BEFORE THE WASHINGTON

UTILITIES & TRANSPORTATION COMMISSION

In the Matter of the Petition of PUGET SOUND ENERGY, INC.

For an Order Approving the Allocation of Proceeds of the Sale of Certain Assets
To the Public Utility District #1 of Jefferson County

DOCKET UE-132027

DIRECT TESTIMONY OF JAMES R. DITTMER

(Exhibit No. JRD-1T)

ON BEHALF OF

PUBLIC COUNSEL

MARCH 28, 2014

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I. INTRODUCTION AND TESTIMONY SUMMARY

Q: Please state your name and business address.

My name is James R. Dittmer. My business address is Post Office Box 481934, Kansas City, Missouri 64148.

Q: By whom are you employed and in what capacity?

A: I am a Senior Regulatory Consultant with the firm Utilitech, Inc., a consulting firm engaged primarily in utility rate work. The firm's engagements include review of utility rate applications on behalf of various federal, state and municipal governmental agencies as well as industrial groups. In addition to utility intervention work, the firm has been engaged to perform special studies for use in utility contract negotiations.

Q: On whose behalf are you testifying?

A: I have been retained by the Public Counsel Division of the Office of Attorney General to review and respond to Puget Sound Energy's application for an accounting order to allocate 75 percent of the gain realized from the sale of a portion of its transmission and distribution system to the Jefferson County Public Utility District #1 (JPUD) to shareholders, while allocating the remaining 25 percent of such gain to ratepayers. The testimony I am presenting herein is filed on behalf of Public Counsel.

Q: Please summarize your professional experience.

A: My education and professional experience is summarized in Exhibit No. JRD-2.

Q: What exhibits are you sponsoring in this proceeding?

A: I am sponsoring the following exhibits:

Exhibit No. JRD-2	Statement of Qualifications
Exhibit No. JRD-3	PSE Response to Public Counsel Data Request No. 34
Exhibit No JRD-4	Revised Calculation of Net Present Value Power Supply Cost Savings Resulting from Jefferson County's Departure from the PSE System

Q: Have you previously filed testimony before the Washington Utilities and Transportation Commission?

A: Yes. I have filed testimony with the Washington Utilities and Transportation Commission (UTC or Commission) on several occasions over approximately the past 25 years. Most recently I participated in the 2013 Puget Sound Energy (PSE or Company) applications for Expedited Rate Relief (ERF) and implementation of a decoupling mechanism – Dockets UE-12167, *et al.*

Q: What is the purpose of your testimony?

A: I will address within this testimony my analysis of PSE's claimed benefits and/or lack of harm to existing ratepayers purported to exist or occur as a result of the sale of a portion of PSE's transmission and distribution (T&D) system to JPUD. I also address this Commission's precedents for assigning gains and losses to customers and shareholders. Ultimately, as a result of my analysis and research, I am proposing an alternative split of the gain than has been proposed by PSE.

Q: Please summarize the more significant conclusions you have drawn as a result of your research and analysis undertaken within this docket.

A: My major findings and conclusions include:

- In the vast majority of situations when utility property is retired or disposed of, the shareholder experiences no gain or loss.

- This Commission has historically assigned all, or the majority of, gains from sales of utility property to ratepayers.

- In arriving at decisions to assign all or the majority of gains from sales of utility property to ratepayers, this Commission has generally adhered to the principle that since ratepayers have paid the operating costs, borne the risk, and paid the carrying cost on property being sold that they should participate to the greatest extent in gains achieved from the sales of such utility property.

- Customers remaining on PSE's electric system will be detrimentally impacted for a number of years as a result of paying higher rates that are occurring as a direct result of Jefferson County's departure. There exists the possibility that several years down the road remaining PSE customers could experience power supply cost savings as a result of Jefferson County's departure. However, those potential savings, years down the road, are much less certain to occur than the cost penalties that are currently being experienced and can be expected to be experienced for at least four years.

Q: Please summarize your recommendations in this proceeding.

A: In light of past Commission precedents assigning gains and losses to ratepayers and shareholders and the underlying reasoning employed within those decisions, the probable harm to existing ratepayers that can be expected as a direct result of the sale of a portion of PSE's service territory, as well as other facts and circumstances unique to this docket, I am proposing an assignment of the net book gain on the JPUD sale of 95 percent to ratepayers and 5 percent to shareholder.

I am also recommending that the net book gain assigned to ratepayers be credited to ratepayers through bill credits amortized over a two to four year period. The amount allocated to ratepayers should accrue interest at the Company's authorized rate of return, all of which will be returned to customers. I do not oppose PSE's proposal that the gain assigned to ratepayers be allocated to classes of customers in the same manner that costs are allocated in setting rates.

II. REGULATORY GUIDANCE FOR SHARING GAINS ON SALE OF UTILITY PROPERTY

A. General Treatment of Depreciable Property.

Q: Please begin by describing the general treatment afforded utility property that is removed from service.

A: For the vast majority of situations when utility plant is removed from service, no explicit gain or loss is recognized. However, implicit gains or losses are effectively enjoyed or borne by ratepayers.

Q: Please explain.

A: Most electric utility property is depreciable in nature. The majority of depreciable property is not sold, but rather simply removed and retired when it is physically or technologically obsolete. In some situations, such as the widening of a street or highway, transmission or distribution plant is neither physically nor technologically obsolete, but nonetheless because of other extenuating circumstances it becomes necessary to be prematurely retired and in some manner replaced.

Under prescribed plant accounting set forth within the Federal Energy Regulatory Commission's (FERC) Uniform System of Accounts (USOA), whenever utility property is retired, the original cost value of the plant is deducted from both Gross Plant in Service as well as the Accumulated Depreciation Reserve.[1] If costs are incurred in dismantling or removing plant that is retired, such costs are charged to the Accumulated Depreciation Reserve. Further, to the extent that elements of the retired plant can be sold for scrap or any other valuation, the entirety of the proceeds are recorded as a credit – or reduction to – the accumulated depreciation reserve.

The upshot of the unique plant accounting prescribed for electric utilities is that upon disposition or retirement of most depreciable plant, the utility realizes neither a gain nor loss. Sales or salvage from disposing of retired plant, as well as costs incurred to retire a plant unit, are both recorded within the Accumulated Depreciation Reserve account.

Further, regardless of whether a given unit of property is less than fully depreciated at retirement, or effectively more than fully depreciated at retirement as a result of outliving its expected useful life, the utility again recognizes neither a gain nor a loss on such retirement. Instead, cost of removal, salvage realized, as well the net "over" or "under" recovered original cost plant value are all recorded within the Accumulated Depreciation Reserve account. All such elements are then considered and measured in the utility's next depreciation rate study where the cumulative impact of all elements of all previous plant retirements are considered in developing prospective depreciation rates.

[1] 18 CFR, Part 101, Electric Plant Instructions Section 10 *Additions and Retirements of Electric Plant.*

The important conclusions to be drawn from the USOA plant instructions are:

- The vast majority of depreciable electric utility plant is disposed of through normal retirement rather than outright sale of property as occurred with the Jefferson County property.

- Under prescribed plant accounting, the utility recognizes neither an explicit gain nor loss upon plant retirements.

- PSE's proposal to assign to shareholders the majority of the gain from the sale of utility property to Jefferson County represents a significant departure from that which occurs with the majority of depreciable utility plant that is removed from service wherein no assignment of gains or losses to shareholders occurs. Instead, what effectively represents "gains" or "losses" in the retirement of depreciable plant is considered in the development of depreciation rates – which will be used to calculate depreciation expense that is passed to customers through rates. In sum, in the vast majority of instances, ratepayers effectively bear any losses and enjoy any implicit gains arising when plant is removed from utility service.

B. The Regulatory Compact and Equitable Considerations in Regulation.

Q: Please explain how regulation provides a framework to equitably address issues between shareholders and ratepayers.

A: The framework for regulation is designed to equitably treat both ratepayers and shareholders. As this Commission is well aware, utilities have a number of rights as well as obligations that are not applicable to unregulated companies providing or selling non-essential goods or services. The various rights and obligations that utilities acquire as regulated companies are frequently referred to as the *regulatory compact.*

Electric utilities provide what has generally been considered to be an essential service for approximately 100 years. The utility benefits because the essential service provided in most instances cannot be substituted with a similar or comparable service, and accordingly, the utility operates in a relatively non-competitive environment. Additionally, utilities typically enjoy the right of *eminent domain* that permits them to condemn property for public use – a right typically not enjoyed by unregulated companies.

In exchange for the noted benefits, if not privileges, that utilities enjoy over non-regulated entities, utilities acquire a number of obligations not applicable to unregulated utilities. For example, utilities have an obligation to provide service. The service cannot be discriminatory. And of course, utility service is price regulated. None of the noted obligations are typically applicable to unregulated companies.

While utility rates are price regulated, the utility is entitled to establish rates that provide for recovery of normal and prudently incurred operating expenses as well as the opportunity to earn a reasonable return on investments made in the provision of utility service. Again, because utility service is "essential" and relatively free from competitive pressures, the targeted returns established when rates are set have a reasonable opportunity to occur. While targeted returns are not always achieved, utilities virtually never experience a true operating loss on their regulated operations – as can frequently occur for unregulated businesses. Importantly, even when a utility experiences a significant cost that is unusual, that was neither envisioned nor considered when the utility's rates were established, utilities typically seek and receive authority to defer such significant unusual costs on their balance sheet for later recovery from ratepayers – whenever the utility's rates are again reestablished. Thus, regulated electric utilities are typically protected from the economic consequences of uncontrollable catastrophic events such as earthquakes, fires, floods, ice storms or hurricanes.

My experience is that even for events that were arguably avoidable or somewhat controllable, unless the utility's actions or inactions are deemed to be specifically imprudent, regulators will typically permit any significant costs to be deferred for later recovery within customers' rates. Events falling into the category of being somewhat controllable or avoidable include boiler plant explosions and abandoned capital investments.[2]

C. Regulatory Treatment of Sale of Utility Property.

Q: Do equity arguments exist to support a position that shareholders typically should not experience a gain or a loss on disposition or sale of utility property?

A: Yes. Given the rights and obligations inuring to regulated utilities under the regulatory compact, it logically follows that utilities typically should not expect to experience or enjoy an extraordinary windfall or gain upon disposition of property, just as they should not expect to experience or bear a loss from premature or earlier-than-anticipated disposition of a utility asset formerly employed in the provision of utility service. Thus, the recording of typical retirements of depreciable plant components, as prescribed within the FERC Uniform System of Accounts, ensures that the utilities will neither profit nor be financially harmed upon removing plant from service.

[2] *See People's Organization for Washington Energy Resources v. WUTC*, 104 Wn.2d 798 (1985)(The costs of an abandoned nuclear plant was included in rates, allowing the utility to recovery the cost of the investment.).

Q: Have regulatory bodies provided guidance regarding the accounting and ratemaking treatment to be afforded the gain a utility receives upon sale of an operating unit or system or land that was previously employed in public service?

A: Yes. I have observed regulatory bodies ordering significant amounts – if not the totality of – gains on sale of operating units, operating systems, and land, to be assigned to ratepayers. For instance, the precedent in Washington is that generally ratepayers are credited100 percent of gains or losses from sales of land previously used in providing utility service. Further, in a docket established to consider the sale of the Centralia Steam Electric Generating Plant by PSE, Avista and PacifiCorp, as well as the disposition of the gain from the sale of such plant, this Commission determined that the majority of the gain should be allocated to ratepayers.

Q: Please state your understanding of this Commission's reasoning for allocating all, or the majority of, gains on sales of utility property to shareholders.

A: My review of UTC orders leads me to conclude that generally this Commission has adhered to the reasoning that the right to a gain from the sale of utility property should follow the risk of loss and burdens borne by parties during the time period that the asset was operating and providing service.

The current precedent for assigning 100 percent of gains from sales of land previously included in rate base originated within Cause U-85-53. In that docket, Public Counsel argued that ratepayers had provided shareholders a return on the land assets being sold, had borne the costs of maintaining and insuring such property, and paid the associated ownership cost of items such as property taxes. Accordingly, Public Counsel recommended that 100 percent of gains from land sales should be reflected as a reduction to rate base.

In the subsequent PSE rate case, filed as Cause U-89-2688T, both Public Counsel and Staff proposed that 100 percent of gains from land sales be reflected as a reduction to rate base *and* amortized as a credit to ratepayers over a five-year period. Specifically in adopting Staff and Public Counsel's position in that docket, this Commission referred back to reasoning first set forth in the Cause-85-53 rate order which stated:

> [T]he risk analysis proposed by Public Counsel in its brief, recognizing that once acquired, all costs and risks of ownership – such as taxes, insurance, maintenance, and costs of the money for the acquisition, etc. – are borne by the ratepayers. The arguments are persuasive that, because the ratepayers have shouldered the risks of ownership, they should share in the benefit of sale.[3]

To my knowledge, PSE and this Commission have adhered to the precedent that 100 percent of gains from sales of land should be credited to ratepayers since the noted order was issued in Cause U-89-2688T.

More recently, this Commission determined that the majority of gains from the sale of the Centralia Steam Generating Unit achieved by UTC-regulated

[3] Docket U-85-53, Second Supplemental Order, p. 33, dated May 16, 1986.

electric companies PSE, Avista Corporation and PacifiCorp should be allocated to ratepayers. In its order issued in the Centralia disposition case[4] this Commission ordered the following assignment of the gain from sale to shareholders and ratepayers:

Table 1
Assignment of Centralia Plant Gain on Sale
Shareholders Versus Ratepayers
($millions)

	PSE	Avista	PacifiCorp
Total Gain	$22.26	$33.96	$21.89
Shareholder Portion	$3.19	$3.52	$1.56
Ratepayer Portion	$19.07	$30.44	$20.33
Shareholder Percentage	14.3%	10.4%	7.1%
Ratepayer Percentage	86.7%	89.6%	92.9%

In arriving at the gain assignment shown in Table I, while adhering to the broad principle that reward or gain should follow risk and cost burden borne while the asset was employed in providing service, this Commission reviewed and considered facts and circumstances unique to that docket.

Q: **What is your understanding of the unique facts and circumstances considered, and reasoning adopted, when the Commission ordered the Centralia Plant gain distribution shown on Table 1?**

A: The total gain on the Centralia Plant exceeded the total Accumulated Depreciation Reserve balance for the plant existing at the time of the sale. Accordingly, the Commission first assigned all of the accumulated depreciation reserve balance associated with the Centralia Plant to ratepayers. In arriving at the assignment of

[4] Dockets UE-991255, UE-991262 and UE-991409, Second Supplemental Order, pp. 24 -40 (March 6, 2000).

the Accumulated Depreciation Reserve portion of the gain to ratepayers the Commission stated, in relevant part:

> The fact that the facilities are selling for an amount greater than original cost is evidence that the facilities have an increasing, not decreasing value, as an asset in a competitive wholesale generation market. Thus, a portion of the gain equivalent to the difference between net book value and the original cost should be returned to ratepayers, as they have, in effect, overpaid necessary depreciation. This amount would be equivalent to accumulated depreciation.[5]

The Commission noted that ratepayers supported the Centralia facilities through a return *of* the investment through straight-line depreciation and further supported the facilities through rates that provided the utilities with a return *on* their investment through paying a fair rate of return on the un-depreciated balance.[6]

The amount of the gain which exceeded the value of the Accumulated Depreciation Reserve that was assigned in its entirety to ratepayers, represents the *appreciation* of the value of Centralia Plant above its original cost. Regarding the appreciation in the value of the Centralia Plant above original costs, the Commission determined that a portion should be allocated to the shareholders. In the context of the specific equity arguments presented in the Centralia case, the Commission determined that an equal sharing between shareholders and ratepayers was reasonable. In arriving at such determination, the Commission relied on principles that rewards/gains should follow risk and burden, and also

[5] Dockets UE-991255, UE-991262 & UE-991409, Second Supplemental Order, p. 28.
[6] *Id.*

considered facts unique to that docket. In relevant part, the Commission stated:

> Given the risks and burdens borne by the ratepayers and shareholders, and given the other benefits they stand to gain from the sale, we find that it is fair in this case to allocate the appreciation between ratepayers and shareholders. When we apply the principles of *Democratic Central* to the facts in this case, we conclude that one-half of the appreciation should go to shareholders, and one half to ratepayers. This is not based on a preconceived formula, but on the equities of this distinctive case.[7]

Thus, while again considering the principle that rewards/gains should follow risk and burden, the Commission also looked at facts unique to that docket before determining that the majority, albeit not 100 percent, of the gains in that case, should be assigned to ratepayers.

Q: Are you in agreement with this Commission's conclusions that ratepayers should receive the majority, if not 100 percent, of the gain from the sale of assets, when they are paying a return upon the plant, as well as bearing the cost of maintaining and insuring the plant that is being sold at a gain?

A: Yes. In fact, I was Public Counsel's witness in Cause U-89-2688T, wherein this Commission agreed that ratepayers were entitled to 100 percent of net gains from sales of land parcels that had previously been used in providing utility service and whose costs had been considered in the development of PSE's rates. As I first argued in that docket, and as I reiterate herein, in general, I believe that to the extent utility ratepayers have borne the carrying charges, property taxes and maintenance costs of utility property which has historically been included in rate base, it is appropriate and equitable to credit ratepayers for gains received from

[7] Docket UE-991255 *et al*, Second Supplemental Order, pp. 29 – 30,

the sale of such property.

That stated, I am also in agreement with this Commission's conclusion drawn in Docket UE-991255 *et al*, which states that unique facts and circumstances may be present suggesting that it may be appropriate to allocate a portion of the gain to shareholders.

Q: Did any of the cases mentioned above included a situation in which there was concurrent loss of service territory and/or existing customers as occurred with the sale of the Jefferson County T&D system

A: No. PSE's loss of Jefferson County customers and territory is one of the case-specific circumstances that the Commission will consider in its analysis of this docket.

Q: Do either the fact that PSE is concurrently losing customers at the same time it is selling the T&D system or the argument that the departing customers paid for the operating costs and bore the risks associated with the assets sold suggest that remaining PSE customers should have no right to the gains from this sale?

A: No. As I shall discuss in ensuing testimony, there are other extenuating facts and circumstances in this case that I believe should be given much more weight than focusing solely on the fact that PSE is experiencing a loss of customers concurrent with its sale of utility property. Those facts and circumstances include stranded costs, effect on non-power supply costs and ERF rates, and impact on power supply costs and PCORC rates. Additionally, PSE's rates are set on a total-company basis, meaning that all of PSE's customers pay for all of PSE's rate base.

III. IMPACT TO REMAINING RATEPAYERS OF PSE'S SALE OF TRANSMISSION AND DISTRIBUTION SYSTEM TO JPUD

A. Current Stranded Costs/Avoided Future Costs Resulting from Loss of Service Territory.

Q: When addressing the issue of an appropriate distribution or sharing of gain achieved from the sale of a slice of a utility's T&D system, while it is concurrently relieved of any obligation to continue providing service to departing customers, is it appropriate to consider the impact of the sale upon customers who remain to be served by the selling utility?

A: Yes. Up until the time that it becomes reasonably known that a utility will lose a portion of its service territory, a utility will continue to plan and design its production and transmission system, target its customer service and billing operations, and size all corporate common or back office support systems as if it were obligated to provide service to the departing service territory customers into perpetuity. In the short run, the costs or revenue requirements associated with an entire utility system as planned, designed and "sized" to serve a larger population of customers will be absorbed or paid for by the smaller number of customers that remain after a slice of the utility's T&D system is sold. Thus, at least for a period of time, as a result of dividing the relatively fixed costs of a utility system – or costs that tend to remain fixed over the short-to-midterm timeframe – by the smaller number of remaining customers, such remaining customers will be called upon to pay a somewhat higher unit cost for service being provided. In other words, when a utility's investment in infrastructure and customer service/back office support are underutilized for a period of time, it can be anticipated that the utility will experience "stranded costs."

Thus, to the extent the utility attempts to pass on all stranded costs resulting from a loss of a portion of its service territory, for the period of time until such facilities are again fully utilized, existing customers can be expected to be detrimentally impacted in the form of paying higher rates that reflect the collection of such stranded costs.

Q: **The scenario you just described suggests that remaining customers can be harmed, at least in the short run, when a utility loses a portion of its service territory. Is it possible that remaining customers could benefit by the loss of a portion of a utility's service territory?**

A: It may be possible under certain scenarios, or when the cost/benefit impacts of losing load is analyzed and measured over a longer period of time, to arrive at a conclusion that remaining customers could benefit when a utility loses a portion of its service territory.

Q: **Under what conditions might remaining customers *immediately* benefit when a portion of a utility's service territory is sold to another entity?**

A: This situation would occur when revenues collected within a given geographic area are not sufficient to cover the costs incurred directly and exclusively to provide service to the geographic area.

Q: Please further explain the scenario you describe wherein remaining customers might immediately benefit from a utility losing a portion of its service territory.

A: Most utilities have system-wide class rates that are developed based upon the "average cost" to provide service to a given class of customers taking service across the utility's entire service territory. By definition, the average cost to serve a given class of customers will consist of some subsets or regions of customers for which the utility will incur above-average costs to serve as well as subsets or regions of customers for which the utility will incur below-average costs to serve. In general, sparsely populated rural areas will incur higher distribution costs to serve customers than more densely populated metropolitan areas. Accordingly, sparely populated rural areas will generally require higher-than-system-average costs to serve. Further, in areas where a utility such as PSE provides both electric and natural gas distribution service, the cost to provide service in the dual utility service areas can be expected to be lower than the cost to provide only electric or only gas service, as a result of synergies in meter reading and distribution services.

Also, it should be remembered that in consideration of the cost to provide utility service within a specific area, so long as the revenues derived from a that area exceed the costs that are directly and solely incurred to serve it, those customers provide some amount of contribution to cover the indirect, common and relatively fixed costs incurred to serve the utility's entire service territory. However, if the direct costs incurred solely to serve a given subsection of a utility's service territory exceed the revenues derived from those customers, the loss of such extremely-high-cost-to-serve territory would result in an almost immediate benefit to remaining customers on the utility's system. This immediate benefit would be expected inasmuch as remaining customers would no longer be called upon to subsidize the direct costs associated with the departing service territory. In short, the average cost to serve remaining customers should fall following the loss of a portion of the utility's extremely-high-cost-to-serve service territory.

Q: Under what conditions or scenarios could remaining customers experience a longer term benefit from a utility's loss of a portion of its service territory?

A: It is possible that longer term benefits may accrue to remaining customers in scenarios where the cost of the "next" production unit, the "next" purchased power arrangement, or the "next" major transmission project exceeds the cost of such facilities presently in service. More specifically, it is likely that the utility will eventually be required to acquire new production and transmission facilities after organic growth absorbs any surplus capacity realized when a portion of the system was lost. If those new facilities come into service with all-in costs that are significantly higher than the average cost of existing generating units or power supply resources, the average cost to serve all customers will begin to rise. Under this scenario, the stranded costs remaining customers will pay a return upon following the loss of the utility's service territory could be offset completely over a longer evaluation period, as the higher cost of the "next" generating or transmission resource may be delayed for a period of time.

In summary, when immediate stranded costs and prospective cost avoidance resulting from a utility's loss of a portion of its service territory are measured over a longer period of time, it is possible that on a net present value basis remaining customers could expect to benefit from a utility's loss of a portion of its service territory. As I will discuss further in following testimony, PSE alleges in this proceeding that remaining PSE customers will benefit over a 20 year period from lower power supply costs as a result of the loss of Jefferson County load because it can delay the acquisition of higher cost resources.

B. Analysis of Harm and Benefits.

Q: Has PSE presented studies in this docket and others that provide information about the impact of the loss of the Jefferson County service territory to remaining PSE customers?

A: There are a number of studies that directly or tangentially address the impact on remaining customers. In my analysis, I considered information provided in several studies presented in various dockets, which are summarized below:

- **Exhibit No. JAP-7.** Within this docket, PSE studied long term power supply costs with and without the Jefferson County load. The results of those studies, presented in the testimony and exhibits of Mr. Jon Piliaris, indicate that on a net present value basis over a 20 year period, existing customers will experience power supply cost *savings* of approximately $83 million.

- **Exhibit No. JAP-3.** Within this docket, PSE undertook two different approaches to quantifying whether the non-power supply costs of providing utility service in Jefferson County was recovered in the revenues collected there. Unlike the power cost study discussed above, which looked at 20 years, these studies considered only one year of revenues and costs associated with serving Jefferson County.

- In the first analysis, PSE identified and quantified the directly assignable non-power supply costs incurred to serve Jefferson County.[8] It is assumed that the directly assigned non-power supply costs incurred to serve Jefferson County will be totally avoidable by PSE following Jefferson County's departure from its system. The results of this study indicate that Jefferson County ratepayers were annually paying rates that provided approximately $3.2 million above directly assignable costs incurred to serve Jefferson County that presumably are now completely avoidable as a result of completing the JPUD sale. The noted $3.2 million amount represents a contribution to common fixed costs that are not incurred directly and exclusively to serve any one geographic portion of PSE's service territory.

- In the second analysis, PSE added to the directly assignable Jefferson County costs an allocated portion of other common costs that could not be directly assigned to serving any specific area of PSE's service territory.[9] The results of the second analysis, sometimes referred to as a "fully distributed cost study,"[10] suggest that Jefferson County ratepayers were not paying a rate that was fully compensatory for the cost of serving the area. Specifically, PSE suggests that Jefferson County ratepayers provided annual revenues that were approximately $1.1 million less than the fully distributed costs incurred to serve the county.

- Using these two "bookends" of cost calculations, PSE witness Mr. Piliaris effectively concludes that Jefferson County revenues were approximately equal to the costs incurred to provide service in Jefferson County.[11]

• **UtiliPoint Study.** A "Preliminary Feasibility Study" was prepared for PSE by UtiliPoint International, Inc. (UtiliPoint) in July 2008, and presented to the Commission as a part of the Company's testimony and exhibits in Docket UE-101217.[12] The study undertaken was designed to provide the Jefferson County Community with a preliminary assessment

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[8] Exhibit No. JAP-3, p.1.
[9] Exhibit No. JAP-3, p. 2.
[10] The costs being addressed herein consist of non-power supply costs or that were considered in PSE rates addressed within Dockets UE-121697 and UE-130137. The noted dockets addressed rates being established over a multi-year period through an Expedited Rate Filing and Revenue Decoupling Mechanism. The "non-power supply cost" rates established within the noted dockets are sometimes referred to herein as "ERF" rates.
[11] Exhibit No. JAP-1T, p. 5:7-16.
[12] The noted UtiliPoint study was included as an exhibit to PSE witness Mr. Karl Karzmar's testimony in the UTC docket addressing the transfer of assets to JPUD. *See,* Docket UE-101217, Exhibit No. KRK-5, *Feasibility Considerations for the Proposed Government Takeover of Puget Sound Energy's Electric Utility Business within Jefferson County.*

of the costs that would be involved to purchase, finance, and operate PSE's electric utility within the boundaries of Jefferson County by another utility entity such as JPUD.

- **Hittle Study.** JPUD retained D. Hittle & Associates to assess the feasibility of JPUD acquiring and operating PSE's electric service territory in Jefferson County. The Hittle study addressed a presumed reasonable purchase price to be paid to PSE.[13] PSE provided this study as a part of the Company's testimony and exhibits in Docket UE-101217.

C. Issues Specific to this Case.

1. Stranded Costs.

Q: Were stranded costs considered in the early evaluations of a possible takeover of PSE's Jefferson County service territory?

A: Very much so. In UtiliPoint's "Preliminary Feasibility Study" of the probable cost for JPUD to serve the Jefferson County service territory, UtiliPoint assumed a relatively low cost to acquire the distribution assets ($61,750,500).[14] No stranded costs or severance costs were included in the analysis, purportedly in part, because such costs could not be decided until after extensive litigation was completed. Additionally, UtiliPoint's analysis concluded that an acquisition by JPUD was unlikely to be economically feasible even at the bargain basement price that UtilitPoint was employing in its study, thus implicitly concluding that it was unnecessary for PSE to expend additional resources on a stranded cost analysis that would effectively increase the cost of acquisition.[15]

[13] *See,* Docket UE-101217, Exhibit No. KRK-4, *Preliminary Feasibility Study – Public Utility District No. 1 of Jefferson County - Electric System Acquisition.*
[14] Docket UE-101217, Exhibit No. KRK-5, p. 7. Utilipoint assumed that distribution assets would be purchased for $46,502,862 and that "going concern" costs in the amount of $15,247,638 would also be paid to PSE resulting in a total purchase price of $61,750,500.
[15] *Id.*, p. 18.

Q: Did the UtiliPoint report nonetheless address the stranded cost issue?

A: Yes. In relevant part the UtiliPoint report stated:

> Stranded costs can occur when an asset is rendered useless or impaired by the taking or purchase of private utility property by a government entity. These costs are a form of severance damage ***for which PSE is entitled to compensation***. Broadly speaking, stranded costs are investments made on behalf of customers to ensure future electric service that are rendered uneconomic when those customers leave the system. ***Stranded costs are distinctly different from going concern value***. Stranded costs are calculated based on capital investments in assets such as generation, transmission, and distribution that are dedicated to providing service to customers. Using standard accounting methods, these investments can be allocated customers in a specific geographic area. The term "stranded costs" is often used in relation to stranded generation assets – although many other kinds of assets can come under the umbrella of this definition.[16]

Later within the same report, after discussing the difficulty of quantifying stranded costs, the UtiliPoint report went on to state:

> Given the high level of uncertainty in this calculation and the ever changing wholesale market prices, no attempt is made in this report to quantify the damages FERC will provide as a result of the PUD actions. As a result of this transaction, ***other economic damages may occur, such as the idling of PSE facilities or the loss of contributions from customers residing in the PUD toward fixed costs such as billing systems, customer call centers, etc.*** These and other costs, sometimes referred to as ***severance damages, are not considered in this report but would likely arise when more complete investigations are made*** during the legal proceedings. As the analysis will show, the ***PUD's attempted purchase of the electric utility business within the county limits is economically infeasible even before a stranded cost or severance determination is made.***[17]

[16] *Id.*, p. 16, emphasis added.
[17] *Id.*, p. 18, emphasis added.

In short and in sum, the study undertaken on behalf of PSE addressed, and agreed with, the very stranded cost concerns described in my earlier discussion about short-term harm to remaining customers.

Q: Did the Hittle Study provide any information or include analysis of whether PSE would experience stranded costs and underutilization of billing and customer service systems?

A: Yes, at least in part. The Hittle study addressed a presumed reasonable purchase price to be paid to PSE. It did not undertake a detailed appraisal. But by considering the probable original cost less depreciation (OCLD) value of the Jefferson County T&D system, and adding a typical premium (35 percent) paid above the OCLD value in other similar utility property acquisitions, the Hittle study concluded that a reasonable acquisition price of the Jefferson County T&D system would be approximately $47.1 million.[18] In developing such "typical premium," the Hittle study specifically rejected any consideration for the possibility of the need to pay for "stranded costs," stating in relevant part:

> Similarly, stranded costs have not been explicitly included, as they are likely to be zero. Specifically, FERC has defined stranded costs to compensate utilities for the loss of customers that would jeopardize utility investment in generation or transmission facilities due to FERC's implementation of transmission open access policy. PSE has stated in many forums that it will need to add or upgrade significant amounts of generation and transmission to its system to meet future loads. Therefore, a loss of customer load and revenues from the creation of a PUD electric utility in Jefferson County will reduce the need for new generation to be added by PSE. This means no PSE generation will be shut down or underutilized based on reduced loads in Jefferson County and consequently, no generation will be "stranded" because of FERC's open access transmission policy.

[18] Docket U-101217, Exhibit No. KRK-4, p. 19.

> Furthermore, the FERC definition of "Stranded Cost" is based on a complex formula. One of the components in the formula is the length of time that PSE could have reasonably expected to have served its customers within Jefferson County. Since it will most likely take a few years to establish a new PUD, PSE will have been put on notice for that time period and the resulting adjudicated time value is likely to be zero or a very small number. In this kind of situation it is likely that there could be benefits to PSE if the District forms an electric utility and frees PSE from the need to acquire additional generation in the future.[19]

As I shall describe below, I submit that "stranded costs," as addressed within the UtiliPoint and Hittle studies, are occurring with regard to PSE's power supply and non-power supply investments that are, or will be, creating a detriment to remaining PSE customers.

2. Impact of loss of Jefferson County load upon electric delivery system rates.

Q: Do you agree with PSE's conclusions that customers remaining on the PSE system after the loss of the Jefferson County load will be neither harmed nor benefited, with regard to ERF rates?[20]

A: No.

[19] Docket UE-101217, *Preliminary Feasibility Study – Public Utility District No. 1 of Jefferson County - Electric System Acquisition*, Exhibit No. KRK-4, pp. 18-19. The Hittle study's qualitative suggestion that "there could be benefits to PSE if the District forms an electric utility and frees PSE from the need to acquire additional generation in the future" is effectively a precursor of the quantitative conclusion offered by PSE in this proceeding that, on a net present values basis, remaining PSE customers will experience $83 million in power supply cost savings over a 20 year period, which is discussed in further detail below.

[20] "Electric delivery system" revenue requirement is a term used by Mr. Piliaris to address "categories of costs used in the development of PSE's recently-approved Expedited Rate Filing (ERF) in Docket UE-130137. These categories exclude expenses related to PSE's Power Cost Adjustment (PCA) mechanism and property taxes, the latter of which are now recovered through a separate rate tracker (Schedule 141)." *See,* Exhibit No. JAP-1T, n.1.

Q: Please explain.

A: I conclude from PSE's study of ERF revenues and only directly-assigned non-power supply costs, that approximately $3.2 million of annual contributions to common fixed costs that were being provided by Jefferson County customers will now be absorbed by remaining PSE customers.[21] Further, I conclude from PSE's second study, which also reflected an allocation of common costs to Jefferson County, that relative to PSE's entire distribution system, Jefferson County was a relatively high cost area to serve.[22]

This conclusion is logical inasmuch as Jefferson County is a relatively sparsely populated rural service territory, and because PSE does not provide natural gas distribution service in Jefferson County, so the area does not benefit from cost synergies between the two. The fact that it was a relatively high cost area to serve does not in any way discredit the conclusion that $3.2 million of contributions toward PSE's common fixed costs will now need to be absorbed by remaining customers. Rather, this "lost contribution" is the exact concern first raised by UtilitPoint in its Preliminary Feasibility Study prepared at PSE's request that concluded that as "a result of this transaction, other economic damages may occur, such as the idling of PSE facilities or the loss of contributions from customer residing in the PUD toward fixed costs such as billing systems, customer call centers, etc."[23]

[21] Exhibit No. JAP-3, p. 1.
[22] Exhibit No. JAP-3, p. 2.
[23] Docket UE-101217, Exhibit No. KRK-5, p. 18.

Q: Did you attempt to verify the conclusion you state above through additional discovery with PSE?

A: Yes. As shown in Exhibit No. JRD-3, Public Counsel asked if the Company agreed that remaining customers will have to absorb approximately $3.2 million of non-power supply costs that Jefferson County customers previously paid. In its response, the Company indicated it does not agree. Instead, PSE argued that Public Counsel is misinterpreting the analysis, and that shareholders, not its customers, will absorb those costs. Additionally, the Company stated that, even if Public Counsel's assumption was correct, because "the Jefferson County service area represented about one year's load and customer growth on PSE's entire system, any costs would have been quickly "absorbed" by the new customers (and load) added to the system after PSE discontinued providing electric service in Jefferson County."

Q: Did anything in PSE's response to Public Counsel Data Request No. 34 dissuade you from your original conclusion that remaining PSE customers will be required to absorb the $3.2 million of Jefferson County customers' contributions to common fixed cost?

A: No.

Q: Please explain.

A: First, the second paragraph of the response clearly and unequivocally states that *PSE shareholders are currently absorbing the loss of the $3.2 million margin previously provided by Jefferson County.* Thus, there is no doubt that the contribution previously provided by Jefferson County ratepayers must be absorbed by some other entity – be it shareholders or ratepayers.

While I would concede that theoretically PSE's shareholders could be absorbing the Jefferson County $3.2 million contribution shortfall at the present time, I strongly disagree with PSE's second conclusion found in response to Public Counsel Data Request No. 34. There PSE states that by the time that ERF rates are reset, PSE's organic load growth will exceed the load lost in Jefferson County, and therefore, remaining PSE customers will never be harmed by the loss of the Jefferson County contribution to fixed common costs. Rather, if at the time of the next general rate case PSE experiences the organic load growth it is predicting, *and if Jefferson County had continued to be served by PSE*, the relatively fixed common non-power supply costs would be spread over an even larger load or number of customers than will occur when non-power supply cost rates are established without the Jefferson County load.

Q: Beyond the impact of absorbing "lost contributions" of electric delivery system costs just described, are there other non-power supply costs that will be borne by remaining PSE customers?

A: Yes. While not nearly as significant as the "lost contribution" to fixed common costs just described, a modest increase in property taxes to be borne by remaining customers following the loss of the Jefferson County load can be expected to occur. Within Docket UE-130137 *et. al.*, this Commission authorized the recovery of PSE electric operations' property tax expense through a property tax expense rider. According to Mr. Jon Piliaris's testimony filed within this docket, Jefferson County electric operations customers would be paying approximately $370,000 in rates, while the actual property taxes paid in Jefferson County in 2011 and 2012 was $210,000 and $249,000, respectively.[24] Thus, the sale of the Jefferson County T&D will result in reduced property tax expense to be paid by PSE, however, the loss of property tax revenues being received by Jefferson County customers will exceed such Jefferson County-specific taxes being paid by over $100,000. The excess of property tax revenues collected from Jefferson County customers above directly-incurred Jefferson County property tax expense could also be viewed as a contribution that was being made by Jefferson County ratepayers to property tax expense associated with "common plant" that will now have to be borne by remaining PSE customers.

3. Impact of loss of Jefferson County load upon power supply cost rates for remaining PSE ratepayers.

Q: Turning to the topic of PSE-claimed power supply cost savings estimated to be experienced by remaining PSE customers as a result of the loss of the Jefferson County load, please briefly summarize your understanding of calculations undertaken and conclusions drawn by PSE.

A: As mentioned above, PSE undertook 20 year power supply cost studies assuming service would continue to be provided to Jefferson County and assuming that Jefferson County would no longer be served by PSE. The output of those two studies predicted total variable costs and incremental fixed production costs to be incurred "with" and "without" the Jefferson County load. The results of the two studies are discussed within Mr. Piliaris' testimony and can be observed within

[24] Exhibit No. JAP-1T, p. 9.

Exhibit No. JAP-7. According to Mr. Piliaris' testimony, remaining PSE customers will benefit on a net present value basis over the 20 year study period by roughly $83 million.

Q: Did you review in detail all assumptions and calculations included in PSE's long term power supply studies?

A: No. I have not reviewed in very much detail the "with" and "without" the Jefferson County load power supply studies undertaken by PSE. These two studies relied, in part, upon results obtained from PSE's Portfolio Screening Model III (PSM III), which includes a myriad of assumptions and thousands of calculations. Accordingly, I am not taking specific exception to any one assumption or calculation employed in these long term power supply cost studies.

While I did not conduct a specific review of each input and calculation included in Exhibit No. JAP-7 and its work papers, I am familiar with long-term studies that rely upon numerous inputs and assumptions. I draw upon my experience with such studies in my analysis below.

Q: Are you in agreement with the power supply cost savings for remaining customers that PSE predicts to occur?

A: No. As I shall explain in more detail, the Company's own study results reflect a fairly significant early-years cost penalty to remaining PSE customers as a result of the loss of serving Jefferson County. The predicted early-years cost penalty is offset in the out years of the Company's study which predict significant power supply cost avoidance and/or deferrals. However, the assumptions and calculations employed to predict power supply cost avoidance/power supply cost deferrals in the later years of the study forecast are undoubtedly much less certain to occur than the cost penalties predicted in the early years of the study.

Further, while I am not contesting any one element in the Company's two power supply cost studies, I do take specific exception to the Company's calculations of expected net present value savings that rely upon the output of the two long term power supply cost studies.

Q: Please expand upon your previous answer wherein you assert that the Company's claim of net present value savings is dependent upon less certain events occurring in the out years of the two studies undertaken.

A: In my experience, when I have undertaken or reviewed in detail long term studies such as the one PSE relies upon in this docket, I have found that seemingly small changes to input assumptions, such as those for inflation rates and load growth, can significantly impact study results – particularly in the out years of very long term studies. The more significant changes to study results in the out years of long term studies occur as the impacts of seemingly small inflation and/or load growth assumption changes become greatly magnified after numerous years of "compounding."

Thus, while I have no specific flaws to point out regarding PSE's two long term production cost studies, I would emphasize that in any long term power supply cost study, the early or "front end" study results will be more reliable than the out-year study results, which are heavily dependent upon the "compounding" of inflation and load growth rate assumptions. This outcome is expected as the inputs underlying the early years' calculations are simply more knowable than the out-years of the study because they are to a much greater degree generated by considering today's actual investment and today's actual expense levels being incurred to provide service to today's customer base.

Q: Please expand upon the second point in your earlier answer wherein you stated that you do take specific exception to the Company's calculations of expected net present value savings that rely upon the output of the two long term power supply cost studies.

A: Aside from the uncertainty associated with this type of long-term study, PSE's calculation of NPV savings of $83 million is further unreliable because PSE did not properly match PCA revenues with productions costs assumed in its long term power supply cost study.

Specifically, the lower loads employed in the "without" Jefferson County study result in lower variable production costs, but also predict forestalling for a period of years the assumed building or acquiring of PSE's "next" production resource from that predicted in the "with" Jefferson County load study. The difference in annual production costs produced by the two studies represents PSE's estimate of total production costs *avoided* as a result of terminating service to Jefferson County.[25]

On the revenue side, PSE calculated lost or foregone PCA revenue expected to be experienced as a result of the loss of Jefferson County load.[26] PSE's estimate of the forecasted PCA factor was not precise inasmuch as it did

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[25] PSE's estimate of avoided production costs over the 20 year study period can be observed within Column (c) of Exhibit No. JAP-7, p. 1.

not undertake a calculation that considered each element of forecasted production costs and attempt to calculate a precise "fixed" and "variable" PCA rate component to be applicable during the 20 year study period. Rather, it held the current "fixed" portion of the PCA rate of $44.656 per MWH constant over the entire 20 year study period. For the "variable" PCA component, PSE assumed that the market cost for purchased power and natural gas prices would increase at the long term forecasted escalation rate for each component.

Thus, one implicit assumption in developing the expected total PCA rate to be experienced during the 20 year period was that the "fixed" PCA rate to be realized would remain constant, even though the long term power supply cost studies PSE undertook to derive "avoided" production costs assumed significant increases in "incremental fixed" costs associated with "incremental capacity" being acquired to meet load growth throughout the 20 year study period. Accordingly, the Company's calculation of foregone PCA revenues resulting from the loss of Jefferson County load is understated inasmuch as its forecast of the "fixed" component of the PCA factor has not been appropriately synchronized with PSE's own projection of incremental fixed production costs over the study period.

Q: Have you estimated the impact of correcting the mismatch problem of forecasted fixed production costs versus the forecast of the "fixed" component of foregone PCA revenues?

[26] PSE calculated such "lost PCA revenues" in each year by multiplying the forecasted Jefferson County MWH loads times an estimate of the PCA factor predicted to be experienced during the 20 year period.

A: Yes. Public Counsel Data Request No. 31 asked PSE to provide forecasted "fixed" PCA rates that would be synchronized with the higher production costs being forecasted within its long term power supply cost studies. Utilizing the PSE-forecasted "fixed" PCA rates I then recalculated "lost PCA revenues" over the entire 20 year study period. The results of such calculations, which are shown on Exhibit No. JRD-4, reflect that the correction or synchronization of "lost PCA revenues" with forecasted power supply costs have the impact of lowering the net present value savings from $83,192,000 as calculated by PSE down to $57,973,000.

Q: Given that the revised calculation of net present value power supply cost savings, do you conclude that at least with regard to long term power supply cost implications, remaining PSE customers will benefit from Jefferson County's departure from the PSE system.

A: Not at all. First, one relatively simple correction to PSE's study reduced the Company's estimated NPV savings by a full 30.0 percent. Second, as previously noted, small input changes to long term studies can result in significantly different outcomes primarily as the result of the "compounding" effect of such seemingly small changes over a long term forecast period. Third, and importantly, the PSE-estimated net present value savings calculated over the entire 20-year study period are dependent upon the realization of large savings predicted to occur following the first four years of significant "cost penalties" occurring shortly following Jefferson County's departure from the PSE electric system. As previously described, front end cost and savings projections – due simply to their dependence upon better known costs, loads and events – can be considered much more reliable than the longer term projections and study results that are built upon a myriad of assumptions. Given the far more certain cost penalties predicted at the front end of the 20 year study period versus the more speculative out years' projected cost savings, it is far from certain that remaining PSE customers will actually experience long term power supply cost savings from the loss of Jefferson County load over the entire 20 year study period.

Q: Can you provide an example of how small input changes to PSE's long term power supply cost studies could significantly impact the studies' outcome.

A: Yes. For example, small changes in assumed annual load growth can significantly affect both the *timing* and the size of the "next" resource acquisition. The expected need for the "next" resource can be easily be delayed by a year or two by employing a lower load growth rate assumption. For instance, in PSE's case, a slight quarter of a percent (0.25 percent) reduction in peak load growth shaves peak capacity needs by about 12 megawatts per year.[27] Accordingly, over a four-year period, such quarter of percent reduction in peak load growth would result in the need for approximately 50 fewer megawatts of peak capacity which would be sufficient to delay the need for the "next" peaking unit by a year – if not two.

Q: Could delaying the assumed in service date of PSE's "next" peaking unit by even one year significantly impact the study results?

[27] Per response to ICNU Data Request No. 3.4, Attachment A, PSE's forecasted 2014 normal peak is 4,922 megawatts. Multiplying the forecasted 2014 peak times 0.25 percent equals 12 megawatts.

A: Yes. There are many moving, interrelated parts to power supply cost studies such as those prepared by PSE to develop net present value savings reflected on Exhibit No. JAP-7. Thus, it is impossible – without completely rerunning the studies – to precisely quantify the impact of deferring the in service date of a "next' peaking unit by even one year. That stated, looking at the timing and size of assumed peaking unit additions in each of PSE's long term studies undertaken, it appears PSE-predicted net present value power supply cost savings are heavily influenced by assumptions that PSE's need for each new 206 megawatt gas peaking unit will be delayed about approximately three years as a result of the Jefferson County load departing PSE's system.

More specifically, in the Company's production cost study "with" Jefferson County, it is concluded that a 206 megawatt gas peaking unit will be required to be placed in service in 2018. However, in the "without" Jefferson County version of the same study, a gas peaking unit does not appear to be required until 2021.[28] This correlates with the Company's summary power supply cost savings calculations reflected on Exhibit No. JAP-7 as well as my revised calculation reflected on Exhibit No. JRD-4, which show that the first annual "savings" of approximately $30 million from Jefferson County's departure is predicted to take place in 2018.

Similarly, the in service date for the second 206 megawatt peaking unit is slipped from 2022 in the "with" Jefferson County power supply study to 2023 in the "without" Jefferson County study. The slippage of the assumed in service

[28] PSE's response to ICNU Data Request No. 3.4, Attachments A and B.

date of the second peaking unit from 2022 to 2023 between the studies appears to be the largest contributor to another large $30-plus million calculated annual savings presumed to be resulting from Jefferson County's departure. In essence, if lower load growth assumptions delay the perceived need for the "next" higher cost generating resource, all other things held constant, it follows that the early years cost penalties now predicted to occur from 2014 through 2017 could continue for a longer period of years, and that there will be fewer, and farther down the road, "savings" years calculated as a result of presumed deferral of new generating units stemming from the Jefferson County load loss.

D. Conclusions Regarding Impact of Loss of Jefferson County Load Upon Remaining PSE Customers.

Q: What do you conclude regarding the probable impact that Jefferson County's departure from the PSE electric system will have upon remaining PSE customers?

A: In summary:

- The stranded costs predicted within the PSE-ordered UtiliPoint study are being experienced, and can be expected to be experienced for a period of time, as a result of Jefferson County's departure. Stranded costs in the form of production capacity that is surplus at this time and underutilization of fixed corporate common costs and investment will have a detrimental impact to remaining PSE customers.

- Regarding non-power supply costs, or costs that are for the most part being collected in what is commonly referred to as "ERF rates," following the expiration of the current K-factor rate plan, remaining customers will experience a detriment as they will be called upon to absorb the approximate $3.2 million in contributions toward common fixed costs that was previously provided by Jefferson County customers.

- I take specific exception to PSE's conclusion that remaining PSE customers will never be detrimentally impacted with regard to ERF rates because organic load growth occurring since Jefferson County's departure will more than offset the load lost as a result of Jefferson County's departure. Common relatively-fixed costs would have been spread over an even larger number of customers and billing determinants had the Jefferson County customers continued to be served by the PSE electric system. A legitimate disagreement may exist concerning whether the previous $3.2 million contribution – or some portion of the $3.2 million contribution – from former PSE customers should be calculated as a detriment to remaining customers for five, ten or twenty years following the expiration of the current rate plan. But in my opinion, remaining PSE customers will most definitely be detrimentally impacted to some fairly significant degree for several future years.

- Regarding power supply cost impacts, even the Company's unadjusted power supply cost savings calculations indicate that remaining customers will experience in excess of $10 million of economic harm per year for four years following Jefferson County's departure.[29] PSE predicts the early years cost penalties will be more than offset by savings predicted to occur beginning in 2018 and beyond. However, the long-term cost savings assumed are inherently less certain to occur than the cost penalties predicted for the early years following Jefferson County's departure.

Taken together, the detriments or cost penalties in total rates predicted to be experienced by remaining PSE customers for the years 2014 through 2017 approaches the full amount of the gain on the sale of the Jefferson County assets.[30]

Q: Viewed in isolation, what does the expected harm to remaining PSE customers resulting from Jefferson County's departure suggest to be an equitable allocation of the gain between ratepayers and shareholders in this docket?

[29] Per Exhibit No. JAP-7, column e, PSE predicts "negative" benefits in excess of $11 million per year for years 2014 through 2017. As described in other testimony herein, those "negative" benefits are understated due to PSE's failure to synchronize lost PCA revenues with assumed increases in fixed production costs.
[30] Per Exhibit No. MRM-3, the total gain from the transaction is $59,964,313. The sum of net losses or penalties in power supply cost impacts to remaining customers per Exhibit No. JAP-7 for years 2014 through 2017 equals $47,253,000. Thus, the majority of the total gain is offset by power supply cost penalties predicted to occur in years 2014 through 2017 – before consideration is given to remaining PSE

A: This exposure to harm to remaining customers would indicate that the majority of the gain should be allocated to remaining PSE customers. In comparing this case to the Commission's decision regarding the gain on sale of the Centralia Steam Generating Unit,[31] the exposure to harm would suggest that not only should ratepayers receive the portion of the gain that represents the "over depreciated" balance recorded in the Accumulated Depreciation Reserve, but also the majority of "appreciation" in the value of the plant sold that exceeds its original in service cost.

IV. RECOMMENDATION

Q: How do you propose that the net book gain on sale of the Jefferson County T&D property be assigned to ratepayers and shareholders?

A: I recommend that 95 percent of the net book gain be credited to ratepayers and 5 percent be credited to shareholders. Under the Commission's analysis in the Centralia case, my recommendation regarding net book gain has the same effect of allocating the net book value to the shareholders, accumulated depreciation to the ratepayers and allocating 90 percent of the appreciation to ratepayers and 10 percent to shareholders.

Q: How do you propose that the portion of the gain allocated to ratepayers be credited to ratepayers?

A: I recommend that the gain assigned to ratepayers be credited to ratepayers through bill credits amortized over a two to four year period. Importantly, the amount

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ratepayers being required to bear for a number of years all or some portion of the $3.2 million in contributions toward common fixed costs previously being made by Jefferson County customers.

[31] Dockets UE-991255, UE-991262, UE-991409, Second Supplemental Order (March 6, 2000).

allocated to ratepayers should accrue interest at PSE's authorized rate of return during the amortization period, and both the allocated gain and the interest accrued should be returned to ratepayers. With respect to allocating the gain among the classes of customers, I do not oppose PSE's proposal that the gain be allocated to classes of customers in the same manner that costs are allocated in setting rates.

Q: How have you arrived at your recommended distribution of the gain?

A: In arriving at the recommended gain distribution of 95 percent to ratepayers and 5 percent to shareholders, I have considered the harm to remaining PSE customers. The harm can be expected to continue for a number of years as a result the loss of the Jefferson County service territory.

I have also considered this Commission's strong precedent for assigning the majority of gains from property sales to ratepayers. More importantly, I considered the underlying reasoning employed by the Commission – namely, that ratepayers have borne the costs and risks associated with the property being sold, and therefore should enjoy the majority of benefits to be derived from the sale.

I have also considered the fact that PSE is losing customers at the same time it is selling a portion of its T&D system. I have only given very modest weight to this fact.

Q: Please explain why you have given very little weight to this fact.

A: First and foremost, the detriment or harm to remaining PSE customers resulting from the sale weighs in favor of allocating the majority of the gain to the remaining customers. The detriment or harm to remaining customers outweighs any argument that the loss of customers might harm the Company. That the departing customers paid the carrying costs and operating expenses associated with the Jefferson County T&D system carries little weight because PSE's rates are set on a total company basis and all customers pay for PSE's entire rate base. Additionally, it is easily concluded that Jefferson County customers have enjoyed being served at system-average rates even though on a fully distributed cost basis they were incurring above-system-average costs to be served. It therefore logically follows that remaining PSE customers have contributed more than their fair "allocated" share of depreciation on plant that is common to serving all customers irrespective of their geographic location wherein they receive electric service.

Q: Please continue with your discussion of other considerations made in arriving at your gain sharing recommendation in this proceeding.

A: I expect the Company will argue, and perhaps this Commission will question whether, if all of the gains from these types of transactions are credited to ratepayers, the Company would have no incentive to maximize gains from potential future property sales such as the Jefferson County property. My professional opinion is that pursuant to the terms of the regulatory compact, utility management has an obligation to strive to hold down long term costs in serving its ratepayers in return for other rights and privileges that the utility enjoys by virtue of its status as a monopoly providing an essential service to customers. I do not believe additional incentive should be required to push utility management to achieve that obligation already accepted by virtue of the regulatory compact.

Nonetheless, in my recommendation I have given at least some weight to the argument that PSE should be given an explicit incentive to oppose future condemnation proceedings perceived to be detrimental to its customers, or if condemnation is unavoidable, strive to obtain the highest gain possible that might be available to offset the detriments expected to be experienced by customers remaining on its system.

Finally, I have given at least modest consideration to this Commission's determination in the Centralia sales docket that both ratepayers and shareholder should share in that portion of the gain that represents appreciation above the original investment made by the utility in plant constructed to serve ratepayers.

Q: Does this conclude your direct testimony?

A: Yes, it does.