**EXHIBIT NO. \_\_\_(GSS-1T)
DOCKET UE‑161123
PSE SCHEDULE 451
WITNESS:  GARY S. SALEBA**

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| **WASHINGTON UTILITIES AND****TRANSPORTATION COMMISSION,****Complainant,** **v.****PUGET SOUND ENERGY,****Respondent.** |  | **Docket No. UE-161123** |

**PREFILED DIRECT TESTIMONY OF GARY S. SALEBA**

**ON BEHALF OF MICROSOFT CORPORATION**

**October 12, 2016**

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**I. INTRODUCTION**

Q. Please state your name and business address.

A. My name is Gary S. Saleba. I am the CEO and President of EES Consulting, Inc. My business address is 570 Kirkland Way, Suite 100, Kirkland, Washington 98033.

Q. Please describe your background and experience.

A. I hold an MBA in Finance from Butler University and a BA in Economics and Mathematics from Franklin College. I am a founder of EES Consulting, Inc. (EES). I have over 30 years of experience working in the utility industry and have managed projects related to resource planning, contract negotiations, mergers and acquisitions, financing, rates studies, operational prudency and strategic planning. I have considerable experience appearing as a subject matter expert in various jurisdictions that include numerous utility commissions and provincial tribunals, the Federal Energy Regulatory Commission, National Energy Board and numerous courts of law. I have testified over 100 times as a subject matter expert on utility matters. A further description of my educational background and work experience can be found in Exhibit (GSS-2) attached to this testimony.

**Q.** **On whose behalf are you appearing in this proceeding?**

A.I am testifying on behalf of Microsoft Corporation (Microsoft).

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

A. Microsoft desires to purchase its power supply from a third party vendor and no longer take power supply service from Puget Sound Energy (PSE). As outlined by Witness Irene Plenefisch, Microsoft and PSE have agreed to an arrangement to facilitate the transfer of Microsoft’s power supply service to a non-PSE supplier with the understanding that Microsoft will (1) pay an “exit fee” to PSE and its remaining customers in the amount of about $23.7 million; and (2) continue to pay PSE for the transmission and distribution services provided to Microsoft by PSE under PSE’s Schedule 451. *See* Exhibit No. **\_\_\_(IP-1T).** My testimony opines on the reasonableness of this $23.7 million exit fee payment.

**Q. How is your testimony organized?**

A. My testimony is organized as follows:

* Background on exit fees
* Precedents for exit fees
* Summary of PSE’s proposed exit fee
* Critique of PSE’s proposed exit fee
* Impacts of using a more standard exit fee construct
* Summary observations and conclusions

Each of these major sections is discussed below.

**II. BACKGROUND ON EXIT FEES**

**Q. What is an “exit fee”?**

A. An exit fee is a term of art in utility regulation which has been defined and refined over the past three decades.

With the advent of open access and customer choice within the utility industry, there are often times options for an existing customer to no longer take power supply service form the incumbent utility and to begin purchasing power supply from a third-party vendor. Under this arrangement, the incumbent utility continues to provide transmission and distribution services to the customer but allows the customer to purchase its power supply services from another supplier. As part of the regulatory construct which allows power purchases from a third party, the incumbent utility collects or credits the departing customer an “exit fee” in an amount that keeps the remaining customers financially indifferent or “held harmless” from the actions of a customer taking power supply from a non-incumbent supplier. This payment or credit is set so that the remaining customers will be no better off and no worse off with respect to the costs of supporting the incumbent utility’s existing power supply assets when a customer elects to no longer take power supply service from the incumbent utility.

**Q. Why is an exit fee being paid by Microsoft?**

A. PSE has determined that Microsoft buying its power supply from a non-PSE supplier will result in net costs to remaining PSE customers of approximately $23.7 million over the first 5 years of this transition as the result of foregone revenue that Microsoft would have contributed to supporting PSE’s current costs of supplying power, which is in excess of PSE’s reduced costs. In order to hold harmless PSE’s remaining customers over these first 5 years, PSE proposes Microsoft should pay this $23.7 million net cost as an exit fee.

**Q. After Microsoft begins purchasing its power supply from a non-PSE source, will Microsoft pay other charges to PSE?**

A. Yes. Microsoft will continue to pay PSE under Schedule 451 – Large Customer Retail Wheeling. Under Schedule 451, Microsoft will pay PSE for all of the costs associated with using PSE’s transmission and distribution facilities plus riders that cover such things as conservation services, low income programs, property taxes, expedited rate filings and revenue decoupling adjustments.

**Q. Have you been involved in the calculation of exit fees before?**

A. Yes. I have actively participated in calculating appropriate exit fees in numerous jurisdictions over the past three decades representing both departing customers and the incumbent utilities.

**III. PRECEDENT FOR EXIT FEES**

**Q. Is there regulatory precedent for calculating exit fees?**

A. Yes. Many state, federal and provincial utility regulators that allow customers to purchase power supply services from a third-party or offer “open access” have gone through the exercise of calculating exit fees. These jurisdictions have adjudicated exit fees for customers that wish to purchase their power supply service from a supplier other than the incumbent utility.

**Q. Are there specific regulatory forums that are well known for the calculation of an exit fee?**

A. Yes. The western states have been front-runners in this exercise including California, Nevada, and Oregon. The Federal Energy Regulatory Commission (FERC) has also been a lead in calculating exit fees. The FERC Order 888-A is considered by most as providing appropriate guidance in the calculation of these exit fees.

**Q. Is there a standard method for calculating exit fees?**

A. No. Exit fees are always situation-specific but they all generally embrace the higher principle of holding harmless remaining customers from the financial and rate impacts of departing customers who no longer take power supply services from the incumbent utility and will therefore no longer contribute to costs associated with the utility’s existing power supply assets, which were acquired by the utility to serve the larger (pre-departure) customer load.

**IV. SUMMARY OF PSE’S PROPOSED EXIT FEE**

**Q. What is your understanding of PSE’s proposed exit fee if Microsoft purchases its power supply from a non-PSE source?**

A. The details of PSE’s proposed exit fee for Microsoft are contained in Witness Jon A. Piliaris’s testimony. In summary, PSE proposes to collect the net present value (NPV) of the difference between (a) the power supply revenues PSE would have collected from Microsoft if Microsoft continued to purchase power supply service from PSE and (b) the amount of reduced PSE power supply expenses that are realized by not having to provide Microsoft with this power supply service. This NPV is aggregated over the first five years after Microsoft begins purchasing power supply from a non-PSE source. The end result of this PSE proposal is an exit fee for Microsoft of approximately $23.7 million.

**V. CRITIQUE of PSE’S PROPOSED EXIT FEE**

**Q. Have you reviewed the input assumptions associated with PSE’s proposed exit fee for Microsoft?**

A. Yes. I have.

**Q. Is it your opinion that PSE’s proposed exit fee is the amount necessary to hold remaining ratepayers harmless?**

A. No. My review of PSE’s proposed exit fee reveals that it is in excess of the amount needed to hold PSE’s remaining customers harmless if Microsoft purchases its power supply from a non-PSE source.

**Q. Why do you opine that PSE’s proposed exit fee is in excess of what is needed to hold PSE’s remaining customers harmless?**

A. I find two assumptions that are in conflict with the principle that the proposed exit fee’s objective is to hold PSE’s remaining customers financially harmless. These inappropriate assumptions are:

* The analysis period should extend beyond five years for the forecast of the NPV difference in rate revenues from Microsoft and the reduced PSE power supply expenses.
* The assumed value of reduced PSE power supply costs attributable to Microsoft taking power from a non-PSE supplier is too low.

Taken in total, correction of these two inappropriate assumptions will result in a net benefit to PSE’s remaining customers if Microsoft purchases its power supply from a non-PSE source.

**Q. Can you explain why the forecast period should be beyond five-years?**

A. Yes. The theory behind an exit fee is that the net costs/benefits associated with an existing customer taking power supply service from a third party should be analyzed over the remaining useful lives of the assets at issue. Once the affected assets at issue are fully depreciated or obsolete, the costs/benefits associated with a departing load on these assets become a moot issue. In this case, the assets at issue are only PSE’s power supply assets as all costs related to PSE transmission and distribution assets are covered under the rates paid to PSE by Microsoft under Schedule 451.

In reviewing the PSE power supply assets, the remaining useful lives of these assets are much more than five years. Based on data included in PSE’s 2015 FERC Form 1, dated April 14, 2016, the average remaining useful life of PSE’s generating assets is at least 20 years. Additionally, an initial review of PSE’s power supply portfolio indicates that they have roughly 20 years of depreciation associated with them. As such, the remaining useful lives for these same power supply assets are at least 15-20 years, and a 15 – 20-year period of analysis of the relative costs/benefits of Microsoft no longer taking power supply service from PSE is a much more appropriate period of analysis.

**Q. What effect does extending the period of analysis for the calculation of a Microsoft exit fee have on PSE’s proposed exit fee?**

A. Based upon its most recently filed Integrated Resource Plan (IRP), PSE is power supply surplus until Colstrip 1 and 2 are retired. Once Colstrip 1 and 2 are retired, PSE goes power supply deficit and must replace this lost generation output with more expensive power supply options. By terminating power supply service from PSE, Microsoft’s procurement of power from a non-PSE source allows PSE to avoid purchasing or building a corresponding amount of new power supply resources which saves the remaining PSE customers a considerable amount of money. For example, termination of Colstrip 1 and 2 costs PSE at least $20 million per year in power supply expense. These savings continue through the term of the exit fee analysis. Thus, extending the exit fee analysis period to match the remaining useful life of PSE’s current power supply resources more accurately and fairly calculates the value to remaining PSE customers of Microsoft taking power supply service from a non-PSE source and results in net benefits to the fully-bundled PSE customers remaining after Microsoft has moved its Schedule 40 load onto Schedule 451.

**Q. What is the next assumption made in the proposed PSE exit fee calculation for Microsoft that you find inappropriate?**

A. The next assumption which is inappropriate is the value to PSE of Microsoft not taking PSE power supply services. In its exit fee analysis, PSE assumes that the power supply freed up by Microsoft’s use of Schedule 451 will be used to reduce PSE’s purchases of power supply for its remaining customers. However, the Schedule 40 power supply product purchased by Microsoft from PSE is a firm, load-following product with all the necessary ancillary services (i.e., schedule, dispatch, balancing and reactive power services). If PSE sold the power freed up by Microsoft on the open market as a firm load-following product, PSE would realize a price for that power that exceeds the value to PSE of reducing its purchases of power supply by an equivalent amount. As such, PSE should assume a higher value for the power not being sold to Microsoft. It would be more appropriate to assume this product’s wholesale market value equals a 50 MW block of a load-following product with all ancillary services. A description of the BPA Tier 1 product, which would be a low cost proxy for such a power supply product, can be found in Exhibit No. **\_\_\_(GSS-3)** attached to this testimony. My initial research indicates a 4-year load following power supply product such as the BPA Tier 1 product would garner a value near 35 percent higher than the value PSE has attributed to this surplus power supply in the calculation of PSE’s exit fee.

**VI. FINANCIAL IMPACTS OF USING A MORE
STANDARD EXIT FEE CONSTRUCT**

**Q. Have you estimated the financial impacts of making your appropriate changes to the proposed PSE exit fee for Microsoft?**

A. Yes. I have.

**Q. Can you estimate the impacts of using a 15-20 year forecast of net benefits/costs on PSE’s proposed exit fee for Microsoft?**

A. Yes. PSE Exhibit No. **\_\_\_**(JAP-03) shows the benefits/costs of Microsoft terminating PSE power supply service. By referencing this exhibit, the basis for the $23.7 million exit fee over a five-year forecast is displayed. As reflected in Exhibit No. **\_\_\_**(GSS-4) attached to this testimony, if the PSE forecast period is properly extended to 15 years, which is a conservative time period (i.e., relatively short when compared to resource planning periods and power supply asset useful lives), the net benefit to PSE remaining customers is roughly $15.4 million. In other words, using a 15-year period of analysis, Microsoft would theoretically receive a payment from PSE of $15.4 million, instead of having to pay over $23.7 million. Extending the period of analysis thus would result in a swing of about $39 million of net benefit. PSE’s proposal to have Microsoft pay a $23.7 million exit fee is obviously highly protective of the remaining PSE customers.

Q. Did you estimate the effect on PSE’s exit fee proposal if an appropriate market value for the surplus Microsoft power is assumed?

A. Yes. A firm load following product with ancillary services and a 4-year term should be used as the assumed value of the Microsoft-related surplus power. As shown in Exhibit No. **\_\_\_**(GSS-3) attached to this testimony, the value of this type of power supply product greater than the avoided power supply expenses assumed by PSE even when using this low cost BPA Tier 2 product for comparison. Based upon this, the PSE stranded cost proposal would decrease to $7.8 million if a 5-year forecast period is used and become a net benefit of $35.2 million if a 15-year forecast is used. The basis for these calculations can be referenced on Exhibit No. **\_\_\_**(GSS-5).

VII. SUMMARY OBSERVATIONS AND CONCLUSIONS

Q. In your opinion, is PSE’s proposed exit fee of $23.7 million calculated based upon generally-accepted exit fee principles?

A. No. PSE’s proposed exit fee for Microsoft is not in keeping with generally-accepted rate setting principles as they apply to the calculation of a fair, just and reasonable exit fee.

Q. If the higher principle associated with exit fees to hold remaining customers harmless is the objective, would PSE’s proposed exit fee meet this standard?

A. No. The proposed PSE exit fee for Microsoft is far in excess of the amount needed to hold remaining PSE customers harmless. This proposed $23.7 million exit fee would make PSE customers better off than they would have been if Microsoft had remained a full service customer of PSE.

Q. In your opinion, how should the exit fee for Microsoft be calculated?

A. An exit fee in this circumstance should be calculated over a forecast period of at least 15 years and be predicated on the highest and best use of the surplus PSE power supply created by Microsoft taking power supply services from a non-PSE source.

Q. Have you estimated what a fair, equitable, non-discriminatory and adequate exit fee should be for Microsoft?

A. Yes. Using generally-accepted rate setting standards and the factual basis noted above, Microsoft should receive a payment from PSE for not using PSE’s power supply sources of between $15.4 million and $35.2 million.

Q. Based upon your aforementioned analysis, is PSE’s proposed exit fee for Microsoft of $23.7 million in the public interest of the remaining PSE customers?

A. Yes. This level of exit fee payment is significantly in excess of what regulatory precedent would dictate, in excess of what is needed to hold the remaining PSE customers harmless and is more than generous on the part of Microsoft.

Q. Does this conclude your testimony?

A. Yes. It does.