

EXHIBIT NO. ___(MRM-1T)
DOCKET NO. UE-121373
DOCKET NO. UE-121697/UG-121705
DOCKET NO. UE-130137/130138
WITNESS: MATTHEW R. MARCELIA

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of PUGET SOUND ENERGY, INC. For Approval of a Power Purchase Agreement for Acquisition of Coal Transition Power, as Defined in RCW 80.80.010, and the Recovery of Related Acquisition Costs	DOCKET NO. 121373
In the Matter of the Petition of PUGET SOUND ENERGY, INC. and NW ENERGY COALITION For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms	DOCKET NOS. UE-121697 and UG-121705 (Consolidated)
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondent.	DOCKET NOS. UE-130137 and UG-130138 (Consolidated)

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
MATTHEW R. MARCELIA
ON BEHALF OF PUGET SOUND ENERGY, INC.

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

MAY 8, 2013

PUGET SOUND ENERGY, INC.
PREFILED REBUTTAL TESTIMONY
(NONCONFIDENTIAL) OF MATTHEW R. MARCELIA

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1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF**
3 **MATTHEW R. MARCELIA**

4 **I. INTRODUCTION**

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

6 A. My name is Matthew R. Marcelia. I am employed as Director of Tax for Puget
7 Sound Energy, Inc. ("PSE" or "the Company"). My business address is 10885 NE
8 Fourth Street, Bellevue, WA 98009-9734.

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

11 A. Yes, I have. It is Exhibit No. ____ (MRM-2).

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

13 A. I respond to issues raised in response testimony addressing the property tax
14 tracker and two elements of the Multiparty Settlement—the decoupling K-factor
15 in Docket Nos. UE-131697 and UG-121705 (consolidated) and PSE's proposed
16 Expedited Rate Filing in Docket Nos. UE-130137 and UG-130138 (consolidated)
17 ("ERF"). Specifically, I address the following response testimony and issues:

- 18 (i) the Property Tax Tracker;
- 19 (ii) the Direct Testimony of James R. Dittmer, Exhibit No. ____ (JRD-1T), on
20 behalf of Public Counsel, with respect to Accumulated Deferred Income
21 Taxes ("ADIT"), the tax Net Operating Loss ("NOL"), and bonus
22 depreciation;
- 23 (iii) the Prefiled Direct Testimony of Kevin C. Higgins, Exhibit No. ____ (KCH-
24 1T), on behalf of Kroger and Nucor, with respect to ADIT and the tax
25 NOL; and

1 (iv) the Response Testimony of Michael P. Gorman, Exhibit No. ____ (MPG-
2 1T), on behalf of the Industrial Customers of Northwest Utilities
3 ("ICNU") with respect to the proper income tax rates to use.

4 **II. PROPERTY TAX TRACKER**

5 **Q. Did the Company include the Property Tax Tracker in the Multiparty**
6 **Settlement?**

7 A. Yes, the Company included the Property Tax Tracker, Schedule 140, in this filing
8 pursuant to Paragraph 143 of Order 08 in the Company's last general rate case,
9 Docket Nos. UE-111048 and UG-111049 (consolidated). In that case, the
10 Commission required the Company "to work with Commission Staff and others
11 who may take an interest in the matter to bring forth an agreed mechanism."

12 **Q. Was the mechanism that the Company filed "an agreed mechanism" as the**
13 **Commission required?**

14 A. Yes, it is. The Company worked with Commission Staff on the mechanism as
15 part of this filing. While both Mr. Dittmer who filed testimony on behalf of
16 Public Counsel and Mr. Higgins who filed testimony on behalf of The Kroger Co.
17 referred to the Property Tax Tracker in their testimonies,¹ none of the intervening
18 parties opposed the tracker. As explained in the Company's initial filing, the
19 tracker is a very simple mechanism for the collection of actual property taxes – no
20 more, no less.

¹ See Exhibit No. __ (JRD-1T) page 12, line 23, through page 13, line 2, and Exhibit
No. __ (KCH-1T), page 9, lines 8 through 10.

1 **Q. What actions would you advise the Commission to take in the absence of**
2 **intervener opposition to the Property Tax Tracker?**

3 A. Due to the clarity in Order 08 and based upon the testimony in this filing, I would
4 urge the Commission to adopt the Property Tax Tracker, Schedule 140, as filed.

5 **III. INCOME TAX ISSUES WITH RESPECT TO THE**
6 **DECOUPLING K FACTOR AND EXPEDITED RATE FILING**

7 **A. Response to Public Counsel Witness Mr. Dittmer**

8 **Q. Please respond to Mr. Dittmer's claims that PSE's analysis fails to "consider**
9 **the mitigating impact of significant growth in the Accumulated Deferred**
10 **Income Tax balance ... that can reasonably be expected to occur over the**
11 **term of the rate plan." Exhibit No. ___(JRD-1T), page 25, lines 12-15.**

12 A. I have several concerns with Mr. Dittmer's statement, as discussed in more detail
13 below. First, it is not clear on what Mr. Dittmer bases his expectation that there
14 will be significant growth in ADIT. Second, the exclusion of deferred taxes is
15 acceptable when establishing the proper K-factor.

16 **Q. On what does Mr. Dittmer base his "reasonable expectation" that there will**
17 **be significant growth in ADIT?**

18 A. Mr. Dittmer does not specifically cite the source of his expectations.

19 **Q. On what does Mr. Dittmer base his conclusion of "significant growth" in**
20 **ADIT?**

21 A. Mr. Dittmer introduces Exhibit No. ___(JRD-6C), which is PSE's Response to
22 Public Counsel Data Request No. 32, and apparently relies on this response to

1 support his conclusion of "significant growth" in ADIT. However, that data
2 response simply breaks down the value of the NOL at June 30, 2012, between
3 electric and gas operations. It provides no insight into the breakdown between
4 electric production versus electric non-production, which is the subject of this rate
5 filing. In addition, the speculative numbers provided in part (b) of the response
6 concerning the possible reversal of the NOL are Company-wide values. Those
7 values cannot be split between electric and gas operations (as noted in the data
8 response). Furthermore, they cannot be allocated between production and non-
9 production. Mr. Dittmer commits a simple but major error in assuming that the
10 entire NOL relates to property that is the subject of this filing. The speculative
11 NOL reversals are predicated on Company-wide estimates of taxable income –
12 which includes much beyond the scope of this filing.

13 **Q. Does Mr. Dittmer cite any other evidence of the "significant growth" in**
14 **ADIT?**

15 A. No. Beyond his errant use of the possible reversal of the NOL, Mr. Dittmer does
16 not cite any evidence to show that the change in the future ADIT will be
17 significant.

18 **Q. Why do you say that the exclusion of deferred taxes is acceptable?**

19 A. First, when the property-related ADIT is allocated to non-production activities,
20 which is what the K factor addresses, the impact is not significant. As evidenced
21 in the Prefiled Rebuttal Testimony of Katherine J. Barnard, Exhibit No. ___(KJB-
22 11T), the inclusion of ADIT, properly allocated to non-production assets, would

1 not change the proposed K-factor for electric or gas operations. This analysis
2 directly controverts Mr. Dittmer's unsubstantiated testimony at Exhibit
3 No. ___(JRD-1T), page 34, lines 14-20, where he speculates about the "probable
4 significant growth" in ADIT.

5 **Q. Are there other reasons for excluding the ADIT?**

6 A. Yes, the movement in the ADIT is unpredictable and ultimately unknowable,
7 especially the subset of ADIT which is relevant to this filing.

8 **Q. Please provide an overview of ADIT as it relates to this proceeding.**

9 A. The ADIT that is the focus of the discussion in this case is the balance of all of the
10 historical book/tax difference related to non-production property for which
11 deferred taxes have been provided. That balance is reflected on the Company's
12 balance sheet as a Deferred Tax Liability. In a general rate case, the ADIT
13 liability would be a reduction in the rate base calculation. This filing is unlike a
14 general rate case in that the rate base analysis is but one data point in establishing
15 the K-factor.

16 **Q. What is the driving force behind ADIT and the NOL?**

17 A. By far, the number one factor behind ADIT and the NOL is bonus depreciation.
18 In general, it has been the Company's experience that when bonus depreciation
19 has been available, the Company has experienced a tax loss (i.e., an NOL).

20 **Q. What do you mean by "bonus depreciation"?**

21 A. Bonus depreciation allows taxpayers, like PSE, to deduct a "bonus" amount of
22 depreciation in the tax year in which a qualifying asset is placed in service. In

1 addition to the "bonus" amount, taxpayers can claim normal depreciation on the
2 remainder of the tax basis after removing the bonus amount. Essentially, bonus
3 depreciation accelerates a large amount of tax depreciation into the asset's first
4 year.

5 **Q. What impact has bonus depreciation had on PSE in the past?**

6 A. Large deductions for bonus depreciation in prior years have put PSE in a tax NOL
7 position. The practical implication of an NOL carryforward is that the tax
8 benefits of some deductions will be delayed until a future tax year. In the case of
9 PSE, the Company has claimed tax deductions (e.g., bonus depreciation) for
10 which it has not received a cash benefit. Under normal circumstances, a tax
11 deduction will have the effect of reducing the taxpayer's cash outlay for taxes – in
12 essence, deferring a tax payment until a later tax year. That is not so when the tax
13 deduction only serves to create an NOL carryforward. An NOL carryforward is
14 similar to a tax receivable from the IRS, except that it can only be used on future
15 tax returns and it will likely take some time (i.e., years) to recover.

16 **Q. How predictable have the bonus depreciation rules been?**

17 A. The tax laws surrounding bonus depreciation have been extremely unpredictable.
18 In the Second Exhibit to my Prefiled Rebuttal Testimony, Exhibit No. ___(MRM-
19 3), I lay out the history of bonus depreciation legislation. This exhibit highlights
20 the unpredictability of the primary cause of the Company's growth in property-
21 related ADIT and tax NOLs. As indicated in Exhibit No. ___(MRM-3), bonus
22 depreciation has been in effect for every year since 2008. However, the
23 legislation giving rise to bonus depreciation is typically enacted **after** the start of

1 the year for which bonus depreciation is effective. This causes an interesting
2 problem. It prevents taxpayers, including PSE, from incorporating bonus
3 depreciation into their capital spending plans.

4 Whenever Congress reauthorizes bonus depreciation, PSE's tax picture looks
5 significantly different than prior to the rule change. However, no one can
6 reasonably predict what Congress will do based on the history displayed in
7 Exhibit No. ____ (MRM-3). The year 2009 provides a prime example of this
8 uncertainty. In that year, Congress did not grant bonus depreciation until
9 September 27, 2009 and made it retroactive back to January 1, 2009. There is no
10 way to plan for this. A few months later, in mid-December, Congress enacted, for
11 the first time ever, 100 percent bonus depreciation, effective September 9, 2009,
12 which **predated** the enactment of the initial law for bonus depreciation for 2009.

13 No one knows with any level of certainty what is going to happen with bonus
14 depreciation or what the bonus rate will be. The evidence shows that it is not
15 uncommon for the rules to change well after the year has started.

16 Only one time in the last six years has the rule for bonus depreciation been known
17 one year ahead of time – that was in 2012.

18 Based on this history, I do not see a basis for Mr. Dittmer's "reasonable
19 expectation" that the NOL will, in fact, reverse over the course of the rate plan as
20 he claims.

1 **Q. How does the Company forecast its ADIT and NOL?**

2 A. The Company forecasts its ADIT and NOL in a mechanical fashion based on the
3 tax laws that are in effect at the time of the projection. The Company makes no
4 attempt to divine the tea leaves. As a result, the Company provides significant
5 disclaimers around such estimates so that the reader understands the uncertainty
6 and unpredictability that is imbedded in the tax numbers.

7 **Q. How does the Company account for ADIT and NOLs?**

8 A. For regulatory purposes, the Company accounts for its NOL as an offset to its
9 plant-related ADIT. This treatment was validated and confirmed in the
10 Company's last general rate case.² This treatment, which remains as appropriate
11 now as it was then, recognizes the fact that the Company has not received the full
12 cash flow benefit of the tax savings associated with bonus depreciation.

13 **Q. On page 35, lines 17-20, of Exhibit No. __ (JRD-1T), Mr. Dittmer states that**
14 **"PSE's available 'regulatory' ADIT balance" will continue to grow and that**
15 **he "expect[s] this growth to be significant." What does Mr. Dittmer mean by**
16 **"available 'regulatory' ADIT balance"?**

17 A. Mr. Dittmer does not offer an explanation or definition of this phrase. However,
18 there are a couple of rules that must be followed when addressing plant-related
19 ADIT and one of the most important rules to follow is the tax normalization

² See *WUTC v. Puget Sound Energy, Inc.*, Docket UE-111048 and UG-111049, Order 08 ¶¶ 177-184 (May 7, 2012).

1 provisions of the Internal Revenue Code ("IRC") §168(i)(9) and Treasury
2 Regulation §1.167(l)-1(h).

3 **Q. Why are you bringing up the tax normalization rules?**

4 A. I raise the tax normalization rules because Mr. Dittmer has characterized the
5 ADIT balance as "available." It is not truly "available" as I understand that term.
6 The plant-related ADIT balances are required by the Internal Revenue Code if the
7 Company is to avoid severe sanctions. In that sense, the ADIT balance is not
8 "available".

9 **Q. What do you think Mr. Dittmer means by the term "'regulatory'ADIT"?**

10 A. He does not define the term, but I assume he means the subset of ADIT that
11 applies to this rate filing as opposed to the entire ADIT that would appear in a
12 general rate case, for example.

13 **Q. Mr. Dittmer expects the growth in ADIT to be significant. Why?**

14 A. I suspect this belief stems from the conflation of the subset of ADIT relevant to
15 this filing with all ADIT. It further appears that he may be under the mistaken
16 belief that all of the potentially reversing NOL would be attributable to the subset
17 of ADIT relevant to this filing, which is most certainly not the case as I explained
18 above.

19 **Q. When will the NOL reverse?**

20 A. No one knows when the NOL will reverse. It depends on the future of the bonus
21 depreciation provisions. If the bonus depreciation provisions were allowed to
22 expire and if the Company's taxable income actually increases, the NOL could

1 potentially reverse in two or three years. However, if Congress continues to
2 extend those provisions for the next six years as it has for the last six years, it
3 would be unlikely that the NOL would reverse.

4 Further complicating the matter, whenever the NOL is used, that usage would
5 need to be appropriately allocated to the non-production rate base. In other
6 words, all NOL usage would **not** be attributable to or applicable to this filing, as I
7 discussed above.

8 **Q. Please summarize your testimony addressing Mr. Dittmer's concern over**
9 **ADIT.**

10 A. Mr. Dittmer's claim of significant ADIT growth based on the reversal of the NOL
11 is flawed. Ms. Barnard has demonstrated, to the contrary, that the inclusion of
12 ADIT and NOL would not have changed the Company's request for rate relief in
13 this filing. The movement in the ADIT and NOL is unpredictable based on tax
14 laws which change almost annually. PSE cannot predict with any level of
15 certainty how and when the NOL will reverse. The inclusion of the ADIT and
16 NOL in the factors used to establish the Multiparty Settlement would greatly
17 complicate this and all future filings (as is evidenced by this very testimony).

18 **B. Response to Kroger Witness Mr. Higgins**

19 **Q. Mr. Higgins states that the rate base in 2011 was "skewed upward" due to**
20 **the presence of the NOL. Exhibit No. ___(KCH-1T), page 10, line 7. Please**
21 **explain this.**

1 A. As I mentioned above, the NOL represents tax deductions for which the Company
2 has not yet receive the full cash benefit in its tax payments. Order 8, paragraph
3 179-180, confirms and explains this rate making treatment. It is misleading to
4 describe this as a "skewing" of rate base, when in fact, the inclusion of the NOL is
5 necessary to accurately reflect reality.

6 In addition, this treatment is consistent with and required by the tax normalization
7 provisions of the IRC.

8 **Q. Would the K factor be lower if the NOL had not existed?**

9 A. As I mentioned earlier, Ms. Barnard has demonstrated that the presence or
10 absence of the ADIT and NOL would not have changed the rate request in this
11 filing.

12 **Q. Do you have any other comments on Mr. Higgins testimony?**

13 A. One minor point. On page 10, line 12, of his testimony, Mr. Higgins states that
14 "depreciation deductions" can be carried forward for up to twenty years. Mr.
15 Higgins misspeaks. It is NOLs that can be carried forward as he describes, not
16 "depreciation deductions".

17 **C. Response to ICNU Witness Mr. Gorman**

18 **Q. ICNU Witness Mr. Gorman thinks the Company should use a tax rate of 35**
19 **percent for this filing. Do you agree?**

20 A. The statutory tax rate is 35 percent. PSE has used that rate consistently
21 throughout this filing. However, it is important to distinguish between when the

1 statutory tax rate should be used and when the effective tax rate should be used.

2 The effective tax rate for this filing is 36 percent.

3 **Q. When should the statutory tax rate be used?**

4 A. The statutory rate should be used whenever the income tax impact of a specific
5 item is being evaluated, assuming that the item has a tax impact. For example,
6 bonus depreciation impacts tax expense/benefit at the rate of 35 percent. It is a
7 timing difference for which deferred taxes are provided (i.e., it is normalized).
8 However, there are some items for which there is no tax impact. An example of
9 this would be permanent items or items that are subject to flow through rate
10 treatment.

11 **Q. How is a permanent or flow through item treated?**

12 A. Permanent items have no tax impact – meaning they are removed from the tax
13 calculation when a tax return is filed. An example would be 50 percent of meals
14 and entertainment expenses or the amortization of Treasury Grants. Both of these
15 items are excluded from the tax return.

16 Flow through items have the same impact as permanent items but for a different
17 reason. Flow through items are timing differences for which no deferred taxes are
18 provided. An example would be AFUDC. By omitting the deferred tax, AFUDC
19 impacts tax expense as if it were a permanent item. However, AFUDC will
20 impact tax expense twice – once when it originates (it will be a benefit to tax
21 expense) and again when it reverses through book depreciation expense (it will be
22 a charge to tax expense).

1 Permanent and flow through items essentially have a tax rate of zero, even though
2 the statutory rate is 35 percent.

3 **Q. How is the effective tax rate calculated?**

4 A. The effective tax rate is calculated by taking the tax expense and dividing it by the
5 related pre-tax income. The effective rate should be used to calculate tax expense
6 when pre-tax income is the starting point. If the statutory rate were used, the
7 effect of the permanent and flow through items would be eliminated. That would
8 not be appropriate as the Company is entitled to recover those amounts in the rate
9 making process.

10 **Q. Has the Company adequately explained how the 36 percent effective rate was**
11 **determined?**

12 A. Yes, the workpapers supporting Exhibit No. ____ (KJB-5) in the ERF docket
13 demonstrate this calculation. In addition, these calculations were reiterated in
14 PSE's Response to Public Counsel Data Request No. 017.

15 **Q. Which tax rate should the Company use?**

16 A. The effective tax rate is the appropriate rate to use in this filing as that is the rate
17 which captures the impact of permanent and flow through items.

18 **IV. CONCLUSION**

19 **Q. Does this conclude your prefiled rebuttal testimony?**

20 A. Yes.