EXH. CGP-1CT
DOCKETS UE-22___/UG-22____
2022 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-22____** **Docket UG-22____**

PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF

CARA G. PETERMAN

ON BEHALF OF PUGET SOUND ENERGY

REDACTED VERSION

JANUARY 31, 2022

PUGET SOUND ENERGY

PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF CARA G. PETERMAN

CONTENTS

PUGET SOUND ENERGY

PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF CARA G. PETERMAN

LIST OF EXHIBITS

PUGET SOUND ENERGY

PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF CARA G. PETERMAN

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 Peterman. My business address is Puget Sound Energy, P.O. Box 97034, Bellevue, Washington 98009-9734. I am employed by Puget Sound Energy ("PSE" or the "Company") as Corporate Treasurer.

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

A. Yes, I have. It is Exh. CGP-2.

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. Please summarize the purpose of your testimony.

A. My testimony describes PSE's requested capital structure, cost of capital, and overall rate of return for each year of the multiyear rate plan. In addition, I provide testimony on PSE's recent credit ratings performance and discuss the impacts that tax reform and the final order in PSE's 2019 general rate case had on the Company's cash flow and credit ratings. I discuss steps PSE has taken to improve its cash flow and credit metrics. I also demonstrate that PSE's requested return on equity, equity ratio, and overall rate of return for the multiyear rate plan are credit positive. In this regard, I discuss PSE's cost of long-term debt and how PSE has been successful in reducing the cost of long-term debt over the past decade. Notably, PSE's requested overall rate of return over the course of the multiyear rate plan is consistent with PSE's overall rate of return in 2019 and 2020. Further, I highlight other actions PSE has taken to manage the cost of capital. Finally, I demonstrate that PSE is in compliance with all regulatory commitments regarding capital structure and cost of capital.

II. PSE'S CAPITAL STRUCTURE REQUEST

A. PSE's Capital Structures for the Test Year and Projected for Calendar Years 2021 and 2022

Q. Please provide PSE's capital structures for the test year and projected for calendar years 2021 and 2022.

A. Please find PSE's test year (i.e., July 1, 2020, through June 30, 2021) capital structure and projected capital structures as of December 31, 2021 and December 31, 2022 in Table 1 below:

Table 1. PSE'S Capital Structure
For Test Year (July 1, 2020 - June 30,2021), Projected CY 2021 and CY 2022
(Average of Monthly Averages)

Components	Test Year	Projected CY 2021	Projected CY 2022
Short-Term Debt	2.6%	1.9%	1.4%
Long-Term Debt	48.4%	49.1%	50.1%
Total Debt	51.0%	51.0%	51.5%
Common Equity	49.0%	49.0%	48.5%
Overall Capitalization	**100.0%**	**100.0%**	**100.0%**

I present PSE's test year capital structure in Exh. CGP-3, at pages 1 and 2. I present PSE's projected capital structure for calendar year 2021 in Exh. CGP-4, at pages 1 and 2. I present PSE's projected capital structure for calendar year 2022 in Exh. CGP-5, at pages 1 and 2.

Q. Does PSE propose any adjustments to the test year capital structure?

A. No. PSE does not propose any adjustments to the test year capital structure.

Q. What was PSE's authorized common equity ratio in the test year?

A. PSE's authorized common equity ratio for the test year was 48.5 percent. However, PSE was able to maintain an actual equity ratio of 49 percent for the test year and calendar year 2021, calculated on an average of monthly averages ("AMA") basis.

Q. Why is PSE projecting the common equity ratio will be 48.5 percent in calendar year 2022 when the Company was able to maintain a 49 percent equity ratio in the test year and calendar year 2021?

A. The cumulative effect of the implementation of the TCJA, the current prolonged under-recoveries of investments and costs incurred on behalf of PSE customers, and forecasted cash flow constraints in 2022 are limiting PSE's ability to hold an equity ratio that is higher than the allowed 48.5 percent in calendar year 2022. As discussed in the Prefiled Direct Testimony of Kazi K. Hasan, Exh. KKH-1CT, PSE is carrying over four years of under-recoveries on investments made to its generation assets, electric and gas transmission and distribution grids, technological systems and other assets dating back to the 2017 general rate case, since the Commission did not authorize all investments to be reflected in rate base in its final order in the 2019 general rate case. This prolonged under-recovery of investment, along with the tax revenue lost from the TCJA, is continuing to suppress cash flows. As a result, PSE has to borrow money to fill the gap. This, in turn, increases the debt ratio and decreases the equity ratio. Additionally, forecasted rising costs and growth in deferrals in 2022 such as power costs etc.

will continue to require that PSE borrow until proper cost recovery is achieved. As a result, PSE's cash flow projections in 2022 inhibit its ability to maintain an AMA equity ratio of 49 percent. Rather, PSE is planning to maintain the currently authorized equity ratio of 48.5 percent in 2022.

B. PSE's Requested Capital Structures for the Multiyear Rate Plan

Q. Please present PSE's requested capital structures for the multiyear rate plan (i.e., calendar year 2023, 2024, and 2025).

A. PSE respectfully requests that the Commission adopt the requested capital structures in Table 2 for the multiyear rate plan (i.e., calendar year 2023, 2024, and 2025).

Table 2. PSE'S Multiyear Rate Plan Requested Capital Structures
For CY 2023, CY 2024 and CY 2025
(Average of Monthly Average)

Components	CY 2023	CY 2024	CY 2025
Short-Term Debt	2.4%	2.4%	1.9%
Long-Term Debt	48.6%	48.1%	48.1%
Total Debt	51.0%	50.5%	50.0%
Common Equity	49.0%	49.5%	50.0%
Overall Capitalization	**100.0%**	**100.0%**	**100.0%**

I present PSE's requested capital structure for 2023 in Exh. CGP-6C, at pages 1, 2 and 3. I present PSE's requested capital structure for 2024 in Exh. CGP-7C, at pages 1, 2 and 3. I present PSE's requested capital structure for 2025 in Exh. CGP-8C, at pages 1, 2 and 3.

III. PSE'S REQUESTED COST OF CAPITAL AND RATE OF RETURN

A. Methodologies Used by PSE to Calculate Costs of Capital and Rates of Return

1. Methodology Used to Calculate Cost Rates for Short-Term Debt

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

A. PSE currently has an $800 million unsecured revolving credit facility, which matures in October 2023. PSE plans to renew the facility before expiration. This unsecured revolving credit facility primarily serves to provide necessary liquidity to fund utility operational requirements and the expected variability of such requirements.

Q. Is the structure of the unsecured revolving credit facility consistent with short-term credit facility discussed in PSE's 2019 general rate case?

A. Yes. The existing $800 million unsecured revolving credit facility is the very same facility that existed during PSE's 2019 general rate case, Dockets UE-190529 and UG-190530 (the "2019 general rate case"). As mentioned in the 2019 general rate case, the $800 million unsecured revolving 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 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.

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 agreement loans for the period. PSE then divided this interest cost by the total weighted average short-term debt balance for the period to determine the weighted average short-term debt cost rate for the respective period. The cost rates for commitment fees (including letter of credit fees) and amortization of short-term debt issue cost are identified specifically as its own line item in Exh. CGP-6C through Exh. CGP-8C.

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 previous general rate cases?

A. Yes. PSE's presentation of the cost of short-term debt in this proceeding is consistent with PSE's presentations in past general rate cases.

Q. Has PSE included the cost of commercial paper in its requested cost of short-term debt in this proceeding?

A. Yes. In the past, PSE has met 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 been the lower cost option for short-term financings in recent history, the tier 2 commercial paper market can become difficult to access cost effectively particularly in times of macro-economic stress.

Accordingly, PSE realizes that it cannot rely solely on commercial paper to fund its short-term liquidity needs. Therefore, PSE has projected commercial paper issuances and costs, along with borrowing under its credit agreements, in each rate year's short-term debt costs. This methodology is consistent with PSE's projection of commercial paper issuances and costs in previous general rate cases.

Q. How has PSE calculated its projected cost of short-term debt during the rate year?

A. To calculate the projected cost of short-term debt during each rate year, PSE determined the spread between its short-term borrowing costs and the London Inter-bank Offered Rate ("LIBOR"). PSE then applied that spread to a projected LIBOR during the applicable rate year.

Q. Is LIBOR expected to be the standard market reference rate for the entirety of the MYRP?

A. No. In response to the LIBOR scandal in 2012, the Federal Reserve Board and Federal Reserve Bank of New York convened the Alternative Reference Rates Committee ("ARRC") to identify an alternative reference rate to replace LIBOR. The ARRC identified Secured Overnight Financing Rate ("SOFR") as the preferred alternate reference rate to LIBOR. The key dates of SOFR transitions are as below:

- One-week and two-month LIBOR rates are expected to phase out by December 31, 2021; and
- Overnight/Spot Next, one-month, three-month, six-month and twelve-month LIBOR rates are expected to phase out by June 30, 2023.

The new SOFR will have an impact on the short-term borrowing cost projections in the 2023 to 2025 Proposed Cost of Capital and Rate of Return (Exh. CGP-6C to Exh. CGP-8C) calculations.

Q. Why is PSE using a LIBOR rate projection, rather than a SOFR rate projection to forecast its short-term debt costs?

A. Unfortunately, at the time of this filing, there is not a reliable long-term forecast of SOFR rate projections on the market. However, most banks predict that LIBOR and SOFR rates will be similar in cost and behavior; that is why we opted to utilize a more reliable LIBOR long-term projection by Moody's. Moody's LIBOR projection has been applied consistently in previous general rate cases.

Q. Does PSE believe that the switch in LIBOR and SOFR costs will materially impact short-term debt borrowings?

A. No, the impact of SOFR versus LIBOR on the cost of capital should not be material. As can be seen in Exh. CGP-6, short-term debt cost is only three basis points (or 0.03 percent) of the forecasted weighted average cost of capital in 2023 of 7.39 percent.

2. Methodology Used to Calculate Cost Rates for Long-Term Debt

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

A. PSE currently has over $4.8 billion of debt in:

1. 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
2. pollution control bonds.

Table 3 presents PSE's existing long-term debt as of December 31, 2021.

Table 3. PSE's Long-Term Debt
(as of December 31, 2021)
(Dollars in Thousands)

Series	Type	Due	Amounts
7.150%	First Mortgage Bond	2025	$15,000
7.200%	First Mortgage Bond	2025	2,000
7.020%	Senior Secured Note	2027	300,000
7.000%	Senior Secured Note	2029	100,000
3.900%	Pollution Control Bond	2031	138,460
4.000%	Pollution Control Bond	2031	23,400
5.483%	Senior Secured Note	2035	250,000
6.724%	Senior Secured Note	2036	250,000
6.274%	Senior Secured Note	2037	300,000
5.757%	Senior Secured Note	2039	350,000
5.795%	Senior Secured Note	2040	325,000
5.764%	Senior Secured Note	2040	250,000
4.434%	Senior Secured Note	2041	250,000

Table 3. PSE's Long-Term Debt
(as of December 31, 2021)
(Dollars in Thousands)

Series	Type	Due	Amounts
5.638%	Senior Secured Note	2041	300,000
4.300%	Senior Secured Note	2045	425,000
4.223%	Senior Secured Note	2048	600,000
3.250%	Senior Secured Note	2049	450,000
4.700%	Senior Secured Note	2051	45,000
2.893%	Senior Secured Note	2051	450,000
Debt discount, issuance cost and other			(39,143)
		Total PSE Long-Term Debt	**$ 4,784,717**

Q. Are any of PSE's outstanding issues of long-term debt identified in Table 3 callable as of December 31, 2021?

A. Yes. Certain of PSE's outstanding issues of long-term debt identified in Table 3 above are callable, subject to a make-whole penalty. In Exh. CGP-9, I provide a list of PSE's outstanding issues of long-term debt that are callable as of December 31, 2021.

Q. What actions must PSE take to call these issues of long-term debt?

A. To call these issues of long-term debt, PSE must pay any required make-whole penalty in place to protect debtholders from early termination. At this time, PSE does not project that it would be cost-effective to call any long-term debt early. 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 remove amortization costs on reacquired debt from its cost rate calculation for long-term debt consistent with prior cases?

A. Yes. PSE removed amortization costs on reacquired debt from its cost rate calculation for long-term debt, consistent with past general rate cases. Instead, reacquired debt cost is identified specifically as its own line item in Exh. CGP-6C through Exh. CGP-8C.

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

A. No. PSE did not issue any long-term debt during the test year. However, PSE issued a $450 million, 2.893 percent 30-Year Senior Note on September 15, 2021, which matures on September 15, 2051. PSE used the proceeds to pay down outstanding commercial paper borrowings and for general corporate purposes. This coupon is the lowest cost bond the company has ever issued and reduced the long-term imbedded cost of debt by 22 basis points.

Q. Are there any issues of PSE long-term debt that will mature or retire between the end of calendar year 2021 (i.e., December 31, 2021) and the end of the multiyear rate plan (i.e., December 31, 2025)?

A. As shown in Table 3, above, there are two issuances that will mature in 2025, totaling $17 million.

<u>3. Methodology Used to Calculate Cost Rates for Equity</u>

Q. How has PSE calculated its authorized return on equity during the test year (July 1, 2020, through June 30, 2021)?

A. Typically, PSE utilizes the allowed return on equity from the most recent general rate case as the input for the cost of capital calculation. However, for the test year in this case, PSE's authorized rate of return changed during the test year. As a result, PSE calculated a blended authorized return on equity for the test year.

Q. What was PSE's authorized return on equity for the test year?

A. PSE's authorized return on equity for the test year was an average of 9.43 percent This is a blended rate because the authorized return on equity during the test year changed as a result of the final order in PSE's 2019 general rate case. From July 1, 2020 to September 30, 2020, PSE's authorized return on equity was 9.5 percent. This rate was authorized in the 2017 general rate case in Dockets UE-170033 and UG-170034. From October 1, 2020 to June 30, 2021, PSE's authorized return on equity was 9.4 percent, as established by the 2019 general rate case final order.

Q. How has PSE projected its authorized return on equity for each of the three rate years of the multiyear rate plan (i.e., calendar years 2023, 2024, and 2025)?

A. PSE has relied upon the expertise of Ann E. Bulkley, a Principal with the Brattle Group, to project an appropriate return on equity for PSE for each of the three years of the multiyear rate plan (i.e., calendar years 2023, 2024, and 2025). The Prefiled Direct Testimony of Ann E. Bulkley, Exh. AEB-1T, concludes that a 9.9 percent return on equity for each of the three rate years is a fair and reasonable return for PSE.

Q. Has Ms. Bulkley projected a different return on equity for each of the three years of the multiyear rate plan?

A. No. Ms. Bulkley has not projected a different return on equity for each of the three years of the multiyear rate plan. Instead, Ms. Bulkley has projected an appropriate return on equity that PSE would use throughout the three-year multiyear rate period.

B. PSE's Cost of Capital and Rate of Return For the Test Year

1. PSE's Cost of Short-Term and Long-Term Debt For the Test Year

Q. What was PSE's cost of short-term and long-term debt for the test year?

A. PSE's cost of short-term debt for the test year was 0.27 percent. Please see Exh. CGP-3, at pages 3 and 4, for the calculation of PSE's cost of short-term debt for the test year. PSE's cost of long-term debt for the test year was 5.28 percent. Please see Exh. CGP-3, at page 6, for the calculation of PSE's cost of long-term debt for the test year.

2. PSE's Authorized Return on Equity For the Test Year

Q. What was PSE's authorized return on equity for the test year?

A. As previously mentioned, PSE's authorized blended return on equity for the test year was 9.43 percent.

3. PSE's Cost of Capital For the Test Year

Q. What were PSE's cost of capital and rate of return for the test year?

A. Table 4 provides PSE's capital structure, cost of capital, weighted-average cost of capital, and rate of return for the test year.

Table 4. PSE's Capital Structure, Cost of Capital, Weighted-Average Cost of Capital and Rate of Return Test Year (i.e., July 1, 2020, through June 30, 2021)
(Average of Monthly Averages)

Components of Rate of Return	Capital Structure	Cost Rate	Weighted Cost
Short-Term Debt Rate			
Marginal Short-Term Debt Rate	2.6%	0.27%	0.01%
Commitment Fees			0.02%
Amortization of Short-Term Debt Issue Cost			0.01%
Weighted Short-Term Debt Rate			**0.04%**

Table 4. PSE's Capital Structure, Cost of Capital, Weighted-Average Cost of Capital and Rate of Return Test Year (i.e., July 1, 2020, through June 30, 2021)
(Average of Monthly Averages)

Components of Rate of Return	Capital Structure	Cost Rate	Weighted Cost
Long-Term Debt Rate			
Marginal Long-Term Debt Rate	48.4%	5.28%	2.56%
Amortization of Reacquired Debt			0.02%
Weighted Long-Term Debt Rate			**2.58%**
Total Debt	**51.0%**		**2.62%**
Common Equity	**49.0%**	**9.43%**	**4.61%**
Overall Rate of Return			**7.23%**

Please see Exh. CGP-3, which provides PSE's test year capital structure, cost of capital, weighted-average cost of capital, and rate of return.

C. PSE's Cost of Capital and Rate of Return Projected For Calendar Year 2021

1. PSE's Cost of Short-Term and Long-Term Debt For Calendar Year 2021

Q. What is PSE's projected cost of short-term and long-term debt for calendar year 2021?

A. At the time of this filing, the audited financial statements for the fourth quarter of 2021 are not available. As a result, PSE's calendar year 2021 cost of capital is based on a projection using nine months of actuals and three months of forecast.

As shown on Exh. CGP-4, at pages 1 and 2, PSE's cost of short-term debt for calendar year 2021 was 0.35 percent. As shown on Exh. CGP-4, at page 6, PSE's projected cost of long-term debt for calendar year 2021 was projected to be 5.21 percent.

2. PSE's Projected Cost of Capital and Rate of Return For Calendar Year 2021

Q. What were PSE's projected cost of capital and rate of return for calendar year 2021?

A. PSE's projected cost of capital, weighted-average cost of capital, and rate of return for calendar year 2021 is shown in Table 5.

Table 5. PSE's Projected Capital Structure, Cost of Capital, Weighted-Average Cost of Capital and Rate of Return for Calendar Year 2021
(Average of Monthly Averages)

Components of Rate of Return	Capital Structure	Cost Rate	Weighted Cost
Short-Term Debt Rate			
Marginal Short-Term Debt Rate	1.9%	0.35%	0.01%
Commitment Fees			0.02%
Amortization of Short-Term Debt Issue Cost			0.01%
Weighted Short-Term Debt Rate			**0.04%**
Long-Term Debt Rate			
Marginal Long-Term Debt Rate	49.10%	5.21%	2.56%
Amortization of Reacquired Debt			0.02%
Weighted Long-Term Debt Rate			**2.58%**

Table 5. PSE's Projected Capital Structure, Cost of Capital, Weighted-Average Cost of Capital and Rate of Return for Calendar Year 2021
(Average of Monthly Averages)

Components of Rate of Return	Capital Structure	Cost Rate	Weighted Cost
Total Debt	**51.0%**		**2.62%**
Common Equity	**49.0%**	**9.40%**	**4.61%**
Overall Rate of Return			**7.23%**

D. PSE's Projected Cost of Capital and Rate of Return for Calendar Year 2022

Q. What is PSE's projected cost of short-term and long-term debt for calendar year 2022?

A. As shown on Exh. CGP-5, pages 1 and 2, PSE's projected cost of short-term debt for calendar year 2022 is 1.43 percent and PSE's projected cost of long-term debt for calendar year 2022 is 5.07 percent. The calculation of PSE's projected cost of long-term debt for calendar year 2022 is shown on Exh. CGP-5, page 1 and 2.

Q. What is PSE's authorized return on equity for calendar year 2022?

A. As previously mentioned, PSE's authorized return on equity is 9.40 percent for calendar year 2022, which has been in place since October 1, 2020.

Q. What are PSE's projected cost of capital and rate of return for calendar year 2022?

A. For calendar year 2022, PSE's projected overall rate of return is 7.16 percent. Table 6 presents PSE's projected test year capital structure, cost of capital, weighted-average cost of capital, and rate of return for calendar year 2022.

Table 6. PSE's Projected Capital Structure, Cost of Capital, Weighted-Average Cost of Capital and Rate of Return Calendar Year 2022
(Average of Monthly Averages)

Components of Rate of Return	Capital Structure	Cost Rate	Weighted Cost
Short-Term Debt Rate			
Marginal Short-Term Debt Rate	1. 4%	1.43%	0.02%
Commitment Fees			0.01%
Amortization of Short-Term Debt Issue Cost			0.01%
Weighted Short-Term Debt Rate			**0.04%**
Long-Term Debt Rate			
Marginal Long-Term Debt Rate	50. 1%	5.07%	2.54%
Amortization of Reacquired Debt			0.02%
Weighted Long-Term Debt Rate			**2.56%**
Total Debt	**51.5%**		**2.60%**
Common Equity	**48.5%**	**9.4%**	**4.56%**
Overall Rate of Return			**7.16%**

PSE's projected capital structure, cost of capital, weighted-average cost of capital, and rate of return for calendar year 2022 are provided on Exh. CGP-5.

E. PSE's Requested Cost of Capital and Rate of Return for the First Year of the MYRP (Calendar Year 2023)

1. PSE's Requested Cost of Short-Term Debt and Long-Term for the First Year of the MYRP (Calendar Year 2023)

Q. What cost of short-term and long-term debt does PSE request for the first year of the multiyear rate plan?

A. PSE's requests a cost of short-term debt of 1.43 percent for the first year of the multiyear rate plan, and Exh. CGP-6C, at page 1 and 3, provides the calculation of PSE's requested cost of short-term debt for the first year of the multiyear rate plan (calendar year 2023). PSE requests a cost of long-term debt of 5.07 percent for the first year of the multiyear rate plan, and Exh. CGP-6C, at page 2, provides the calculation of PSE's requested cost of long-term debt for the first year of the multiyear rate plan.

2. PSE Requests an Authorized Return on Equity of 9.90 Percent for the First Year of the Multiyear Rate Plan (Calendar Year 2023)

Q. What return on equity does PSE request for the multiyear rate plan?

A. Based on the cost of equity analyses presented by PSE witness Ann E. Bulkley, Exh. AEB-1T, PSE is requesting a return on equity of 9.90 percent for all three calendar years of the multiyear rate plan. The return on equity recommendation of 9.90 percent considers (1) PSE's capital expenditure requirements and plans over the multiyear rate plan; (2) the regulatory environment in which PSE operates; (3) the effects of federal tax reform on the cash flow metrics of utilities; and (4) a comparison of PSE's capital structure as compared to peer utilities. Based on these factors, Ms. Bulkley found that 9.90 percent is conservative, would adequately compensate PSE for its efforts to deliver safe, clean, and reliable energy to customers, and would fairly balance the interests of customers and shareholders.

Q. What cost of capital and rate of return does PSE request for the first year of the multiyear rate plan?

A. For the first year of the multiyear rate plan, PSE requests that the Commission authorize the following:

1. a cost of short-term debt of 1.43 percent,
2. a cost of long-term debt of 5.07 percent, and
3. a return on equity of 9.90 percent.

Accordingly, PSE requests that the Commission authorize an overall rate of return of 7.39 percent for the first year of the multiyear rate plan. Table 7 presents PSE's requested test year capital structure, cost of capital, weighted-average cost of capital, and rate of return for the first year of the multiyear rate plan. The 2023 requested rate of return is the same as the currently authorized rate of return of 7.39 percent.

Table 7. PSE's Requested Capital Structure, Cost of Capital, Weighted-Average Cost of Capital and Rate of Return
First Year of Multiyear Rate Period
Calendar Year 2023
(Average of Monthly Averages)

Components of Rate of Return	**Capital Structure**	**Cost Rate**	**Weighted Cost**
Short-Term Debt Rate			
Marginal Short-Term Debt Rate	2. 4%	1.43%	0.03%
Commitment Fees			0.01%
Amortization of Short-Term Debt Issue Cost			0.01%
Weighted Short-Term Debt Rate			**0.05%**
Long-Term Debt Rate			
Marginal Long-Term Debt Rate	48.6%	5.07%	2.47%
Amortization of Reacquired Debt			0.02%
Weighted Long-Term Debt Rate			**2. 49%**
Total Debt	**51.0%**		**2.54%**
Common Equity	**49.0%**	**9.90%**	**4.85%**
Overall Rate of Return			**7. 39%**

PSE's requested capital structure, cost of capital, weighted-average cost of capital, and rate of return for the first year of the multiyear rate period are provided in Exh. CGP-6C.

<u>F. PSE's Requested Cost of Capital and Rate of Return for the Second Year of the Multiyear Rate Plan (Calendar Year 2024)</u>

<u>1. PSE's Requested Cost of Short-Term Debt and Long-Term Debt for the Second Year of the Multiyear Rate Plan (Calendar Year 2024)</u>

Q. What cost of short-term and long-term debt does PSE request for the second year of the multiyear rate plan?

A. PSE requests a cost of short-term debt of 2.36 percent for the second year of the multiyear rate plan. Please see Exh. CGP-7C, at page 1 and 3, for the calculation of PSE's requested cost of short-term debt for the second year of the multiyear rate plan. PSE requests a cost of long-term debt of 5.07 percent for the second year of the multiyear rate plan. Please see Exh. CGP-7C, at page 2, for the calculation of PSE's requested cost of long-term debt for the second year of the multiyear rate plan.

<u>2. PSE's Requested Authorized Rate of Return for the Second Year of the Multiyear Rate Plan (Calendar Year 2024)</u>

Q. What cost of capital and rate of return does PSE request for the second year of the multiyear rate plan?

A. For the second year of the multiyear rate plan, PSE requests that the Commission grant the following:

1. an authorized cost of short-term debt of 2.36 percent,
2. an authorized cost of long-term debt of 5.07 percent, and
3. an authorized return on equity of 9.90 percent.

Accordingly, PSE requests that the Commission authorize an overall rate of return of 7.44 percent for the second year of the multiyear rate plan. Table 8 presents PSE's requested test year capital structure, cost of capital, weighted-average cost of capital, and rate of return for the second year of the multiyear rate plan. This is just 5 basis points higher than the current authorized rate of return of 7.39%.

Table 8. PSE's Requested Capital Structure, Cost of Capital, Weighted-Average Cost of Capital and Rate of Return Second Year of Multiyear Rate Period Calendar Year 2024
(Average of Monthly Averages)

Components of Rate of Return	Capital Structure	Cost Rate	Weighted Cost
Short-Term Debt Rate			
Marginal Short-Term Debt Rate	2.4%	2.36%	0.06%
Commitment Fees			0.01%
Amortization of Short-Term Debt Issue Cost			0.01%
Weighted Short-Term Debt Rate			**0.08%**
Long-Term Debt Rate			
Marginal Long-Term Debt Rate	48.1%	5.07%	2.44%
Amortization of Reacquired Debt			0.02%
Weighted Long-Term Debt Rate			**2.46%**
Total Debt	**50.5%**		**2.54%**
Common Equity	**49.5%**	**9.90%**	**4.90%**
Overall Rate of Return			**7.44%**

Please see Exh. CGP-7C, which provides PSE's requested capital structure, cost of capital, weighted-average cost of capital, and rate of return for the second year of the multiyear rate plan.

G. PSE's Requested Cost of Capital and Rate of Return for the Third Year of the Multiyear Rate Plan (Calendar Year 2025)

1. PSE's Requested Cost of Short-Term and Long-Term Debt for the Third Year of the Multiyear Rate Plan (Calendar Year 2025)

Q. What cost of short-term and long-term debt does PSE request for the third year of the multiyear rate plan?

A. PSE requests a cost of short-term debt of 3.14 percent for the third year of the multiyear rate plan. Please see Exh. CGP-8C, at page 3, for the calculation of PSE's requested cost of short-term debt for the third year of the multiyear rate plan. PSE requests a cost of long-term debt of 5.08 percent for the third year of the multiyear rate plan. Please see Exh. CGP-8C, at page 2, for the calculation of PSE's requested cost of long-term debt for the third year of the multiyear rate plan.

2. PSE's Requested Authorized Rate of Return for the Third Year of the Multiyear Rate Plan (Calendar Year 2025)

Q. What cost of capital and rate of return does PSE request for the third year of the multiyear rate plan?

A. For the third year of the multiyear rate plan, PSE requests that the Commission grant the following:

1. an authorized cost of short-term debt of 3.14 percent,
2. an authorized cost of long-term debt of 5.08 percent, and
3. an authorized return on equity of 9.90 percent.

Accordingly, PSE requests that the Commission authorize an overall rate of return of 7.49 percent for the third year of the multiyear rate plan. Table 9 below presents PSE's requested test year capital structure, cost of capital, weighted-average cost of capital, and rate of return for the third year of the multiyear rate plan. This requested rate of return is just 10 basis points higher than PSE's current authorized rate of return.

Table 9. PSE's Requested Capital Structure, Cost of Capital, Weighted-Average Cost of Capital and Rate of Return
Third Year of Multiyear Rate Period
Calendar Year 2025
(Average of Monthly Averages)

Components of Rate of Return	Capital Structure	Cost Rate	Weighted Cost
Short-Term Debt Rate			
Marginal Short-Term Debt Rate	1.9%	3.14%	0.06%
Commitment Fees			0.01%
Amortization of Short-Term Debt Issue Cost			0.01%
Weighted Short-Term Debt Rate			**0.08%**
Long-Term Debt Rate			
Marginal Long-Term Debt Rate	48. 1%	5.08%	2.44%
Amortization of Reacquired Debt			0.02%
Weighted Long-Term Debt Rate			**2.46%**
Total Debt	**50.0%**		**2.54%**

Table 9. PSE's Requested Capital Structure, Cost of Capital, Weighted-Average Cost of Capital and Rate of Return
Third Year of Multiyear Rate Period
Calendar Year 2025
(Average of Monthly Averages)

Components of Rate of Return	Capital Structure	Cost Rate	Weighted Cost
Common Equity	**50.0%**	**9.90%**	**4.95%**
Overall Rate of Return			**7.49%**

IV. PSE'S RECENT CREDIT RATINGS PERFORMANCE

Q. What are credit metrics?

A. Credit metrics are measures rating agencies utilize to assess financial strength, liquidity risk, and ability to service debt of a company in the credit rating process. They are usually presented as percentages or coverage ratios, and the underlying numerators and denominators used for calculation are financials in a company's published financial statements. The most common components of the credit metrics are: Funds from Operation ("FFO"), Cash Flow from Operation pre Working Capital ("CFO pre WC"), Earnings Before Interest/Taxes/Depreciation and Amortization ("EBITDA"), Interest and Total Debt. All three agencies that assign credit ratings to PSE—S&P, Moody's, and Fitch—have similar but slightly different credit metrics, and they apply discretionary adjustments to their calculations. Credit metrics are an important factor when rating agencies assess a company's credit rating.

Table 10 below shows a list of credit metrics by PSE's rating agencies. Key credit metrics that are emphasized the most by each rating agencies are marked in bold below. For more in-depth discussion about credit ratings and rating agencies, please see PSE witness Todd Shipman's testimony, Exh. TAS-1T.

Table 10. List of PSE's Credit Metrics by Rating Agencies

S&P

FFO/End of Period Debt

Debt/EBITDA
FFO/Interest Ratio
EBITDA/Interest

Moody's

CFO Pre WC / Debt

CFO Pre WC less Div / Debt
CFO Pre WC + Interest / Interest
Debt/Book Capitalization

Fitch

FFO Adjusted Leverage

Debt/EBITDAR
FFO Fixed Charge Coverage

Q. What are PSE's current credit ratings as of the time of this filing?

A. As discussed by Mr. Shipman, PSE's credit ratings are as follows:

Table 11. PSE Credit Ratings

Security	S&P	Moody's	Fitch
Corporate credit/issuer rating	BBB[1]	Baa1	BBB+
Senior Secured Debt	A-	A2	A
Commercial Paper	A-2	P-2	F-2
Outlook	Stable	Stable	Stable

1. As Mr. Todd Shipman mentions in TAS-1T, PSE's stand-alone credit profile (SACP) is BBB+, which is comparable to Moody's and Fitch's ratings of the company

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

A. For the purposes of this testimony, similar to the testimony of PSE witness Todd A. Shipman in Exh. TAS-1T, PSE will focus on S&P and Moody's key credit metrics. These are more comparable because both ratios are calculated as a percentage of "FFO" or "CFO pre WC" over total debt, whereas Fitch's key credit metric, adjusted leverage, is calculated inversely (compared to S&P and Moody's), which makes it difficult to compare numerically to S&P and Moody's metrics. Accordingly, I have excluded Fitch's metrics from my testimony. However, the key credit metric performance themes discussed below for S&P and Moody's hold true for Fitch metrics as well.

Table 12 below provides the recent historical performance of PSE's key credit metrics and benchmark range targeted by PSE:

Table 12. PSE S&P and Moody's Historical Key Credit Metrics Performance

S&P	**2016**	**2017**	**2018**	**2019**	**2020**
FFO/End of Period Debt	22.9%	25.6%	22.2%	21.0%	20.7%
(Targeted benchmark range: 20% to 23%)					

Moody's	**2016**	**2017**	**2018**	**2019**	**2020**
CFO Pre WC / Debt	21.6%	24.0%	20.3%	15.1%	18.1%
(Targeted benchmark range: 19% to 22%)					

Q. Why are credit ratings a subject of focus in this rate case?

A. As is seen in Table 12 above, PSE's credit metric performance has declined significantly in the last few years due to reductions in cash flow and increased borrowings. In fact, the key credit metrics for Moody's illustrate that in 2019 and 2020 PSE experienced financial performance below the bottom of the allowable range for Baa1 of 19 percent. PSE's performance has declined by 500-600 basis points between the two metrics.

Cash flow has declined since the beginning of 2018 for three significant reasons: (1) the last multiyear rate plan ended in 2017 and the new rates from the 2017 general rate case, which became effective in 2018, reintroduced regulatory lag into PSE's rates; (2) the passage of the Tax Cuts and Jobs Act ("TCJA") in 2017, which was implemented in 2018, reduced cash flows an average of $149 million; and (3) certain revenue modifications resulting from the 2019 general rate case final order in July 2020 further constrained cash recovery of investments and expenses.

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

A. As described by PSE witness Matthew R. Marcelia, Exh. MRM-1T, the TCJA negatively impacted 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 and change in the corporate tax rate led to an average annual decrease in available cash flow of $149 million.

Q. Was this a temporary change in cash flow?

A. No. The TCJA elimination of bonus depreciation has caused the accumulated deferred income tax ("ADIT") balance to decline. Prior to the TCJA, the ADIT was increasing. Increasing ADIT balances represent a source of cash while declining ADIT balances represent a use of cash, as described by PSE witness Matthew R. Marcelia. PSE expects this trend to continue throughout the multiyear rate plan unless the tax laws are changed.

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

A. Rating agencies recognized that the TCJA was credit-negative for utilities. A June 18, 2018 S&P Global publication said "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."[1]

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

A. As a result of the TCJA, PSE's credit metrics declined substantially as can be seen in Table 13 below. The $149 million average annual decrease in ADIT was a direct reduction in PSE's calculation of cash flow from operations. As PSE's cash

[1] 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-news-headlines/moody-s-downgrades-outlook-on-regulated-utilities-sector-to-negative-44953275.

was reduced, it had to borrow to fund that loss in cash. The impact of the TCJA on PSE's key credit metrics is identified in Table 13 below.

Table 13. Illustrative Impact of TCJA on PSE Credit Metrics

	2018	**2019**	**2020**
S&P FFO/Debt			
Ratio with TCJA	22.2%	21.0%	20.7%
Ratio without TCJA	26.1%	25.4%	25.9%
Variance (%)	-3.9%	-4.4%	-5.2%
Illustrative TCJA Impact on S&P Credit Metrics (bps)	**-387**	**-441**	**-523**
Moody's CFO pre WC/Debt			
Ratio with TCJA	20.3%	15.1%	18.1%
Ratio without TCJA	24.3%	19.4%	23.2%
Variance (%)	-4.0%	-4.3%	-5.1%
Illustrative TCJA Impact on Moody's Credit Metrics (bps)	**-405**	**-428**	**-510**

As previously discussed, PSE's key credit metrics for both S&P and Moody's are based on PSE's cash flow and utility debt outstanding. The $149 million average annual decrease in ADIT was a direct reduction in PSE's calculation of cash flow from operations, and as PSE's cash was reduced, it had to borrow to fund that loss in cash. The impact to the credit metrics continues to grow annually because PSE has to borrow incrementally each year the TCJA is in effect. In other words, the cumulative average annual $149 million decrease in ADIT yields an increase in borrowings of almost $600 million over the four year period. As the data indicate, all else being equal, the TCJA has reduced PSE credit metrics by 387-523 basis points for S&P and 405-510 basis points for Moody's since its implementation in 2018.

Q. How did the 2019 general rate case impact cash flow?

A. The 2019 general rate case final order impacted cash flow in a variety of ways, but one example is regulatory amortizations. The Commission offset allowed increases in revenue requirement by extending amortizations of both electric and gas regulatory assets. PSE's amortization extension of electric regulatory assets led to a reduction of $17.7 million in revenue, and gas regulatory asset amortization extension yielded another $4.4 million in revenue reduction.[2] Since recoveries of regulatory amortizations constitute increased cash recoveries to PSE, this change yielded a $22.1 million reduction in PSE's cash from operations.

Q. How did the reduction in cash flow impact PSE credit metrics?

A. Like the TCJA, the decrease in cash recoveries from extending the amortizations of regulatory assets, led to the following indicative decrease in PSE's credit metrics at S&P and Moody's in Table 14. The impact in 2020 was moderated due to the fact that rates changed in October 2020, whereas 2021 and 2022 forecasted impacts include a full year's impact of cash loss.

---

[2] *WUTC v. Puget Sound Energy*, Dockets UE-190529/UG-190530, Order 10 and Rev. App. A (July 31, 2020).

Table 14. Illustrative Impact of Extended Amortization of Regulatory Assets on PSE Credit Metrics

	2020	2021	2022
S&P FFO/Debt			
Ratio with Extended Amort. of Regulatory Assets	20.7%	[redacted]	[redacted]
Ratio without Extended Amort. of Regulatory Assets	20.8%	[redacted]	[redacted]
Variance (%)	-0.1%	-0.5%	-0.5%
Illustrative Impact of Extended Amort. on S&P Credit Metrics (bps)	**-13**	**-47**	**-54**
Moody's CFO pre WC/Debt			
Ratio with Extended Amort. of Regulatory Assets	18.1%	[redacted]	[redacted]
Ratio without Extended Amort. of Regulatory Assets	18.3%	[redacted]	[redacted]
Variance (%)	-0.1%	-0.5%	-0.6%
Illustrative Impact of Extended Amort. on Moody's Credit Metrics (bps)	**-13**	**-54**	**-57**

Q. How did the rating agencies respond to the total impact of the 2019 general rate case final order?

A. The cash impact from the extension of regulatory amortizations as noted above was just one piece of the overall order. The rating agency reaction to the entirety of the 2019 general rate case final order was varied but swift. The rating agency reports are provided as Exh. CGP-10. On July 17, 2020, Moody's released an issuer comment and recognized that the 2019 general rate case outcome was credit negative but chose to keep PSE on stable outlook because the economic impacts from COVID-19 limited the Commission's ability to increase rates on customers during a pandemic.[3] Moody's officially reviewed PSE's credit profile

[3] *See* Exh. CGP-10 at 1-4 (Moody's Investors Service, *Issuer Comment - Puget Sound Energy Inc*, Jul. 17, 2020).

in August 2020 and released its Rating Action and Credit Opinion affirming PSE's ratings and stable outlook, despite forecasted credit metric weakness.[4]

However, on July 23, 2020, S&P placed the company on credit watch negative,[5] which meant PSE had a 50 percent chance of being downgraded and had 90 days or less to improve its credit outlook. After certain calculations in the final order were clarified and PSE management communicated its short- and mid-terms plans to stabilize the metrics, S&P took PSE off credit watch negative and placed PSE on negative outlook.[6] This meant that the risk of downgrade was no longer imminent, but S&P still wanted to see PSE act within the next 12 months to stabilize current and future credit metric performance.

On July 27, 2020, Fitch issued a ratings action and changed PSE's ratings outlook to negative from stable because the final order in the 2019 general rate case was credit negative.[7]

Q. Was the response from the rating agencies solely based on prospects of decreased future cash flow at PSE?

A. Not at all. While forecasted future cash flow prospects were a key concern particularly since they had declined since the TCJA and outcome of the 2017

---

[4] *See* Exh. CGP-10 at 4 (Moody's Investors Service, *Rating Action: Moody's affirms the ratings of Puget Energy and Puget Sound-Energy outlooks stable*, Aug. 25, 2020, at 1).

[5] *See* Exh. CGP-10 at 9 (Standard and Poor's, *S&P Research Update: Puget Energy Inc. And Subsidiary Ratings Placed On CreditWatch Negative Over Regulatory Concerns*, Jul. 23, 2020, at 1).

[6] *See* Exh. CGP-10 at 14-18 (Standard and Poor's, *S&P Research Update: Puget Energy Inc., Puget Sound Energy Inc. Ratings Affirmed; Off CreditWatch On Clarification Order; Outlook Negative*, Aug. 26, 2020).

[7] *See* Exh. CGP-10 at 19-29 (Fitch Ratings, *Rating Action Commentary - Fitch Affirms Puget Energy and Puget Sound Energy; Outlook Revised to Negative*, Jul. 27, 2020).

general rate case, the rating agencies were quite concerned that the 2019 general rate case final order was an indication that business risk in Washington had increased substantially. As PSE witnesses Todd Shipman and Ann Bulkley testify in this case, the rating agencies rate companies based on their business risk profiles as well as their financial risk profile. Based on the 2019 general rate case final order, the rating agencies grew concerned that the Commission would not implement rate recovery mechanisms that reduce regulatory lag and allow PSE to remain financially strong as it begins to implement strategies to achieve certain legislative requirements, such as the Clean Energy Transformation Act ("CETA"). In fact, in S&P's research update in May 2021, it stated that PSE's rating may be lower over the next 12-24 months if: "The commission does not implement SB 5295 in a credit-supportive manner that includes the use of an MYRP… [or] PSE cannot earn close to its authorized return on equity… ."[8] In Moody's credit opinion in August 2021, it stated that "[a] rating downgrade could occur if decisions from the WUTC continue to be inconsistent and unsupportive of credit quality, particularly with regard to the utility's next rate case."[9]

[8] Exh. CGP-10 at 31 (Standard and Poor's, *Research Update - Puget Energy Inc. And Subsidiary Outlooks Revised*, May. 27, 2021, at 2).

[9] Exh. CGP-10 at 36 (Moody's Investors Service, *Credit Opinion - Puget Sound Energy Inc*, Aug. 26, 2021, at 2).

Q. What did PSE management do to stabilize PSE's credit ratings after the rating agency response in 2020?

A. PSE management developed and implemented a multi-pronged approach to stabilize the credit metric outlook:

1. PSE management worked to explain to the rating agencies that the 2019 general rate case final order was a direct reflection of the current and forecasted acute economic hardship on PSE customers driven by COVID-19 in the second quarter of 2020, rather than an acute signal of a lack of support of timely rate recovery. In fact, the 2019 general rate case final order mentioned COVID-19 over 20 times, suggesting that the desire to minimize rate increases on customers was the primary, immediate concern; the Order was not an indication of a long-term substantial, permanent elevation in business risk.

2. PSE management supported the passage of Senate Bill 5295 ("SB 5295"), which requires that certain provisions for more timely utility cost recovery be implemented. Key provisions of the legislation that swayed rating agency perspectives included the multiyear rate plan and, importantly, the provision that at a minimum, rates for the first rate year include all plant in service as of the rate effective date. This latter provision is intended to reduce structural regulatory lag (from the end of the historical test year to the beginning of the rate year) inherent in the Washington state's traditional modified historical rate making regime. This is discussed in more detail by PSE witnesses Kazi K. Hasan and Adrian J. Rodriguez.

3. PSE management focused on securing other necessary rate recovery through tariff filings, such as the purchased gas adjustment mechanism, the power cost adjustment mechanism, and the power cost only rate case to illustrate to the rating agencies that the Commission was supportive of timely rate relief. PSE also focused on remediating the excess deferred income tax ("EDIT") issue by working with the Commission and the IRS to clarify normalization rules. The Commission's commitment to make the corrections specified by the IRS on a timely basis was important in this regard.

4. Lastly, PSE management worked to control current and future spending on operations and maintenance ("O&M") expenses as well as capital expenditures. As PSE witness Kazi K. Hasan describes, in the fall of 2020, PSE worked internally to constrain spending by [redacted] from 2020-

2022, where [redacted] came from restraining growth in O&M expenses and [redacted] came from capital expenditure reductions.

Q. What was the impact of these efforts?

A. These efforts illustrated to the rating agencies that PSE management had the right short-term and long-term strategies in place to stabilize PSE's short- and long-term financial risk profile, while illustrating to the agencies that the 2019 general rate case final order was not an indication that the long-term business risk of PSE had substantially increased. In fact, on May 27, 2021, S&P moved PSE's credit outlook back to stable,[10] and Fitch made the same move on June 1, 2021.[11]

Q. Does this mean that PSE's credit risk had been fully remediated by June 2021?

A. No. All three rating agencies recognized that financial metrics remained weak, but the passage of SB 5295 was a credit-positive indicator that regulatory and business risk of the credit profile has a likelihood to decrease in the future as the tools included in SB 5295 should reduce regulatory lag. All three rating agencies are optimistic about the long-term revenue and cash flow stability that can come from a properly implemented multiyear rate plan. The degree to which it is ultimately credit supportive will depend on the design and quantum of the

[10] *See* Exh. CGP-10 at 30-34 (Standard and Poor's, *Research Update - Puget Energy Inc. And Subsidiary Outlooks Revised*, May. 27, 2021).

[11] *See* Exh. CGP-10 at 46-55 (Fitch Ratings, *Fitch Affirms PE and PSE; Outlooks Revised to Stable*, Jun. 1, 2021).

multiyear rate plan. PSE witness Todd. A. Shipman specifically quotes S&P's expectations from its revised outlook in May 2021.

Q. What risks remain to the credit profile of PSE prior to the implementation of the multiyear rate plan?

A. As mentioned before, credit metrics are a function of operating cash flow and debt that the Company borrows to fund operations. Therefore, anything that decreases cash flow or increases borrowings will negatively impact credit metrics. Examples include but are not limited to: increasing power or gas costs; unexpected or unbudgeted increases in operations and maintenance expenses or capital expenses from inflation, storms, or other changes in project costs; changing regulatory policies or requirements; changes in building codes that increase costs; and increases in interest rates that increase borrowing costs.

Q. Do these risks go away during a multiyear rate plan?

A. Not necessarily. Even with a multiyear rate plan, these risks will continue to materialize in some form or fashion and despite proactive management by PSE, they will continue to be sources of cash flow pressure.

V. PSE'S MULTIYEAR RATE PLAN, INCLUDING THE REQUEST FOR AN INCREASE IN ITS RETURN ON EQUITY AND EQUITY RATIO, IS CREDIT POSITIVE

Q. Please describe PSE's requests with respect to return on equity and equity ratio.

A. As described in the testimonies of PSE witnesses Kazi K. Hasan and Ann E. Bulkley, PSE is requesting an increase in its return on equity from 9.40 percent to 9.90 percent in the first year of the multiyear rate plan (calendar year 2023) and to be sustained throughout the multiyear rate plan. PSE is also requesting an increase in its equity ratio from its current 48.5 percent to 50.0 percent over three years, in annual 0.5 percent increments, beginning with a 49.0 equity ratio in 2023.

Q. Why is PSE requesting an increase in its return on equity?

A. As mentioned previously in my testimony, PSE witness Ann Bulkley substantiates through quantitative and qualitative analyses that PSE's return on equity should be increased to 9.90 percent: (1) to allow PSE to earn a fair and competitive rate of return in line with its peers; (2) to adequately compensate PSE for risks it is currently facing to fund critical operational programs for the benefit of customers, including investments to enable PSE to provide safe and reliable service to its customers and make CETA-required investments; (3) to begin to replace losses of cash flow due to legislative changes (such as the TCJA); and (4) to help improve and stabilize the credit profile of PSE.

Q. Why is PSE requesting an increase in equity ratio?

A. PSE is requesting an increase in its equity ratio to improve PSE's credit metric performance over the multiyear rate plan. As PSE witness Matt Marcelia describes in Exh. MRM-1T, and as I substantiate above, the TCJA had a material and lasting adverse impact on PSE's recent credit metric performance and the increase in equity ratio is an important step to returning favorable performance to the credit metrics. After the TCJA was implemented, publicly traded investor owned utilities issued equity to stabilize their credit metrics from the resulting loss of cash flow and upward pressure on borrowings and increase the equity ratios in their regulated capital structures. However, because PSE is not publicly traded, its approach to increasing equity to stabilize credit metrics differs from such companies; PSE restricted dividends, which is the equivalent of an equity injection, to prop up its equity ratio.

Q. Why is PSE proposing an increase in equity thickness over time?

A. In determining the appropriate capital structure for rate setting purposes, an optimal capital structure should balance "safety and economy"—that is, it should balance the safety that results from an equity cushion high enough to strengthen the financial performance of the company with the economy of lower debt. Finding that optimal balance is both art and science. As discussed by PSE witness Kazi K. Hasan, the rates of return requested in the multiyear rate plan, including the increase in the return on equity and the gradual increases to the equity ratio over time, achieve this balance of safety and economy for customers throughout the duration of the multiyear rate plan.

Q. How will PSE increase the equity ratio across the multiyear rate plan to 50 percent?

A. PSE funds company activities using debt and equity proceeds. To increase PSE's actual equity ratio during each year of the multiyear rate plan, PSE will utilize the increases from revenue to fund PSE's capital program. By using the increased revenue to fund investment needs, PSE will be able to defer additional borrowings (debt) that is used to finance company operations. As a result, as cash is retained in the business rather than being distributed as dividends, the equity ratio will rise and the long-term debt level will fall. These restricted dividends are the equivalent of an equity injection.

Q. Is PSE asking for equity ratio increases to be calculated on an AMA basis?

A. Yes. As is included in my rate year exhibits, PSE requests to increase equity ratio by 50 basis points on an AMA basis in each year of the multiyear rate plan.

Q. What assurance can PSE provide that it will maintain the allowed equity ratio in each year of the multiyear rate plan if the increase in equity ratio is granted?

A. PSE is committed to achieving the AMA equity ratio targets set forth in my testimony and exhibits. In fact, Table 15 below illustrates that since the 2011 general rate case order in May 2012, PSE has consistently maintained an AMA equity ratio that is at or above target, except for only 2019.

Q. Please explain why AMA equity ratio fell below the authorized level in 2019.

A. In 2019, PSE's actual AMA equity ratio fell below the regulated equity ratio due to the Enbridge pipeline rupture in the fourth quarter of 2018 that caused a negative financial impact on PSE. Action was taken to raise the equity ratio in September 2019, as $210 million of equity was injected in PSE; however, it took time for the equity ratio to climb back to above 48.5 percent due to the AMA calculation methodology. The equity ratio on an end of period basis was back to 48.4 percent at the end of 2019. The AMA equity ratio climbed back to 48.5 percent in the second quarter of 2020 and has stabilized since then above the authorized level.

Table 15. AMA Equity Ratio - Actual vs. Regulated

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	6/30 TY
AMA Equity Ratio (Actual)	48.7%	48.3%	48.5%	48.2%	48.2%	48.9%	49.8%	49.0%	47.7%	48.8%	49.0%
AMA Equity Ratio (Regulated)	46.0%	48.0%	48.0%	48.0%	48.0%	48.0%	48.0%	48.5%	48.5%	48.5%	48.5%
Difference	2.7%	0.3%	0.5%	0.2%	0.2%	0.9%	1.8%	0.5%	-0.8%	0.3%	0.5%

Q. Once the multiyear rate plan is implemented, what will be the impacts on PSE credit metrics?

A. As previously discussed, the rating agencies anticipate that a properly implemented multiyear rate plan, which includes in rates the plant that goes in service by and during each rate effective date, is likely to be credit supportive to PSE. Figure 1 and Figure 2 below provide PSE's recent historical trends in S&P and Moody's key credit ratios and provide forecasted credit metric performance from 2021 through the duration of the multiyear rate plan. This credit metric forecast is based on PSE's Board-approved Plan from November 2021, which is the same plan that is discussed by PSE witness Joshua A. Kensok. The data illustrate that PSE's proposed multiyear rate plan will indeed bring stability back to PSE's key credit metrics and improve performance during the multiyear rate plan towards the middle of the targeted range for the Company's current ratings.

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

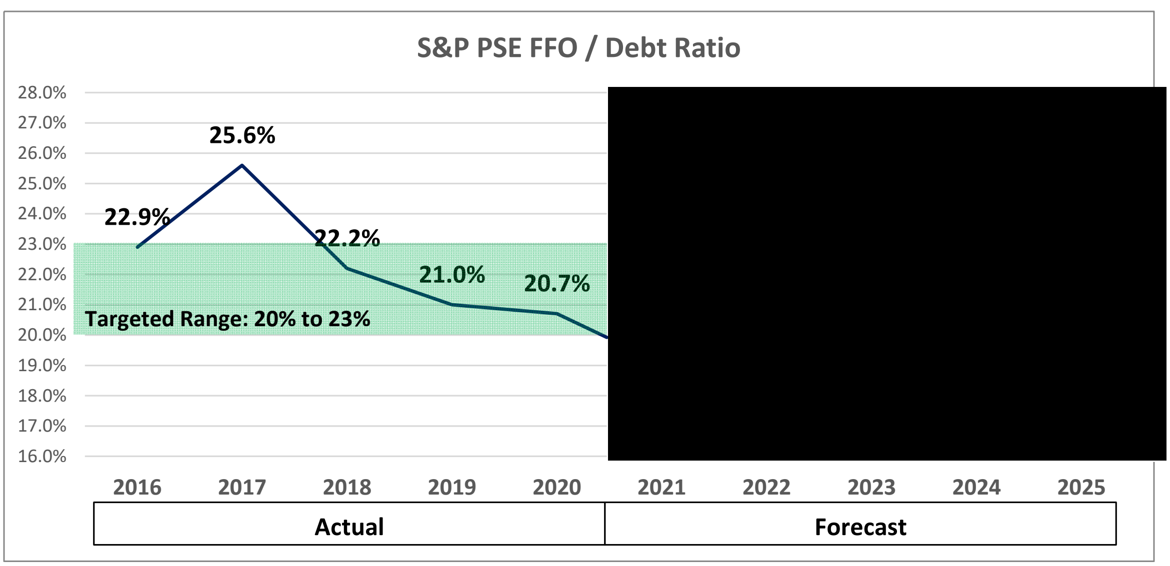
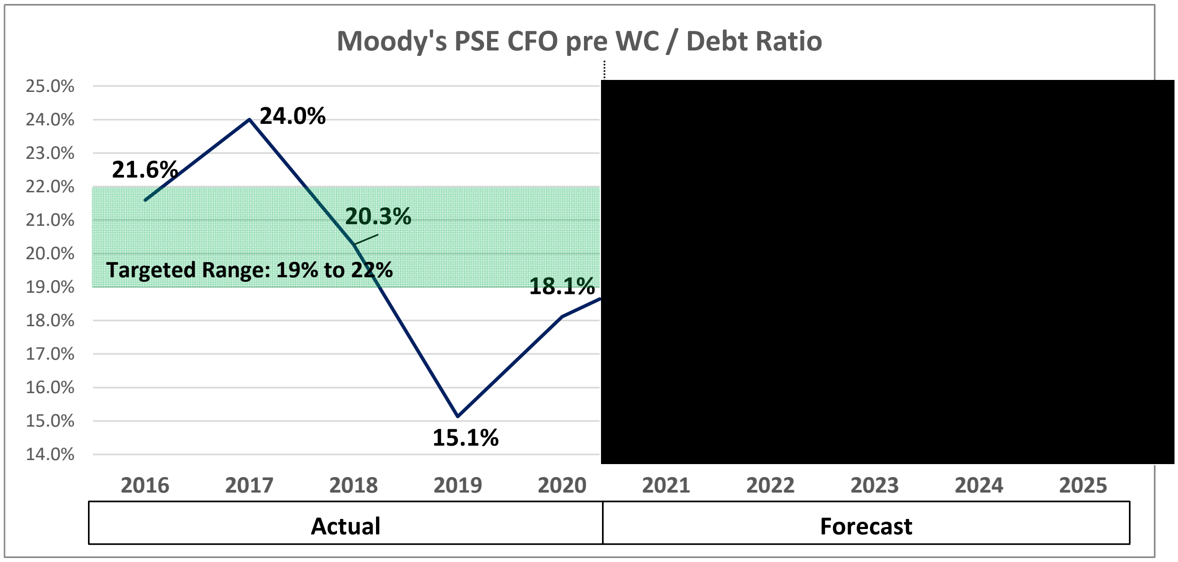


Figure 2. Moody's PSE FFO / Debt 10-Year Trend



Q. What portion of the improvement to the credit metrics is a result of the requested weighted cost of equity?

A. Table 16 below illustrates that the increase in equity ratio and return on equity combined yield an estimated 50 to 70 basis point improvement to PSE's key credit metrics over the duration of the multiyear rate plan. Thus, the weighted cost of equity is an important component to improving credit metrics. However, timely recovery of costs requested in this case is also a significant reason why credit metrics improve. That is why rating agencies and PSE view this multiyear rate plan as critical to enhancing the financial and cash flow stability of the Company.

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

Table 16. Illustrative Impact of Increase in Return on Equity and Equity Ratio on PSE Cash Flow and Credit Metrics

	2023	2024	2025
Incremental Cash Flow ($M)	$25	$27	$29
S&P FFO/Debt			
Ratio with Original Return on Equity & Equity	[redacted]		
Ratio with Proposed Return on Equity & Equity			
Variance (%)	-0.5%	-0.6%	-0.7%
Illustrative Impact on S&P Credit Metrics (bps)	**50**	**62**	**72**
Moody's CFO pre WC/Debt			
Ratio with Original Return on Equity & Equity	[redacted]		
Ratio with Proposed Return on Equity & Equity			
Variance (%)	-0.5%	-0.6%	-0.7%
Illustrative Impact on Moody's Credit Metrics (bps)	**53**	**64**	**73**

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

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

A. Since the 2019 general rate case, external financial market conditions have been such that interest rates across all tenors have remained at historically low levels. This has allowed PSE to reduce the impact of debt capital financings on its cost of capital:

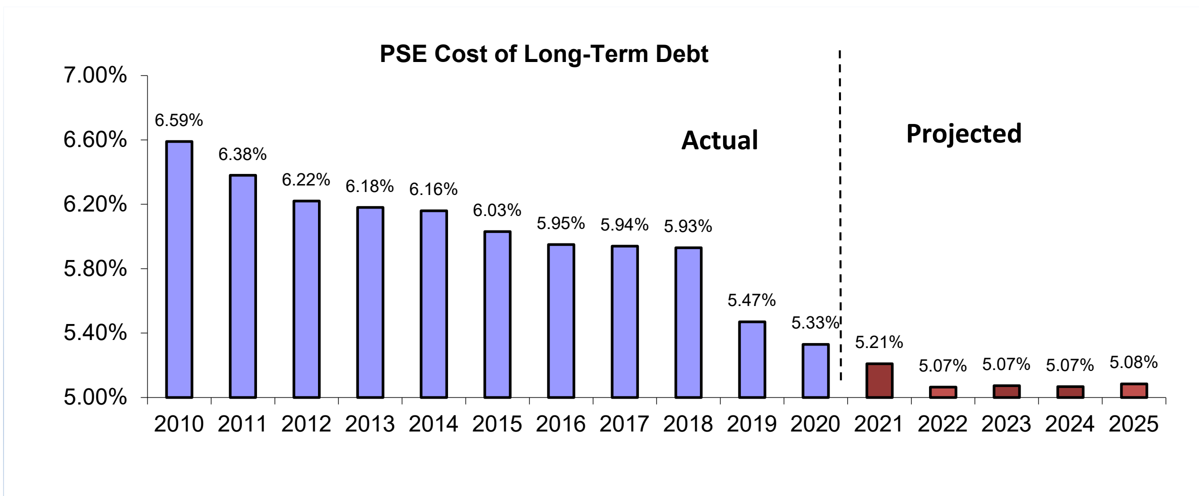
1. Since the rate effective date of the 2019 general rate case, PSE has utilized commercial paper to finance the short-term debt obligations of the Company. Since October 2020, our commercial spread over LIBOR ranges from 7 to 24 basis points, as compared to 125 basis points on our credit facilities. Relying solely on commercial paper rather than the credit facilities has led to a $2.35 million savings from October 2020 to September 2021.

2. As mentioned previously, PSE issued a 30-year, $450 million first mortgage bond at 2.893 percent. This is PSE's lowest cost financing ever. This reduced the long-term cost of debt rate by 22 basis points and will benefit customers for the next 30 years.

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 over 150 basis points, when comparing PSE's request in this rate proceeding in calendar years 2023 and 2024 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.

Figure 3. Improvement in Cost of Long-Term Debt



This declining cost of debt has enabled PSE to finance increasing levels of debt by maintaining virtually the same level of interest expense over the last 10 years. In other words, if PSE had financed the 2021 calendar year ending weighted-average long-term debt balance of $4.4 billion at 2010's cost of debt (6.59%) rather than the 5.33% listed above for 2020, PSE would have paid $55 million more in interest expense. This equates to a $43 million after-tax savings, which is a significant savings to customers.

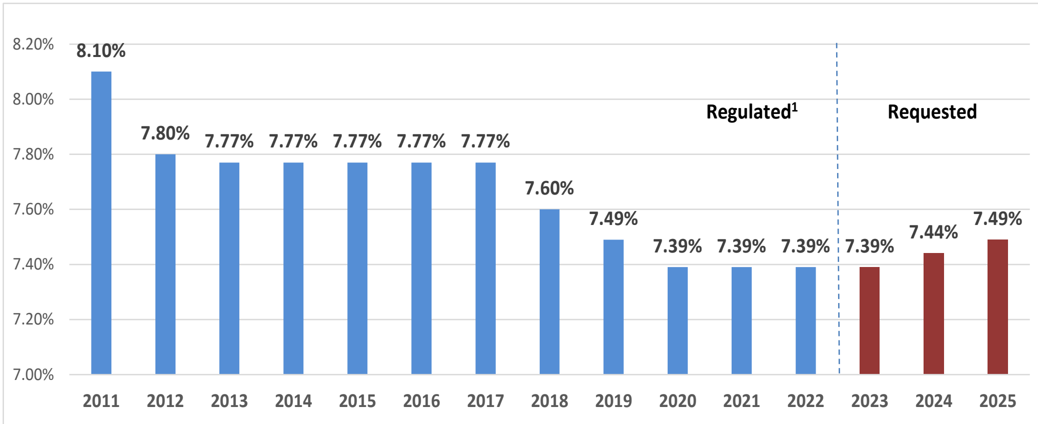
Q. Will PSE need to refinance or issue any debt or credit facilities during the multiyear rate plan?

A. Yes. PSE will continue to issue bonds to pay down short-term borrowings and increase liquidity, as is the Company's usual practice. These forecast bonds and interest rates are included in the cost of capital numbers for the rate year above. The specific timing of these bond offerings is kept confidential because it is market-sensitive information. These bond offerings will not detract from PSE's ability to maintain its authorized equity ratios across the multiyear rate plan.

Q. How do the rates of return requested for this multiyear rate plan compare to previously approved rates of return?

A. As can be seen in Figure 4 below, PSE's requested returns for the multiyear rate plan remain substantially below its regulated rates of returns for the last ten years. In fact, even with the proposed return on equity and equity ratio increase, the requested rate of return in 2023 is *flat* compared to the rate of return authorized by the Commission in the 2019 general rate case. Additionally, the requested rate of return only increases five basis points a year in 2024 and 2025 and does not exceed the allowed rate of return from 2019 —six years prior.

Figure 4. Regulated and Requested Rate of Return by Year



(1) The rates of return in this table represent the regulated rates at the end of each calendar year, rather than the actual blended rate if rate cases effective dates fall in the middle of the year

Q. Please summarize your conclusions related to PSE's requested rates of return in the multiyear rate plan.

A. PSE is mindful of how changes in the authorized rate of return impact customer rates, whether through increases or decreases. That is why PSE has worked hard over the last ten years to secure a lower cost of debt. And that lower cost of debt is the reason why PSE is able to ask for an increase in return on equity and equity ratio in this case without substantially increasing costs to customers. Furthermore, the requested capital structure and return on equity—for minimal incremental cost to customers—will yield both quantitative and qualitative financial benefits for the Company and customers. The quantitative benefits from the requested capital structure are increased cash flow, stronger credit metrics, and overall stronger financial health. Additionally, and equally important, the requested capital structure will also send a qualitatively strong signal to the rating agencies and fixed-income investors that the regulatory environment in Washington is one that is supportive of utilities and is supportive of PSE's long-term financial health. That in turn will enable PSE to secure lower cost of debt on future financings, which ultimately benefits customers through lower future interest costs. As such, the requested rates of return contained herein appropriately balance the needs of customers and the Company.

VII. 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 March 7, 2019, the Commission issued an order that approved a multiparty settlement[12] of a request to sell 43.99 percent of the indirect ownership of Puget Holdings LLC in Docket U-180680, 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.

[12] *In the Matter of the Joint Application of Puget Sound Energy, Alberta Investment Management Corporation, British Columbia Investment Management Corporation, OMERS Administration Corporation, and PGGM Vermogensbeheer B.V. for an Order Authorizing Proposed Sales of Indirect Interests in Puget Sound Energy*, Docket U-180680, Order 6 and App. A (Mar. 7, 2019).

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.[13]

Q. Has PSE complied with Regulatory Commitment 7?

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

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:

---

[13] *Id.* at 3.

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.[14]

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.

VIII. CONCLUSION

Q. Does that conclude your prefiled direct testimony?

A. Yes, it does.

[14] *Id*. at 8.