156 million since 2018.

Q. Was this a temporary change in PSE's cash flow?

A. No. This cash flow reduction resulting from the TCJA will remain absent changes in tax laws applicable to utilities that would replace the cash flows lost from TCJA.

Q. How did the rating agencies respond to the impact on utility credit metrics from the passage of the TCJA?

A. Rating agencies recognized that the TCJA was credit-negative for utilities. A publication dated June 18, 2018, by S&P Global noted that "Moody's Investor Service on June 18 downgraded its outlook on the regulated utilities sector to "negative," citing lower cash flows and higher debt levels as federal tax reform and increased capital spending continue to weigh on the sector."[3]

Q. What was the impact of the TCJA on PSE's credit metrics?

A. As mentioned above, PSE's cash flow from operations fell by an average of approximately $156 million per year following passage of the TCJA in 2017. PSE had to borrow to replace the cash flows lost to the TCJA. Consequently, PSE's credit metrics have also declined substantially. Table 9 below demonstrates the impact of the TCJA on PSE's cash flows and how sensitive PSE's key credit metrics are to such changes.

[3] S&P Global Market Intelligence, Moody's Downgrades Outlook on Regulated Utilities Sector to 'Negative' (Jun. 18, 2018). https://www.spglobal.com/marketintelligence/en/news-insights/latest-newsheadlines/moody-s-downgrades-outlook-on-regulated-utilities-sector-to-negative-44953275.

Table 9. Impact of TCJA on PSE Credit Metrics

	2017	2018	2019	2020	2021	2022	Projections* 2023	2024
S&P FFO/Debt								
Actual Ratio with TCJA		22.2%	21.0%	20.3%	19.8%	17.8%	[redacted]	
Projected Ratio without TCJA	25.6%	25.9%	24.8%	24.4%	23.8%	22.0%	[redacted]	
Variance		-3.6%	-3.8%	-4.1%	-4.0%	-4.2%	[redacted]	
Illustrative TCJA Impact on S&P Credit Metrics (bps)		**-364**	**-385**	**-406**	**-399**	**-415**	[redacted]	[redacted]
Moody's CFO pre-WC/Debt								
Actual Ratio with TCJA		20.3%	15.1%	18.1%	17.1%	16.1%	[redacted]	
Projected Ratio without TCJA	24.0%	24.1%	19.0%	22.3%	21.3%	20.4%	[redacted]	
Variance		-3.8%	-3.9%	-4.2%	-4.3%	-4.3%	[redacted]	
Illustrative TCJA Impact on Moody's Credit Metrics (bps)		**-383**	**-386**	**-423**	**-426**	**-433**	[redacted]	[redacted]

* Based on PSE's current plan

Moreover, the impact of TCJA on PSE's credit metrics continues to grow annually because PSE has to borrow incrementally each year the TCJA is in effect. The cumulative average annual $156 million decrease in cash flow yields an increase in borrowings of almost $400 million over the five-year period (from 2018 to 2022). All else being equal, the TCJA reduced PSE credit metrics by 364-415 basis points for S&P and 383-477 basis points for Moody's following its implementation in 2018. This significant impact continues to affect PSE's financial performance today and will continue to weigh on PSE's credit metrics until solutions are implemented to increase cash flow.

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Q. How did the Commission's order in the 2019 General Rate Case affect PSE's cash flows?

A. In 2020, the Commission issued an order in the 2019 General Rate Case that found PSE's requested rate increase of $200 million was overly burdensome to customers, particularly in the midst of the COVID-19 pandemic. As a result, the Commission ordered that PSE could increase rates by $2 million, initially. Following modifications and clarifying orders, the final rate increase was approximately $60 million. The difference between the relief requested and the relief authorized represents loss of cash recovery.

PSE was able to subsequently change rates by $70.9 million in 2021 from a subsequent power-cost-only rate case ("PCORC"). Similar to TCJA, the net result compounded the stagnation of cash flow growth, which an increase in debt continued to exacerbate.

Q. How did the resolution of the 2022 Multiyear Rate Plan Proceeding affect PSE's financial health?

A. Generally speaking, the outcome of the 2022 Multiyear Rate Plan Proceeding was constructive for PSE's financial strength, flexibility, and integrity and how the rating agencies viewed the business risk and regulatory environment in Washington.

From a credit metric performance perspective, however, the results of the 2022 Multiyear Rate Plan Proceeding has not yielded the type of sustained credit metric performance that PSE needs to be able to maintain current credit ratings in the face of substantial capital funding needs. As can be seen in rows 4 and 8 of Table 8 above, PSE's key credit metrics are projected to [redacted] for S&P FFO / Debt and [redacted] for Moody's CFO pre-WC as compared to 2022. However, the 2023 CFO pre-WC performance is 280 basis points higher than it otherwise should be due to a short-term over-collection of the Purchased Gas Adjustment ("PGA") expense, as discussed in Section IV.D. below. Thus, PSE's performance in this key Moody's metric is not reflective of the true health of that key credit metric for PSE.

Q. Are there any other reasons why the credit metrics have not improved in 2023 and are not projected to improve in 2024 on a sustained basis?

A. Yes. There are several factors preventing metrics from improving on a sustained basis:

(1) the outcome of the 2022 Multiyear Rate Plan Proceeding did not significantly replace the cash flow lost due to passage of the TCJA;

(2) certain under-recoveries beyond what was included in the 2022 Multiyear Rate Plan Proceeding; and

(3) the multiyear rate plan approved in the 2022 Multiyear Rate Plan Proceeding did not include the level of capital commitments PSE needs to achieve the state's decarbonization goals reflected in CETA.

First, as explained in the Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-1CT, there are several ways PSE can increase cash flow (other than the pure cost recovery of expenses it makes on behalf of customers), including increases in the authorized return on equity, equity ratio, and construction work in progress ("CWIP") in rate base. The order in the 2022 Multiyear Rate Plan increased equity ratio from 48.5 percent to 49.0 percent and the authorized return on equity was held flat at 9.4 percent. Although the increase in the authorized equity ratio was a good faith effort to improve cash flow, the weighted cost of equity (authorized return on equity multiplied by equity ratio) was far lower than what was needed to replace the cash flow lost from TCJA.

Second, any time PSE under-recovers its costs from what is in rates, it suppresses cash flows and increases debt. As an example, as noted earlier, the steep, quick rise in interest rates since the 2022 Multiyear Rate Plan is resulting in significant increases in interest expense, which are currently not being recovered in rates.

Finally, as discussed in the Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-1CT, PSE did not build into the 2022 Multiyear Rate Plan Proceeding the capital investment and funding needs for clean energy investments necessary under CETA because PSE was in the early stages of evaluating responses to its 2021 All-Source Request for Proposals. With the recent commitment to build the Beaver Creek Wind Project and potential acquisitions of PPAs and other clean energy generation projects, PSE's capital needs for [redacted] These investments will require incremental debt and associated interest expense, and, as interest expense increases, cash flow decreases. [redacted]

Q. What risks remain to PSE's credit metrics as it pursues its second multi-year rate plan?

A. As stated earlier, credit metrics are a function of operating cash flow and debt that PSE must borrow to fund operations. Therefore, anything that decreases cash flow or increases borrowings beyond what is included in rates will have negative impacts on PSE's credit metrics. Examples include, but are not limited to, increasing power or gas costs, unexpected or unbudgeted increases in O&M expenses or capital expenses from inflation, storms/natural disasters, or other changes in project costs, changing regulatory policies or requirements, changes in building codes that increase costs, increases in interest rates that increase borrowing costs, etc.

D. PSE'S Multiyear Rate Plan Proposals Support Its Ability to Pursue CETA Objectives

Q. How is PSE proposing to improve cash flow during this next multiyear rate plan period?

A. PSE is making three specific proposals to improve cash flow in this proposed multiyear rate plan proceeding:

(i) an increase in PSE's authorized return on equity from 9.4 percent to 9.95 percent for the first year of the multiyear rate plan and then from 9.95 percent to 10.5 percent for the second year of the multiyear rate plan;

(i) an increase in PSE's authorized equity ratio, from 49.0 percent to 50.0 percent for the first year of the multiyear rate plan and then from 50.0 percent to 51.0 percent for the second year of the multiyear rate plan; and

(iii) adoption of a methodology to allow CWIP in ratebase for specific large capital projects, such as the Beaver Creek Wind Project.

Please see the Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-1CT, and the Prefiled Direct Testimony of Susan E. Free, Exh. SEF-1T, for a discussion of the need for CWIP in rate base on large-scale clean energy resources and the mechanism proposed by PSE.

Q. What cash flow benefits would the increased return on equity, the increased equity ratio, and the proposal to allow CWIP in rate base for the Beaver Creek Wind Project provide?

A. Table 10 below provides a quantification of the projected cash flow benefits provided by these three proposals:

Table 10. Illustration of Impact of ROE/Equity Ratio and Beaver Creek CWIP in Ratebase on PSE Credit Metrics

	$ in Millions	Year 1	Year 2
1	Incremental Cash Flow from ROE Increase	$26	$56
2	Incremental Cash Flow from Equity Ratio Increase	9	22
3	Incremental Cash Flow from Beaver Creek CWIP in Ratebase	22	(3)
4	**Total Incremental Cash Flow**	**$57**	**$75**
5	**S&P FFO/Debt**		
6	Ratio with ROE 9.4% & Equity Ratio 49%; w/o CWIP in Ratebase	[redacted]	[redacted]
7	Ratio with Incremental Cash Flows	[redacted]	[redacted]
8	Variance (%)	0.86%	1.17%
9	**Illustrative Impact on S&P Credit Metrics (bps)**	**86**	**117**
10	**Moody's CFO pre WC/Debt**		
11	Ratio with ROE 9.4% & Equity Ratio 49%; w/o CWIP in Ratebase	[redacted]	[redacted]
12	Ratio with Incremental Cash Flows	[redacted]	[redacted]
13	Variance (%)	0.93%	1.29%
14	**Illustrative Impact on Moody's Credit Metrics (bps)**	**93**	**129**

In sum, the projected cash flow benefits provided by these three proposals are

- a projected increase in cash flow of approximately $26 million attributable to the increase in authorized return on equity from 9.4 percent to 9.95 percent in the first year of the multiyear rate plan period;

- a projected increase in cash flow of approximately $30 million attributable to the increase in authorized return on equity from 9.95 percent to 10.5 percent in the second year of the multiyear rate plan period;

- a projected increase in cash flow of approximately $9 million attributable to the increase in authorized equity ratio from 49.0 percent to 50.0 percent in the first year of the multiyear rate plan period;

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- a projected increase in cash flow of approximately $13 million attributable to the increase in authorized equity ratio from 50.0 percent to 51.0 percent in the second year of the multiyear rate plan period; and

- a projected increase in cash flow of approximately $22 million attributable to the proposed adoption of a methodology to allow CWIP in rate base for the Beaver Creek Wind Project.

In total, the projected cash flow benefits attributable to these three proposals are approximately $57 million for the first year of the multiyear rate plan period and approximately $75 million for the second year of the multiyear rate plan period.

Q. Have the credit rating agencies noted a concern about utilities and diminished cash flows?

A. Yes. Moody's has repeatedly noted the reduction in cash flows across the utility industry.[4] In December 2023, Moody's indicated that it is out of patience with utilities that have not addressed cash flow deficiencies.[5] Moody's also noted specific risks the utility sector including:

(i) increased capital investment to fund environmental and renewable energy strategies and mandates,

(ii) the expectation that increased capital investments to fund environmental and renewable energy strategies and mandates cannot be financed without incremental equity financing,

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4 *See*, *e.g*., Moody's Investor Services, *Breakfast with the Analysts: 58th Annual [Edison Electric Institute (EEI)] Financial Conference* at 15 and 18 (Nov. 13, 2023). Please see the Eighth Exhibit to the Prefiled Direct Testimony of Cara G. Peterman, Exh. CGP-9, for a copy of this presentation.

5 Mizuho Securities USA LLC, *Ebenezer Moody; Takeaways from Our Call with Moody's* (Dec. 13, 2023). Please see the Second Exhibit to the Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-3, for a copy of this document.

(iii) an increased interest rate environment that will likely increase both the cost of debt and equity, which, all else equal, will make the increased capital investment more expensive, and

(iv) a growing view that wildfire risk and other climate-related risks will have a more prominent place in the future ratings processes of the agencies.

In particular, Moody's has noted that "[a] rating downgrade could occur if PSE's credit metrics including a CFO pre-WC to debt ratio remains below 19% or if the cost recovery framework in Washington becomes less credit supportive."[6]

Q. How have PSE's credit metrics performed in recent years compared to S&P and Moody's downgrade thresholds?

A. PSE has operated below Moody's downgrade thresholds since 2019 and below S&P's downgrade threshold since 2021.

Q. How does PSE expect that its credit metrics will perform in 2024?

A. PSE expects that its credit metrics [redacted]

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[6] Moody's Investor Services, *Puget Sound Energy, Inc. Update to Credit Analysis* at 2 (Sept. 15, 2023). Please see the Eighth Exhibit to the Prefiled Direct Testimony of Cara G. Peterman, Exh. CGP-9, for a copy of this report.

Q. What effect will PSE's financial proposals in this proceeding have on credit metrics and PSE's financial health over the course of the multiyear rate plan period?

A. Figures 1 and 2 below provide PSE's recent historical trends in S&P and Moody's key credit ratios, along with forecasted credit metric performance for calendar year 2024 and the proposed multiyear rate plan period. The forecasted performance for the proposed multiyear rate plan period (roughly, calendar years 2025 and 2026) in these two figures includes the moderating cash flow effects of PSE's proposed returns on equity and equity ratios and PSE's proposal to include CWIP in rate base for the Beaver Creek Wind Project. The credit metric forecast in Figures 1 and 2 are based on the business plan approved by the Board of Directors in November 2023, which is the same plan discussed in the Prefiled Direct Testimony of Joshua A. Kensok, Exh. JAK-1CT.

Q. Do PSE's financial proposals in this proceeding fully replace the decrease in cash flows beginning in 2018 due to passage of the TCJA?

A. No. PSE's proposals would not, even in the aggregate, completely replace the cash flows lost due to passage of the TCJA. As Figures 1 and 2 demonstrate, however, PSE expects that its financial proposals presented in this proceeding would [redacted]

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Figure 1. S&P PSE FFO / Debt 10-Year Trend

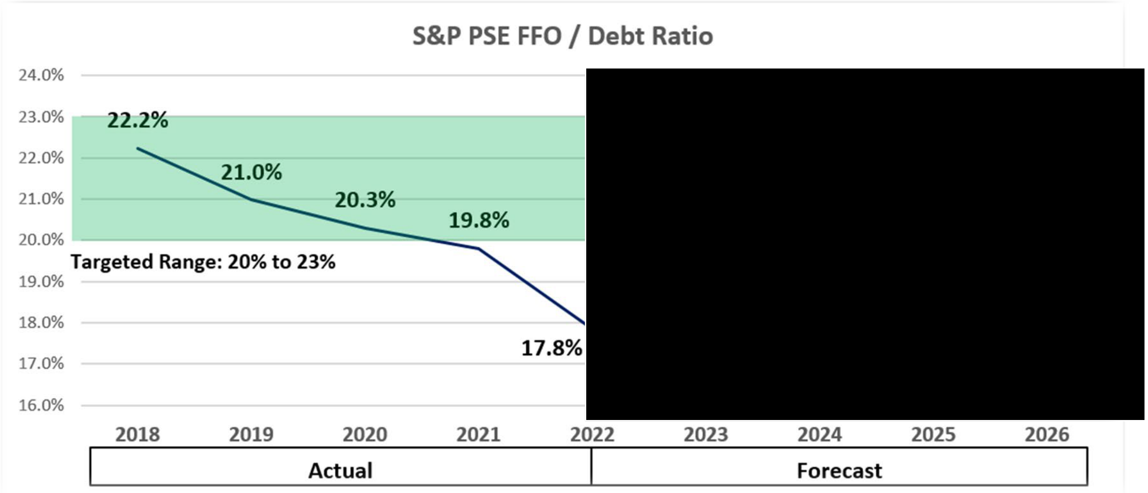
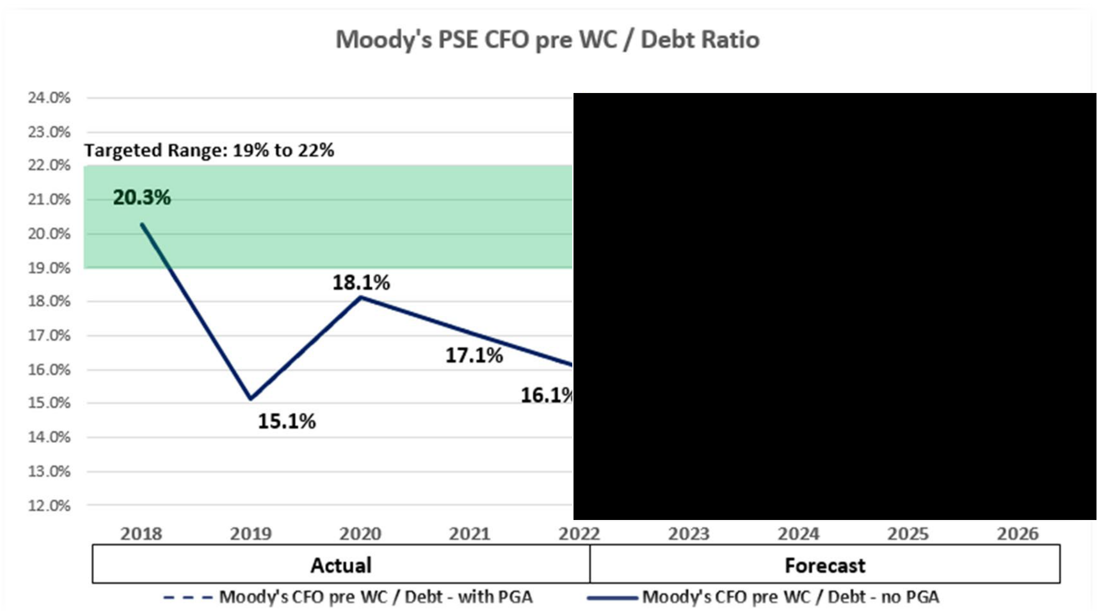


Figure 2. Moody's PSE FFO / Debt 10-Year Trend



Each of Figure 1 and Figure 2 demonstrates that PSE's credit metrics have not increased appreciably notwithstanding the positive Commission order in the 2022 Multiyear Rate Plan Proceeding.

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Q. Please explain the gyration in the Moody's metric in calendar years 2023 and 2024 in Figure 2.

A. As discussed earlier, the PGA over-collection in 2023 and the subsequent one-year pass back in 2024 is causing the Moody's credit ratios to swing dramatically in calendar years 2023 and 2024. Although Moody's does not proactively adjust credit metrics for this swing in cash flow, Moody's will qualitatively acknowledge it in the annual credit assessments of PSE. The solid line in Figure 1 illustrates what the metric would have been for calendar years 2023 and 2024 with the PGA neutralized.

<u>E. Other Mechanisms that Support Credit Metric Improvement</u>

Q. Are mechanisms proposed in this proceeding—other than the proposed increase in return on equity and equity ratio and proposal to allow CWIP in rate base for the Beaver Creek Wind Project—important to maintaining and strengthening PSE's credit ratings and financial health?

A. Yes. There are several other mechanisms proposed by PSE in this proceeding that are important to maintaining and strengthening PSE's credit ratings and financial health. These mechanisms include annual updates to power costs, the Clean Generation Resources Rate Adjustment, and the Wildfire Prevention Tracker (collectively, the "Trackers"). All of these mechanisms align PSE's revenues to costs expended for these various programs. The Trackers also support timely recovery of substantial capital expenditures, mitigate regulatory lag, and will

[redacted]

Q. Do these mechanisms affect PSE's business risk?

A. Yes. In addition to the timely rate recovery of critical expenses and investments, these mechanisms improve the business risk environment in which PSE operates. As discussed in the Prefiled Direct Testimony of Todd A. Shipman, Exh. TAS-1T, credit *metrics* are quantitative calculations, whereas credit *ratings*—the ultimate grade assigned by a rating agency to a company—are determined by a combination of credit metrics and qualitative considerations of the business risk in which a company operates. Qualitative considerations are critical in assessing a utility's likelihood of securing timely rate recovery and/or its ability to maintain strong cash flows through different operating conditions (e.g., power/gas cost volatility, occurrence of storms or wildfires, ability to weather challenging economic environments, etc.). Commission support for cost recovery mechanisms, such as annual updates to power costs, the Clean Generation Resources Rate Adjustment, and the Wildfire Prevention Tracker, will demonstrate to the rating agencies that the Commission is dedicated in partnering with PSE to achieve the state's decarbonization goals codified in CETA.

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Q. Have ratings agencies acknowledged the importance of timely recovery of costs of the clean energy transition or other extraordinary costs?

A. Yes. Ratings agencies have acknowledged the importance of timely recovery of costs of the clean energy transition or other extraordinary costs. In a November summary of recent regulatory developments across the United States, S&P stated its belief that

> the approach taken by the commission in approving PSE's natural gas compliance costs is credit supportive as it facilitates financial stability, specifically as it pertains to the timeliness of cost recovery and the flexibility of the regulatory construct to recover infrequent costs tied to the new cap and trade program. We anticipate a similar approach to cost recovery could be taken for PSE's electric costs and other IOUs.[7]

Moody's has similarly indicated that cost recovery certainty through trackers is critical for strong ratings.

Q. Is PSE currently able to update power costs annually?

A. Yes. In the order approving a settlement agreement in the 2022 Multiyear Rate Plan Proceeding, the Commission authorized PSE to update power costs at the start of each rate year of the multiyear rate plan. The ability to reflect these costs in rates through a regulatory process will continue to support PSE's ability to demonstrate effective and timely recovery of power costs. As discussed in the Prefiled Direct Testimony of Brennan D. Mueller, Exh. BDM-1T, PSE proposes

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[7] S&P Global, Ratings Direct, *North American Utility Regulatory Jurisdictions: Some Notable Developments* (Nov. 10, 2023). Please see the Eighth Exhibit to the Prefiled Direct Testimony of Cara G. Peterman, Exh. CGP-9, for a copy of this report.

to extend this annual update to power costs due to the volatility that has marked power and fuel markets in recent years.

Q. Does the financial community view mechanisms that address power costs favorably?

A. Yes. The financial community views mechanisms that facilitate updates to power costs on at least an annual basis favorably. In PSE's case, power costs represent approximately 45 percent of electric revenue.

Q. Why is PSE requesting a Clean Generation Resources Rate Adjustment?

A. PSE is requesting a Clean Generation Resources Rate Adjustment for many of the same reasons discussed throughout this prefiled direct testimony. Large-scale generation resources require significant levels of capital investment, which PSE must fund through debt and equity. During the construction phases for these projects, PSE incurs significant increases in interest expense to fund construction activities. The proposal to allow CWIP in rate base, if approved, would improve PSE's cash flow position and reduce regulatory lag by allowing PSE to earn on capital expenditures allowed into rate base prior to the project achieving commercial operations. This additional cash flow will help PSE mitigate some of the impact of construction of clean energy projects on PSE's credit metrics and financial health. Please see the Prefiled Direct Testimony of Susan E. Free, Exh. SEF-1T, for a discussion of the Clean Generation Resources Rate Adjustment.

F. Wildfire Risk Mitigation and Financial Health

Q. Why is PSE requesting a tracker for wildfire risk mitigation expenses and capital investments?

A. Utility wildfire risk mitigation and response activities have seen increased focus following the tragic California wildfires of 2017 and 2018, the Labor Day 2020 wildfires in Oregon, and the tragic wildfire in Lahaina, Hawai'i, in the summer of 2023. PSE is proposing a wildfire tracker intended to provide transparency to the Commission, PSE's customers, the communities in which PSE operates, and the financial community concerning some activities that PSE is undertaking and will undertake to mitigate potential wildfire risk. Please see the Prefiled Direct Testimony of Ryan Murphy, Exh. RM-1T, for a discussion of PSE's wildfire risk and mitigation strategies and programs. Please see the Prefiled Direct Testimony of Susan E. Free, Exh. SEF-1T, for a discussion of PSE's Wildfire Prevention Tracker.

Q. Has the financial community expressed concerns about potential wildfire risks of utilities in the West?

A. Yes. The concern about potential wildfire risk amongst the financial community cannot be understated. Until 2023, the financial community's concerns about potential wildfire risk were primarily limited to California, which has suffered prolonged droughts and numerous deadly wildfires since 2017. Liabilities related to wildfires ultimately led Pacific Gas & Electric Company to file for bankruptcy protection. The perception that wildfires and financial liabilities related to damages caused by wildfires were limited to California changed in 2023 due to two events:

(i) a ruling in June 2023 finding PacifiCorp liable with respect to 17 named plaintiffs and all class members within the designated fire boundaries for the Santiam Canyon, Echo Mountain Complex, South Obenchain, and Two-Four-Two fires over Labor Day 2020, and

(ii) the tragic fires in the County of Maui, Hawai'i, in August 2023 that unfortunately resulted in the deaths of 100 individuals and largely destroyed the town of Lahaina in a matter of hours.

These two tragic wildfires alerted the financial communities to the notion that wildfires can and do occur outside of California and can carry significant financial losses, in addition to the tragic loss of life.

Q. How have the rating agencies responded?

A. Ratings agencies spent much of late summer and early fall of 2023 interviewing utilities across the country, with a particular emphasis in the West, regarding their wildfire risk and mitigation activities. Rating agencies were looking to understand the scope of the risk, historic experience with wildfires, what each utility has done to mitigate risk to date, wildfire insurance coverage, and the legal and regulatory environments that are affecting utilities in the event that a catastrophic wildfire were to occur. This work culminated in publications and/or presentations from all three rating agencies at the EEI Financial conference in November 2023. (See Exh. CGP-10C.) While this work was ongoing, Moody's added a three-paragraph disclaimer to PSE's annual credit rating update, writing that wildfires threats are growing in the Pacific Northwest and that, while most of PSE's service territory is in the rainier part of Washington state, PSE is working to mitigate wildfire risk through activities outlined in PSE's 2023 Wildfire Mitigation and Response Plan[8] and discussed in the Prefiled Direct Testimony of Ryan Murphy, Exh. RM-1T.

In November 2023 S&P noted the increase in industry-wide business risk resulting from wildfire threats, stating that

> [c]limate change is increasing the frequency and severity of storms, hurricanes, wildfires, and other natural disasters, which is escalating infrastructure damage and raising credit risks for North America's investor-owned utilities (IOUs) and publicly owned utilities (POUs).[9]

S&P noted that wildfire risks are only increasing:

> According to the National Oceanic and Atmospheric Administration (NOAA) on an inflation-adjusted basis, 2021 and 2022 represent two of the top five most destructive years for extreme weather events since 1980. Our base case assumes these trends will persist, magnifying physical risks for the IOU and POU industries.[10]

S&P emphasized the impact the resulting costs and liabilities can have on a company's credit quality, stating that

> [o]ver the past six years, IOU and POU downgrades directly related to physical risks have significantly increased. The credit quality of utilities with physical risk exposure could come under even more pressure if comprehensive risk-reduction strategies are not effectively implemented.[11]

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8 Available at: https://www.pse.com/-/media/PDFs/Wildfire-Preparedness/7616_WildfirePlan_2023.pdf

9 S&P Global, Ratings Direct, *A Storm Is Brewing: Extreme Weather Events Pressure North American Utilities' Credit Quality* at 1 (Nov. 9, 2023).

10 *Id*.

11 *Id*.

In effect, S&P is putting utilities on notice that they need to take risk mitigation activities seriously and improve their credit health.

Q. Does S&P indicate that it will favor wildfire risk mitigation efforts and timely recovery of wildfire risk mitigation costs favorably?

A. Yes. S&P indicate that it will favor wildfire risk mitigation efforts and timely recovery of wildfire risk mitigation costs favorably:

> we believe it's important for IOUs and POUs in the western U.S. states to implement comprehensive wildfire mitigation plans to reduce physical risks, even though many of these utilities have yet to experience a catastrophic wildfire.[12]

With respect to timely cost recovery, S&P states that it expects utilities to take three actions to improve their risk profile, including "reducing damages from physical events, minimizing litigation risk, and expanding capabilities for cost recovery." Furthermore, S&P states that it "believe[s] it's important for the IOU industry to significantly increase and broaden recovery capabilities." This includes maintaining commercial insurance levels and enhancing wildfire mitigation-related cost recovery.

Q. Does PSE's Wildfire Prevention Tracker align with the advice of S&P and others?

A. Yes. As discussed in the Prefiled Direct Testimony of Ryan Murphy, Exh. RM-1T, PSE has had a wildfire mitigation and response plan for several years, and

[12] *Id.* at 6.

PSE has been investing in efforts to not only better understand its wildfire risk landscape but also invest in capital projects that reduce the risk of wildfires from occurring. The proposed Wildfire Prevention Tracker will support S&P's guidance that PSE expand cost recovery capabilities and mitigate the risk of damages from physical events by investing in additional mitigation activities.

V. PSE'S ACTIONS TO MANAGE THE COST OF CAPITAL

Q. What actions has PSE taken to manage its cost of capital?

A. In the recent past, PSE was able to secure low-cost debt with relative ease. For many years, interest rates across all tenors remained at historically low levels, allowing PSE to reduce the impact of debt capital financings on its cost of capital. For example, in 2021 PSE issued a 30-year, $450 million first mortgage bond at 2.893 percent, PSE's lowest cost financing ever. This reduced the long-term cost of debt rate, which will benefit customers for nearly three more decades.

Macroeconomic conditions began to shift in 2022, reflecting much higher levels of inflation than have been experienced in many years. The debt markets have changed dramatically in response to the Federal Reserve's actions to contain inflation.

Although the utility, like all companies, cannot control interest rates or actions of the Federal Reserve, PSE works to place itself in a positive position in the market when it does issue debt. In 2023, PSE's business plan forecasted that PSE would need to issue a $400 million bond issue in the August / September timeframe. At the start of 2023, however, there was a rumor that a federal government shutdown may occur in the late summer. As government shutdowns have the tendency to raise prices and volatility in the interest rate markets, PSE looked to accelerate the issuance to the May timeframe. Additionally, PSE had a goal for 2023 to issue its inaugural Sustainability Financing Framework, enabling PSE to issue Green, Social and/or Sustainable bonds. These financings are similar to traditional bonds, but PSE commits to allocating those proceeds to eligible investments for green, social, or sustainable causes.[13]

Sustainable Financing Frameworks and the ability to issue Green, Social or Sustainable Bonds is an important way in which the Treasury department can align PSE's financing values with the corporate commitments and values of being a clean energy company for customers. As a result, PSE created the Sustainability Financing Framework, had it reviewed by a second-party to provide an opinion that the Sustainability Financing Framework aligns with the proper international principles of green, social and sustainable bonds, and positioned itself to go to market early in May 2023 to avoid the next issuance window in late summer.

On May 15, 2023, PSE issued its inaugural 30-year $400 million green bond with an interest rate of 5.448 percent. By prefunding the bond in May, PSE avoided interest rate volatility during the summer and fall. If PSE had issued the bond in late September, the bond would likely have secured an interest rate of

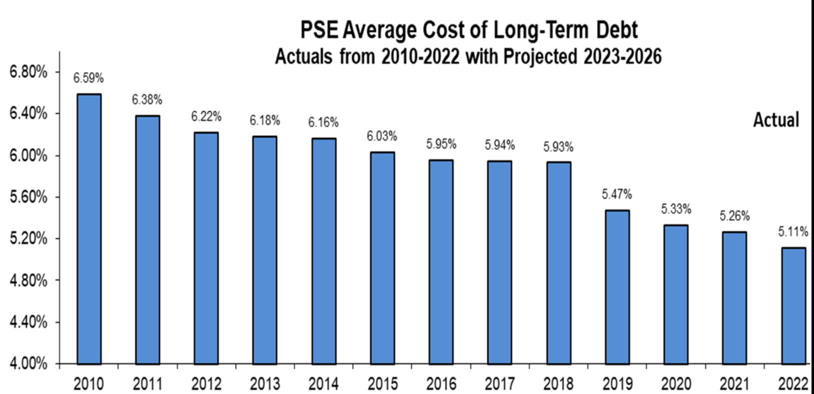
[13] PSE's Sustainability Financing Framework can be found at: https://www.pse.com/en/about-us/Sustainability

approximately 6.18 percent. By issuing the green bond early, PSE was able to save annual interest expense of approximately \$2.9 million, totaling over \$87 million in interest savings over the 30-year term of the issuance.

Q. How has PSE's cost of long-term debt changed over time?

A. As shown in Figure 3 below, PSE's overall cost of long-term debt has fallen by 123-152 basis points, when comparing PSE's request in this rate proceeding in calendar years 2025 and 2026 to the actual cost of long-term debt in calendar year 2010. PSE has been able to achieve this decline in long-term debt cost by financing new borrowings at a cost rate that is lower than the then-current average rate over the last decade. Despite the sharp rise of interest rates from 2022 to 2023, PSE forecasts that the average cost of debt during the proposed multiyear rate plan period will remain at levels below historical averages.

Figure 3. Improvement in PSE's Cost of Long-Term Debt



[redacted]

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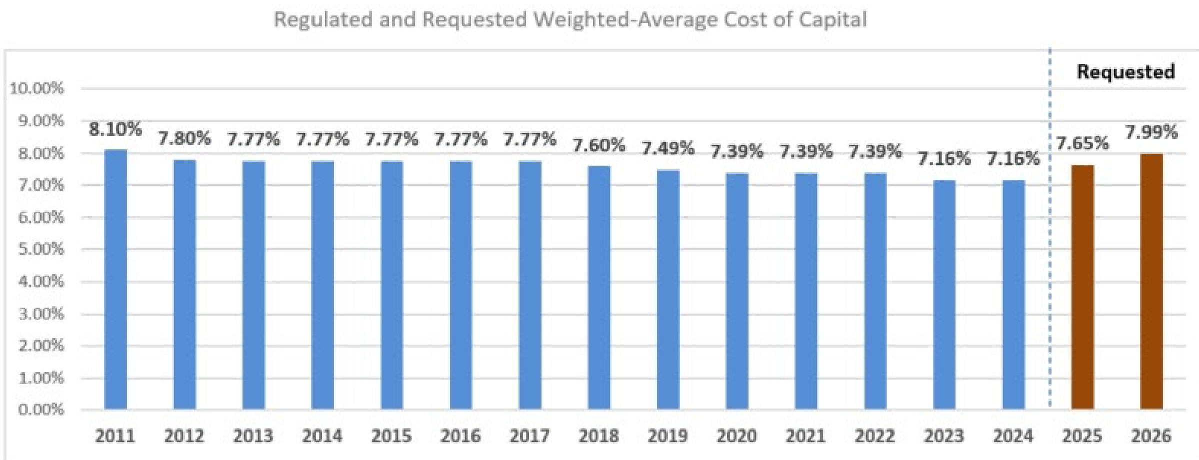
Q. Will PSE need to refinance or issue any debt or credit facilities during the multiyear rate plan period?

A. Yes. PSE will continue to issue bonds to pay down short-term borrowings and increase liquidity, as is its usual practice. In addition, PSE expects to raise additional capital from debt to finance operations as well as capital expenditures for the Beaver Creek Wind Project and other clean energy investments. The cost of capital figures presented in Section II of this prefiled direct testimony reflects these expected financing events. The specific timing of any future bond offerings is kept confidential because it is market-sensitive information. Any such offerings will not detract from PSE's ability to maintain its authorized equity ratios across the multiyear rate plan period.

Q. How does the cost of capital requested for this multiyear rate plan period compare to previously approved rates of returns?

A. As shown in Figure 4 below, PSE's requested weighted average cost of capital for the multiyear rate plan period remains in line with its authorized cost of capital of the early to mid-2010s. In other words, PSE's authorized cost of capital is returning to recent norms after a prolonged period of very low interest rates. PSE's proposed cost of capital of 7.65 percent for the first year of the multiyear rate plan period is 12 basis points less than PSE's authorized cost of capital for the 2013-2017 period, and PSE's proposed cost of capital of 7.90 percent for the second year of the multiyear rate plan period is 20 bps less than PSE's authorized cost of capital in 2011.

Figure 4. Regulated and Requested Weighted-Average Cost of Capital



VI. PSE HAS COMPLIED WITH ALL REGULATORY COMMITMENTS REGARDING CAPITAL STRUCTURE AND COSTS OF CAPITAL

Q. Are there regulatory commitments pertaining to PSE's proposed cost of debt or equity that are relevant to this general rate case?

A. Yes. On January 27, 2022 the Commission issued an order that approved a multiparty settlement[14] to sell 31.57 percent of the indirect ownership of Puget Holdings LLC in Docket U-210542, finding that the transfer would result in no harm to PSE's customers and was in the public interest, as required by state law. The multiparty settlement included 65 regulatory commitments, many of which had been in place since 2009 and are relevant to PSE's proposed cost of debt or equity in this general rate case.

[14] *See In the Matter of the Joint Application of Puget Sound Energy, Ontario Teachers' Pension Plan Board, and Macquarie Washington Clean Energy Investment, L.P., for an Order Authorizing Proposed Sales of Indirect Interests in Puget Sound Energy,* Docket U-210542, Order 01, Attachment A (January 27, 2022).

Regulatory Commitment 7 prohibits PSE from advocating for a higher cost of debt or equity capital as compared to what PSE's cost of debt or equity capital would have been absent Puget Holdings' ownership:

Puget Holdings and PSE will not advocate for a higher cost of debt or equity capital as compared to what PSE's cost of debt or equity capital would have been absent the change in ownership at Puget Holdings. For future ratemaking purposes, Commitments 6(iii), 7, and 8(a) are clarified as follows:

(a) Determination of PSE's debt and equity costs will be no higher than such costs would have been assuming PSE's credit ratings by S&P and Moody's in effect on the day before the Proposed Transactions closed and applying those credit ratings to then-current debt and equity markets, unless PSE proves that a lower credit rating is caused by circumstances or developments not the result of financial risks or other characteristics of the Proposed Transactions.

(b) Determination of the allowed return on equity in future general rate cases will include selection and use of one or more proxy group(s) of companies engaged in businesses substantially similar to PSE, without any limitation related PSE's ownership structure.[15]

Q. Has PSE complied with Regulatory Commitment 7?

A. Yes. PSE has complied with Regulatory Commitment 7.

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[15] *Id*.

Q. Does any regulatory commitment require PSE to maintain a capital structure with a minimum equity ratio?

A. Yes. Regulatory Commitment 29, in part, requires PSE to maintain a capital structure with a minimum equity ratio:

> PSE will have a common equity ratio of not less than 44 percent, except to the extent a lower equity ratio is established for ratemaking purposes by the Commission.[16]

Q. Has PSE complied with Regulatory Commitment 29?

A. Yes. PSE has complied with Regulatory Commitment 29. PSE's equity ratio averaged 49.0 percent for the test year. PSE's equity has been above 44 percent over the past decade. Therefore, PSE has complied with Regulatory Commitment 29.

VII. CONCLUSION

Q. Please summarize PSE's proposed capital structure and rates of return for the multiyear rate plan period.

A. PSE is mindful of how changes in the authorized cost of capital affect customer rates, whether through increases or decreases. The capital structures and returns on equity requested by PSE in this proceeding will yield quantitative and qualitative financial benefits for PSE and its customers. The quantitative benefits are increased cash flow, stronger credit metrics, and overall stronger financial

[16] *Id*. at 8.

health. Additionally, and equally important, PSE's proposed capital structures and returns on equity, if approved, would send a strong qualitative signal to the rating agencies and fixed-income investors that the regulatory environment in Washington is one supportive of PSE's pursuit of the resources required to achieve the state's decarbonization goals reflected in CETA. That, in turn will enable PSE to secure lower-cost debt in future financings, which ultimately benefits customers through lower future interest costs. In short, PSE's financial proposals, including PSE's proposed capital structures and returns on equity, appropriately balance safety and economy, as discussed in the Prefiled Direct Testimony of Daniel A. Doyle, Exh. DAD-1CT.

Q. Does that conclude your prefiled direct testimony?

A. Yes, it does.