**EXHIBIT NO. \_\_\_(MRM-1T)
DOCKETS UE-151871/UG-151872**

**PSE EQUIPMENT LEASING SERVICE
WITNESS:  MATTHEW R. MARCELIA**

**BEFORE THE**

**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| **WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION** **Complainant,** **v.****PUGET SOUND ENERGY** **Respondent,** |  | **Dockets UE-151871** **UG-151872** |
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**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF**

**MATTHEW R. MARCELIA**

**ON BEHALF OF PUGET SOUND ENERGY**

**JULY 1, 2016**

**PUGET SOUND ENERGY**

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

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**PUGET SOUND ENERGY**

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

# I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Matthew R. Marcelia. I am employed as Controller and Principal Accounting Officer for Puget Sound Energy, Inc. (“PSE” or “the Company”). My business address is 10885 NE Fourth Street, Bellevue, WA 98009-9734.

Q. Have you prepared an exhibit describing your professional qualifications?

A. Yes, I have. It is Exhibit No. \_\_\_(MRM-2).

Q. What is the purpose of your testimony?

A. My testimony primarily responds to the accounting and tax issues raised by Ms. Kimball and Ms. O’Connell.

# II. TAX ISSUES

Q. Before you address the particular issues in the testimony, can you please provide an overview of the taxation of leasing activities in Washington State?

A. In Washington, anyone engaged in the business of leasing personal property to another party will be subject to tax. It is common to all. There is a sales tax on the lessee and a business and occupation (“B&O”) tax on the lessor. Everyone similarly engaged in leasing transactions pays the tax.

Q. You say that everyone pays the tax, but would PSE pay the tax at a higher rate than other taxpayers?

A. No. PSE would pay the same rate of tax as anyone else. The B&O tax rate is the same for PSE as for any other taxpayer. The sales tax rate charged to PSE’s leasing customers would be the same rate any non-PSE customer lessee would pay (or that any purchaser of equipment would pay). In other words, the sales tax and the B&O tax is common to all.

Q. Who bears the cost of the sales tax?

A. In Washington, economically, the sales tax is borne by the lessee. Usually, it is added to the invoice and collected along with the lease payment. The lessor receives those dollars and remits them to the state.

Q. Who bears the cost of the B&O tax?

A. The B&O tax is a tax on the lessor or the seller. It is considered a cost of doing business. And as with every cost of doing business, it is baked into the business’ determination of the price of its product. As Mr. Fluetsch points out (page 11, lines 11-13), “[W]e do not separately pass those on to our customers. They are included as part of our overall cost of doing business.” At PSE, it works the same way.

Q. What about utility taxes?

A. Every taxpayer in Washington that has “utility revenue” is subject to the utility tax whether they are a utility or not. The definition of “utility revenue” is determined by the taxing authority and is not the result of any particular regulatory action. For example, a taxpayer can have “utility revenue” and not be subject to regulation by the WUTC. Conversely, a taxpayer can have “non-utility revenue”[[1]](#footnote-1) that is subject to regulation by the WUTC.

Q. What is the definition of utility revenue?

A. The exact definition of utility revenue is not important. The key for this proceeding is that any taxpayer who has it will be subject to utility tax on it.

Q. Is there more than one utility tax?

A. There is a state utility tax which applies throughout the state. In addition, there are some cities that have a municipal utility tax.

Q. How many cities have a utility tax?

A. PSE serves customers in 106 cities where there is a municipal utility tax. Not all cities have a municipal utility tax.

Q. Do unincorporated areas have a utility tax?

A. No, unincorporated areas do not have a utility tax.

Q. How should leasing operations be taxed under the utility tax?

A. Leasing operations should not be subject to utility tax. It should be subject to sales tax. So at the state level, leasing would be subject to sales tax and not utility tax. At the city level, a similar result should be achieved. However, there is one, and only one city, Bellingham, who charges a utility tax on PSE’s leasing activities.[[2]](#footnote-2) No other city makes this same claim. Regardless of any claims made, tax jurisdictions have an obligation to treat all taxpayers equally in the application of their tax laws.

Q. How should taxes factor into the Commission’s decision on PSE’s leasing platform?

A. Since every lease transaction is subject to tax, it is not a point of differentiation that should sway the Commission to support or deny PSE’s leasing platform. One way or another, the state and the cities will get their tax revenue and the law requires them to apply their tax laws indiscriminately.

 The tax laws are subject to change by the legislature or the local jurisdiction. What is taxed today will probably be taxed tomorrow, but that is not always so. If a local jurisdiction wants to apply the sales tax and the utility tax on the same activity or to increase the tax rate, as long as they follow the appropriate legal process (e.g. votes, referendum, etc.), they can make the tax whatever they want it to be. And that should not matter to the Commission, Staff, Public Counsel or anyone else. The citizenry is subject to the taxes that they will tolerate. That does not make PSE’s leasing platform better or worse.

**Q. Can you respond to Ms. Kimball’s testimony on the “substantial” level of taxation?**

A. I agree with Ms. Kimball’s inference that the taxes in the state of Washington are too high and are applied to too many things.**[[3]](#footnote-3)** However, that is a matter to be addressed by the state legislature, not the Commission, or through PSE’s leasing platform.

Q. Ms. Kimball claims that the amount of tax on a hypothetical Olympia resident would be $4,458. Can you confirm this calculation?

A. Ms. Kimball has overstated the Olympia tax by a factor of over two times. Using her lease payment amount of $25,056, the tax charged to an Olympia resident would be $2,205 under current tax law.

Q. What error did Ms. Kimball make to reach her inaccurate calculation of $4,458?

A. She more than doubles the tax by applying the sales tax and the Olympia utility tax when PSE explicitly explained that Olympia is not a city that would calculate the tax in this way, which Ms. Kimball’s testimony acknowledges on page 7, footnote 9. It is not clear why Ms. Kimball chose to ignore this data. But even if Olympia applied an outlandish tax rate on leasing activity, that would not make the leasing platform a good or bad idea as Olympia would treat all taxpayers the same. All taxpayers have an obligation to comply with the tax laws and PSE is no different. If Ms. Kimball does not like the result, it is an issue for the Olympia city council, not a reason to quash the leasing platform for all customers in all jurisdictions.

Q. Are there other tax items in testimony that you need to address?

A. Yes, there are three more items:

First, in Ms. O’Connell’s testimony, in response to a question about costs in addition to the lease payments that customers will see on their bills, (ECO-1T, 24:17-20), she misstates which taxes will be added to a customer bill. The state utility tax would never apply. The city (or municipal) utility tax would not apply, except in Bellingham under current law. Sales taxes would apply. The B&O tax would apply but it would be covered by the lease payment as part of the cost of doing business. It would not be added to the bill as a separate item like the other taxes.

Second, Ms. Kimball (MMK-1HCT 48:6-8) improperly compares home equity lines of credits (“HELOCs”) with PSE’s leasing plan. There are a few important points to make with respect to HELOCs: (a) interest on HELOCs is not always tax deductible as Ms. Kimball indicates; (b) a HELOC is secured by a lien on your house, thereby entitling you to a lower interest rate; and (c) a HELOC offers you no warranty or maintenance plan on your appliance. Therefore, if you make the appropriate adjustments (e.g., adjust for income taxes, compare with unsecured credit, buy an 18 year warranty that assures equipment repair or replacement, and include a scheduled maintenance plan), now you can perform an apple-to-apple comparison with PSE’s leasing platform. Otherwise, a HELOC is not comparable to PSE’s leasing platform.

Third, regarding property taxes addressed by Ms. Kimball (MMK-1HCT 8:6-9), PSE will continue to recover all property taxes via Schedule 140, which will include the tax associated with the equipment used in the leasing program. Through Schedule 140, PSE will allocate the portion of its property tax associated with leasing equipment to Schedule 75 customers, thus ensuring that leasing customers bear the entire incremental share of the property tax burden for which they are responsible. In the compliance filing for the lease case, PSE will update rates to remove property tax that is currently included in the pricing model, as this property tax will be recovered through Schedule 140.

# III. LEASE ACCOUNTING

Q. Ms. O’Connell asserts that General Instructions (“GI”) 19 and 20 of the Uniform System of Account, Title 18, Chapter I, Subchapter F, Parts 101 and 201 in the Code of Federal Regulations do not apply to the utility as a lessor. Do you agree?

A. That conclusion is not supported by the Code of Federal Regulations “CFR.” For example, GI 19, *Criteria for classifying leases*, is agonistic. It explains the FERC criteria to use in determining if a lease is subject to capital or operating accounting treatment. This guidance applies to lessors and lessees alike and FERC does not spell out to which it applies. And in reality, FERC doesn’t need to spell it out. The rules that FERC enumerates in GI 19 are essentially identical to the Financial Accounting Standard No. 13 (FAS 13), which was the US GAAP in place at the time FERC issued GI 19. The GAAP rules apply to lessor and lessee alike.

 Now, when considering GI 20, the situation is clearer. In Parts A and B of GI 20, there is no indication of FERC’s intent. However, in Parts C, D, and E, it is very clear that FERC is considering the utility to be the lessee. Therefore, it is reasonable to conclude that GI 20 informs the FERC accounting for situations where the utility is the lessee.

 The application of GI 20 to the utility as lessee in no way precludes the utility from being a lessor. In fact, we know that FERC does contemplate situations where the utility will be the lessor. See FERC Account 104, *Electric Plant Leased to Others* and *Gas Plant Leased to Others.* The very existence of this account indicates that a utility can be a lessor in FERC’s eyes.

 Even though FERC Account 104 is not specifically referenced in any of the General Instructions, the guidance laid out in GI 19 and 20 is helpful in considering how this account should be used.

Q. What guidance does Ms. O’Connell apply once she believes that FERC doesn’t address PSE’s leasing platform?

A. Ms. O’Connell looks to the new GAAP guidance, ASC 842,[[4]](#footnote-4) to determine her view of the proper accounting treatment. This is a logical step to take but must be considered with caution as neither FERC nor the WUTC is required to follow GAAP. Either or both could go different routes. Especially in light of the new accounting standard, I would not be surprised to see FERC (and even the WUTC) promulgate rules that maintain the historic treatment for lessee/lessor accounting and intentionally diverge from the new standard.

In applying the GAAP guidance, Ms. O’Connell concludes that the PSE lease arrangement would result in a capital lease. Curiously, she also applies GI 19, which she claims does not apply, and similarly concludes that the lease is a capital lease.

Q. What is the significance of the GAAP treatment as a capital lease?

A. The Company does not view the GAAP treatment of the lease as particularly meaningful. For PSE, the accounting treatment is largely an issue of financial statement geography which ultimately will have little or no meaningful impact on the economics of the Company’s regulated leasing activities.

Q. What accounting standard should apply to PSE’s leasing activities?

A. PSE should apply the FERC guidance to its leasing activities, not the GAAP guidance. PSE believes that FERC, particularly GI 19, GI 20, and Account 104, provide the guidance necessary to properly account for PSE’s leasing activities as a lessor.

Q. Please describe how PSE would determine if the leases were capital versus operating?

A. PSE would apply GI 19. PSE’s conclusion pursuant to GI 19 is that the leasing activities would be capital in nature.

Q. How should PSE’s capital leases be recorded under FERC accounting?

A. The equipment in PSE’s leasing program (capital leases) should be recorded to FERC Account 104. Accordingly, PSE would depreciate the equipment over its useful life.

 FERC states that Account 104 “shall include the original cost of electric plant owned by the utility, but leased to others as operating units or systems, where the lessee has exclusive possession.”

Q. If GI 19 required PSE to record the leasing activity as operating leases, how would that be recorded?

A. If they were operating leases, PSE would record the equipment in the leasing program to FERC Account 104. FERC Account 104 applies to capital or operating leases. It does not distinguish between the two and both would be recorded to Account 104.

So whether capital or operating, PSE would include the leased assets (e.g. water heaters and heating equipment) as assets in Account 104. It would depreciate those assets over their useful life. The assets would be included in rate base and earn a return. All of which would be covered by the lease payments.

Q. Ms. O’Connell advocates following ASC 842 (ECO-1THC 40:1-6). Could this be done?

A. Yes, it is possible to follow ASC 842 instead of FERC. However, at the end of the day, it is largely a question of geography and nomenclature. Economically, the results would be nearly the same. In one situation, PSE would have assets in Account 104. In the other, PSE would have assets in Account 142 (i.e. customer receivable for the full lease obligation). Both Accounts 104 and 142 would be included in rate base, albeit different sections. Both would be recovered through depreciation or amortized to cost of goods sold. In both, the lease payments would cover the return on and of the original costs.

Q. If the economics are the same, which approach does PSE prefer and why?

A. PSE clearly prefers the FERC approach. Using Account 104 would enable us to use our existing property accounting team and software to track and depreciate the assets in the leasing platform. This approach would allow simpler, clearer, and more transparent tracking of the leasing activity. Using Account 142 would be cumbersome and require unnecessary effort to achieve no discernable economic benefit to the Company, the customer, or the Commission from the exercise.

Q. Ms. O’Connell raises the specter of double counting. Will PSE be able to avoid double counting its leased assets?

A. It is an absolute and unequivocal certainty that under any arrangement PSE will not double count its assets. PSE follows a rigorous system of double entry accounting. At PSE, there are no dangling debits. Every debit is paired with a credit. Stated another way, PSE’s book are in a state of balanced bliss. The sum of all debits is equal to the sum of all credits.

**Q. If the equipment is recorded in Account 104, what will PSE record to FERC Account 142, *Customer Accounts Receivable*?**

A. Ms. O’Connell appears to misinterpret PSE’s response to WUTC Staff DR 049. She appears to have interpreted the response to mean that the full value of the leased assets would be recognized in both Account 104 and in Account 142. This is not the case.

PSE will only include in FERC Account 142 the amount of the current lease payment that has not yet been collected from customers. The only balance carried in Account 142 would be for the timing difference between recording of the monthly billings and collection of the billings. This is the same way PSE records customer billings today – the Account 142 balance includes amounts billed but not yet collected.

Q. Are assets included in the leasing platform consistent with the FERC definition of distribution plant?

A. Yes. Distribution plant is a broad category. In fact, the FERC chart of accounts includes things like street lighting and signal systems under distribution plant, even though neither would meet the technical definition of distribution plant. Leased property is definitely includable in Sub Account 386 (for gas) and Sub Account 372 (for electric). In addition, PSE’s current water heater program is included in its distribution accounts.

Finally, RCW 80.04.010(11), which is referenced by Ms. O’Connell and shown below, provides for equipment that provides for the furnishing of heat which water heaters and HVAC systems do. So it seems clear that the lease equipment should be included as electric and gas plant.

"Electric plant" includes all real estate, fixtures and personal property operated, owned, used or to be used for or in connection with or to facilitate the generation, transmission, distribution, sale or furnishing of electricity for light, heat, or power for hire; and any conduits, ducts or other devices, materials, apparatus or property for containing, holding or carrying conductors used or to be used for the transmission of electricity for light, heat or power.[[5]](#footnote-5)

Q. Must PSE record the Schedule 75 assets under Distribution Plant?

A. No, PSE could record them in a couple of different places. But PSE believes that distribution plant is a logical place to record the leased assets and that would be consistent with prior practice. However, the lease assets could be placed in Sub Account 398, *Miscellaneous Equipment,* or in Sub Account 399, *Other Tangible Property.* For PSE, the overriding concern is that the Schedule 75 assets be recorded in a consistent and transparent manner in the 300-level accounts so that we can reliably manage and report on the leasing program. Which account to use is not a significant issue, but PSE would prefer to use Sub Account 386 (for gas) and Sub Account 372 (for electric).

Q. Is it the accounting for the leasing program that will determine whether or not that program is considered merchandising under Washington law?

A. No, the accounting is not the driver when determining whether or not a program is merchandising. PSE is embarking on a leasing program for all of the reasons outlined in the Company’s original filing. The goal is not to “move product” or to sell inventory at some mark-up. The Company’s desire is to lease Company assets to customers so that customers can enjoy the benefits of those assets at a fair and reasonable price. The Company is not selling equipment. The Company owns and maintains the equipment throughout its life. This is a leasing program.

Utilities lease their assets and equipment to customers all the time. For example, PSE already leases transformers, substations, and space on utility poles to customers. And PSE continues to rent equipment to over 33,000 customer under its existing rental program. Under ASC 842, those lease arrangement will need to be evaluated for the proper GAAP treatment. It is possible that some of PSE’s current operating leases will be recharacterized as capital leases for GAAP purposes only. That characterization will not convert them into merchandizing any more than it would for the leasing platform. Nor would it automatically change their regulatory or ratemaking treatment.

Q. What standard should the Commission apply to rate base?

A. Ms. O’Connell’s sweeping characterization of the known and measurable standard is misapplied and incorrect (ECO-1THC 15:11). She incorrectly states that the Commission applies this standard when determining whether to include electric plant in rate base. However, it is the actual original costs of the assets that should and would be recorded in rate base. The known and measurable standard is a Commission rule with specific applicability--it addresses pro forma adjustments in general rate cases, and specifically allows known and measurable changes that occur after the close of a historical test year in a general rate case to be pro formed into the test year. See WAC 480-07-510(3)(e)(iii). This rule does not address how the Company records plant in rate base for accounting purposes, outside of a general rate case. It is the Company’s intention to only record the actual original cost of the equipment used in the leasing program in the program’s rate base in Account 104.

# IV. CONCLUSION

Q. Does this conclude your testimony?

A. Yes.

1. In this context, I am using the term “non-utility revenue” to denote any revenue that falls outside of the definition of “utility revenue.” For example, neither contribution in aid of construction nor interest charges are considered “utility revenue” by the State of Washington while it is clear that those charges are subject to Commission regulation. [↑](#footnote-ref-1)
2. This result stems from a 2011 Court of Appeals decision that was decided based on significantly different facts than those under consideration in PSE’s leasing platform. However, PSE will include utility tax for customers in Bellingham on the customer bill and this will be collected along with the lease payment. [↑](#footnote-ref-2)
3. Kimball, Exhibit No. \_\_\_(MKK-1T) 9:4-5 (“[T]he additional taxes would be substantial.”). [↑](#footnote-ref-3)
4. It’s a minor point but it should be mentioned – ASC 842 will not become effective until 2019. For purposes of this discussion the differences between ASC 840, the lease accounting standard currently in effect for US GAAP, and ASC 842 are not significant as it relates to the lessor. [↑](#footnote-ref-4)
5. Similar language is used in RCW 80.04.010(15), which defines gas plant. [↑](#footnote-ref-5)