EXHIBIT NO. ___(BJL-1T)
DOCKET NO. UE-121697/UG-121705
DOCKET NO. UE-130137/UG-130138
WITNESS: BRANDON J. LOHSE

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondent.	DOCKET NOS. UE-121697 and UG-121705 (*consolidated*)
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondent.	DOCKET NOS. UE-130137 and UG-130138 (*consolidated*)

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
BRANDON J. LOHSE
ON BEHALF OF PUGET SOUND ENERGY, INC.

NOVEMBER 5, 2014

PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF BRANDON J. LOHSE

CONTENTS

PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF BRANDON J. LOHSE

I. INTRODUCTION

Q. Please state your name, business address and present position with Puget Sound Energy, Inc.

A. My name is Brandon J. Lohse. My business address is 10885 NE Fourth Street, P.O. Box 97034, Bellevue, Washington 98009-9734. I am the Corporate Treasurer for Puget Sound Energy, Inc. ("PSE").

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

A. Yes, I have. It is Exhibit No. ___(BJL-2).

Q. What are your duties as Corporate Treasurer for PSE?

A. I have responsibility for cash and liquidity management, short- and long-term borrowing programs, customer payment processing, investing activities, rating agency relations, commercial and investment bank relations, and debt investor relations. In addition, I oversee PSE's energy risk control and insurance programs. I am also a member of the Qualified Plan's Committee which oversees PSE's retirement, 401(k) and health and welfare plans. Additionally, I am a Trustee and the Treasurer of the Puget Sound Energy Foundation.

Q. Please summarize the purpose of your testimony.

A. This prefiled direct testimony describes PSE's existing capital structure and overall rate of return during the periods in question.

II. PSE'S 2013 AND 2014 CAPITAL STRUCTURE AND RATE OF RETURN

Q. What is the authorized capital structure and rate of return that PSE is supporting in this proceeding?

A. PSE supports the 7.77 percent authorized rate of return and an authorized capital structure including an equity ratio of 48 percent equity that the Commission authorized in Order 08 in Dockets UE-111048 and UG-111049.[1] Table 1 below provides the supported authorized rate of return and capital structure. Please also see Exhibit No. ___(BJL-3).

Table 1. Capital Structure and Overall Rate of Return as Authorized in Dockets UE-111048 and UG-111049

Capital Component	Capital Structure	Cost Rate	Weighted Cost
Short-term Debt	4.00%	2.68%	0.11%
Long-term Debt	48.00%	6.16%	2.96%
Common Equity	48.00%	9.80%	4.70%
Overall Rate Of Return	**100.00%**		**7.77%**

[1] *WUTC v. Puget Sound Energy, Inc.*, Order 08 Rejecting Tariff Sheets; Authorizing and Requiring Compliance Filing, Dockets UE-111048 and UG-111049 (consolidated) (May 7, 2012) ("Order 08").

Q. What was PSE's actual capital structure and rate of return at March 31, 2013?

A. As shown in Table 2 below, PSE's actual capital structure (calculated using an average of the monthly averages methodology) during the twelve months ending March 31, 2013, included an equity ratio of 48.44 percent, a long-term debt ratio of 50.19 percent, and a short-term debt ratio of 1.37 percent. At PSE's authorized return of equity of 9.80 percent and PSE's actual cost of long- and short-term debt, PSE's actual rate of return (calculated using an average of the monthly averages methodology) during the twelve months ending March 31, 2013, was 7.95 percent.

Table 2. Actual Capital Structure and Overall Rate of Return at March 31, 2013

Capital Component	Capital Structure	Cost Rate	Weighted Cost
Short-term Debt	1.37%	5.74%	0.08%
Long-term Debt	50.19%	6.22%	3.12%
Common Equity	48.44%	9.80%	4.75%
Overall Rate Of Return	**100.00%**		**7.95%**

Q. What was PSE's actual capital structure and rate of return at September 30, 2014?

A. As shown in Table 3 below, PSE's actual capital structure (calculated using an average of the monthly averages methodology) during the twelve months ending September 30, 2014, included an equity ratio of 48.08 percent, a long-term debt ratio of 50.90 percent, and a short-term debt ratio of 1.02 percent. At PSE's authorized return of equity of 9.80 percent and PSE's actual cost of long- and short-term debt, PSE's actual rate of return (calculated using an average of the monthly averages methodology) during the twelve months ending September 30, 2014, was 7.89 percent.

Table 3. Actual Capital Structure and Overall Rate of Return at September 30, 2014

Capital Component	Capital Structure	Cost Rate	Weighted Cost
Short-term Debt	1.02%	4.15%	0.04%
Long-term Debt	50.90%	6.16%	3.14%
Common Equity	48.08%	9.80%	4.71%
Overall Rate Of Return	**100.00%**		**7.89%**

Q. Has PSE prepared an exhibit that demonstrates the actual rate year costs that support PSE's actual rate of return during the 2013 and 2014 periods in question?

A. Yes. Please see Exhibit No. ___(BJL-4) for the actual rate year costs that support PSE's rate of return of 7.95 percent for the period ending March 31, 2013, and Exhibit No__(BJL-5) for the actual rate year costs that support PSE's rate of return of 7.89 percent for the period ending September 30, 2014.

Q. Is PSE requesting any changes to its authorized capital structure as part of this proceeding?

A. No. Consistent with the Prefiled Direct Testimony of Mr. Daniel A. Doyle, Exhibit No. ___(DAD-4T), PSE is not requesting any changes to its capital structure as part of this proceeding.

Q. Does PSE expect to continue to maintain a capital structure that includes an equity ratio of 48 percent in future periods?

A. For the remainder of the rate plan period, PSE expects to maintain an actual capital structure that includes an equity ratio of 48 percent, barring any unforeseen material events that could impact capital requirements.

Q. Please explain how the authorized 48 percent equity ratio compares to that of comparable companies.

A. In rate cases decided in the past 18 months, a 48 percent authorized equity ratio is well below that of PSE's utility peers. In rate cases decided since 2013, the average authorized equity ratio is 49.99 percent. As can be seen in Exhibit No.___(BJL-6) at page 4. For rate cases decided since 2014, the average authorized equity ratio is 50.44 percent. *Id.* All else being equal, PSE would be less attractive to investors as a result of having an equity ratio lower than its peers.

Strong operating cash flows are what drive investors to utilities. Holding authorized return on equity constant, an authorized capital structure that contains a higher equity ratio would improve PSE's opportunity to increase operating cash flows and to boost its return profile, and thus make it more competitive for capital relative to its other utility peers.

Q. Did PSE calculate the actual capital structures reflected in Tables 2 and 3 in a manner similar to the capital structures calculated in PSE's previous rate proceedings?

A. Yes. PSE has calculated the actual capital structures reflected in Tables 2 and 3 in a manner similar to the capital structures calculated in PSE's recent rate proceedings. This methodology removes non-regulated activities and the balance sheet impact of certain other items from PSE's consolidated capital structure. Specifically, PSE made the following three adjustments:

(i) PSE removed the retained earnings from unregulated activities such as Puget Western, Inc. ("PWI");

(ii) PSE removed the unrealized retained earnings impacts resulting from the marking to market the value of its hedging activities; and

(iii) PSE removed the balance sheet impact from pension accounting.

Q. Please identify the three adjustments PSE made to retained earnings to determine PSE's consolidated capital structure.

A. PSE removed the retained earnings generated by PWI from PSE's consolidated capital structure because the retained earnings generated by this subsidiary are non-regulated. PWI is a real estate development and disposition subsidiary.

PSE removed the balance sheet impacts of certain derivative valuations that flow through net income or into Other Comprehensive Income ("OCI"), a component of retained earnings, because PSE recovers the commodity costs it incurs—not these non-cash and unrealized mark-to-market amounts—through customer rates.

PSE removed the balance sheet impacts of accounting for PSE's pension plan because rates do not reflect pension plan expenses. Instead, PSE reflects pension plan contributions in rates, averaged over a four-year period.

Q. Why does PSE remove the balance sheet impacts of certain derivatives from its consolidated common equity?

A. The Commission has typically set PSE's rates in a manner that does not recover through customer rates the accounting income and expense from marking derivatives to their market value. PSE removes the corresponding balance sheet impacts of accounting for the market value of derivatives from its consolidated common equity because rates do not reflect the expense or income. This adjustment removes the variability of the mark to market calculations made for financial reporting purposes. The Commission has not recognized these types of adjustments in setting rates because such adjustments reflect the measurement of a timing difference for financial reporting purposes and do not reflect "cash" transactions. Furthermore, to allow the impacts of hedging gains or losses to affect equity could unintentionally create an incentive for PSE to expand its hedging program in an attempt to increase trading gains, which would be contrary to the intent of its hedging program.

Q. Why does PSE remove the balance sheet impacts of pension accounting from its consolidated common equity?

A. The Commission has typically set PSE's rates in a manner that reflects actual "cash" pension contributions averaged over a period, typically four years, not the financial reporting income and expense related to the pension plan. Therefore, PSE removes the balance sheet impacts of such financial reporting of pension accounting. PSE's treatment of these items in this proceeding is consistent with past practices.

III. CAPITAL COMPONENTS OF PSE'S REQUESTED AUTHORIZED RATE OF RETURN OF 7.77 PERCENT

Q. Has PSE prepared an exhibit that demonstrates the hypothetical rate year costs that supported PSE's requested rate of return of 7.77 percent?

A. Yes. Please see Exhibit No. ___(BJL-3) for the rate year cost rates that support PSE's requested authorized rate of return of 7.77 percent. For clarification, and as supported in Exhibit No. ___(BJL-3), PSE originally requested (and the Commission granted in Order 08 in Dockets UE-111048 and UG-111049) an authorized rate of return of 7.80 percent. At the time of the proceeding in May 2013, however, PSE was in the process of refinancing its pollution control bonds. Since the interest rate reduction associated with the refinancing was known and measurable at the time of the proceeding, PSE agreed to amend and embed the impacts of the refinanced Pollution Control Bonds into its requested authorized capital structure. Therefore, at that time, the only change PSE made to the amended capital structure was to Long Term Debt, holding all other components constant. The effect was to lower the authorized rate of return by three basis points—from 7.80 percent to 7.77 percent.

A. The Cost of Short-term Debt

Q. Is the cost of short-term debt PSE seeks to recover in this proceeding consistent with the approach in Dockets UE-111048 and UG-111049?

A. Yes. The cost of short-term debt PSE seeks to recover in this proceeding is consistent with the approach in Dockets UE-111048 and UG-111049. The current costs of PSE's existing short-term credit facilities are included in the rate year calculation of the cost of short-term debt, and costs for the existing $350 million facility supporting energy hedging are included in energy costs, consistent with prior rate proceedings.

Q. Is PSE including any costs of the facility supporting energy hedging in the costs of short-term debt?

A. No. PSE is not including any costs of the facility supporting energy hedging in the costs of short-term debt because use of that facility is dedicated to providing collateral as needed for gas and electric hedging. Therefore, PSE allocates the costs of that facility between the Power Cost Adjustment (PCA) Mechanism and the Purchased Gas Adjustment (PGA) mechanism, consistent with prior proceedings.

Q. Is the cost of commercial paper included in the costs of short-term debt?

A. Yes. Although PSE realizes that it cannot rely solely on commercial paper to fund its short-term liquidity needs, it has included commercial paper issuances and costs, along with borrowings under its credit agreements, into its short-term debt costs. Liquidity in the commercial paper market has improved dramatically since the financial crisis and as a result, commercial paper currently remains the least expensive source for short term funding needs. Subsequently, most of PSE's short-term debt outstanding during the periods in question relates to commercial paper borrowings.

Q. How did PSE calculate its hypothetical cost of short-term debt used to support the authorized rate of return percent of 7.77 percent?

A. To calculate the cost of short-term debt, PSE determines the total interest expense for borrowings (commercial paper or credit agreement loan) and non-hedging letters of credit for the period. Annual commitment fees and the amortization of upfront costs are then added to the interest expense to obtain the total short-term debt costs for the period. This total cost is then divided by the total weighted average daily short term debt balance for the period to determine the weighted average short term debt cost rate for the period. Please see pages 2 & 3 of Exhibit No. ___(BJL-3) for this calculation.

B. The Cost of Long-term Debt

Q. Please summarize PSE's calculation of the cost of long-term debt.

A. To calculate the cost of long-term debt, PSE calculates 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. Also included in the cost of long-term debt are the costs to reacquire high coupon debt that has been replaced with lower coupon debt. The proportional share that each issue's principal amount represents of the total amount of long-term debt outstanding is then used to weigh these cost rates. This is the same methodology PSE has used, and the Commission has approved, in prior proceedings.

Q. Has PSE prepared an exhibit demonstrating this calculation?

A. Yes. Please see pages 4 thru 7 of Exhibit No. ___(BJL-3) for these calculations.

Q. Is the methodology used to calculate the costs of both long and short-term debt for the authorized rate of return of 7.77 percent consistent with how PSE calculated its costs of both long and short-term debt used to support the actual 7.95 and 7.89 percent rates of return for 2013 and 2014?

A. Yes, while the authorized rate of return of 7.77 percent is based on hypothetical costs and includes some projections, the methodology is materially the same between the hypothetical and actual calculations with a couple of exceptions. PSE refinanced the short-term facilities in 2013. PSE then amended and extended those same facilities in 2014 due to favorable market conditions.

Q. Did PSE have any new issues of long-term debt since the Commission issued Order 08 in Dockets UE-111048 and UG-111049?

A. No. PSE has not issued any long-term debt since the Commission issued Order 08 in Dockets UE-111048 and UG-111049. As discussed above, however, PSE did refinance its Pollution Control Bonds in May of 2013 to take advantage of lower interest rates.

Q. How did PSE's customers benefit from the reduction in interest rates on its refinanced Pollution Control Bonds?

A. The reduction in interest rates lowered PSE's overall cost of capital. That lower cost of capital was reflected and included in Order 07 in this proceeding and effectively reduced the authorized rate of return. Over the life of the issues, PSE estimates it will save over $21 million in interest expense as a result of refinancing to the lower rates.

Q. Does PSE have any new issues of long-term debt in the near future?

A. Yes. PSE has three bonds maturing in 2015 (totaling $162 million) and one bond maturing in 2016 (totaling $250 million). Please see Exhibit No. ___(BJL-7).

Q. Does PSE anticipate refinancing those bonds and if so, what is the estimated savings?

A. Yes. PSE currently has plans to refinance those bonds. Given that those refinancings are sufficiently far out into the future, it would be speculative as to what prevailing interest rates would be at the time of such refinancing and to estimate any savings associated with any such refinancings.

Q. Are any of PSE's outstanding debt issues callable any time in the near future?

A. Certain of PSE's outstanding debt issues are callable but at a penalty. As shown in Exhibit No. ___(BJL-7), those issues maturing in the next few years have make-whole provisions. To call any of the bonds referenced above, PSE would be subject to pay any required make-whole penalty put in place to protect bondholders from early termination.

IV. PSE'S CREDIT RATINGS

Q. What are rating agencies and credit ratings?

A. Rating agencies are independent agencies that assess risks for investors. The two most widely recognized rating agencies are Standard & Poor's Financial Services LLC ("S&P") and Moody's Investors Service ("Moody's"). These rating agencies issue credit ratings to companies and their securities. These ratings provide information to investors regarding risks associated with such companies and their debt securities.

Q. What are PSE's current credit ratings?

A. Table 5 below presents PSE's current credit ratings at March 31, 2013, and at September 30, 2014.

Table 5. PSE Credit Ratings
at March 31, 2013 and at September 30, 2014

Security	S&P		Moody's	
	3/31/13	9/30/14	3/31/13	9/30/14
Corporate credit/issuer rating	BBB	BBB	Baa2	Baa1
Senior Secured Debt	A-	A-	A3	A2
Junior Subordinated Notes	BB+	BB+	Baa3	Baa3
Commercial Paper	A-2	A-2	P-2	P-2
Bank Facilities	BBB	BBB	Baa2	Baa1

Q. Have the credit ratings of PSE recently changed?

A. Yes. In late 2013 both S&P and Moody's revised their individual utility industry ratings methodology. As a result of that change to ratings methodology, many utility companies were upgraded, of which PSE was included. In November 2013, S&P affirmed PSE's existing credit ratings, and then in January 2014, Moody's upgraded PSE to Baa1, resulting in the current split rating.

V. CONCLUSION

Q. Does that conclude your direct testimony?

A. Yes, it does.