

## Description of Applicant

### *Abstract*

Puget Sound Energy (PSE) is a privately-held, foreign-owned imperfectly-regulated monopoly utility providing electric service to approximately 1.1 million ratepayers in Kitsap, Skagit, Thurston and Whatcom counties and parts of Island, King, Kittitas and Pierce counties, and natural gas service to approximately 790,000 ratepayers in parts of King, Kittitas, Lewis, Pierce, Snohomish and Thurston counties.

Some aspects of Puget Sound Energy's utility activities are regulated by the Washington State Utilities Commission (WUTC). The WUTC has regulatory authority over the sale and purchase of privately held utilities as well as over electricity rate changes requested by PSE and the profit, or 'return on equity (ROE)' of any infrastructure investments made by PSE. However, the WUTC does NOT have regulatory authority to permit or deny an infrastructure project before it is built.

PSE's 16-mile Energize Eastside project was estimated to cost between \$100-300M to build. With the anticipated profit rate of 9.8%, PSE's total dollar profit will be \$479M - \$2.1B, depending on initial cost and project life.

No cost estimates have been provided for PSE's new truncated 8.78-mile project, the Talbot Hill to Lakeside Transmission Line (THLTL).

PSE's investor owners' interests are more closely tied to returns on investment for their shareholders than the interests of local ratepayers. In addition, the current downturn in the economic environment for electric utilities provides a powerful motivation for PSE to downplay technical, environmental and community considerations in favor of building the project for huge profits.

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## **1. PSE Ownership**

In 2009, a consortium of private, non-US investors including investment arms of Macquarie Group (an Australian bank), and three Canadian pension funds: the Canadian Pension Plan Investment Board (CPPIB), the British Columbia Investment Management Corp., (bcIMC) and the Alberta Investment Management Corp. (AIMCo), acting as Puget Holdings LLC<sup>1</sup>, finalized the \$7.4 billion acquisition of Puget Holdings, the parent company of PSE.

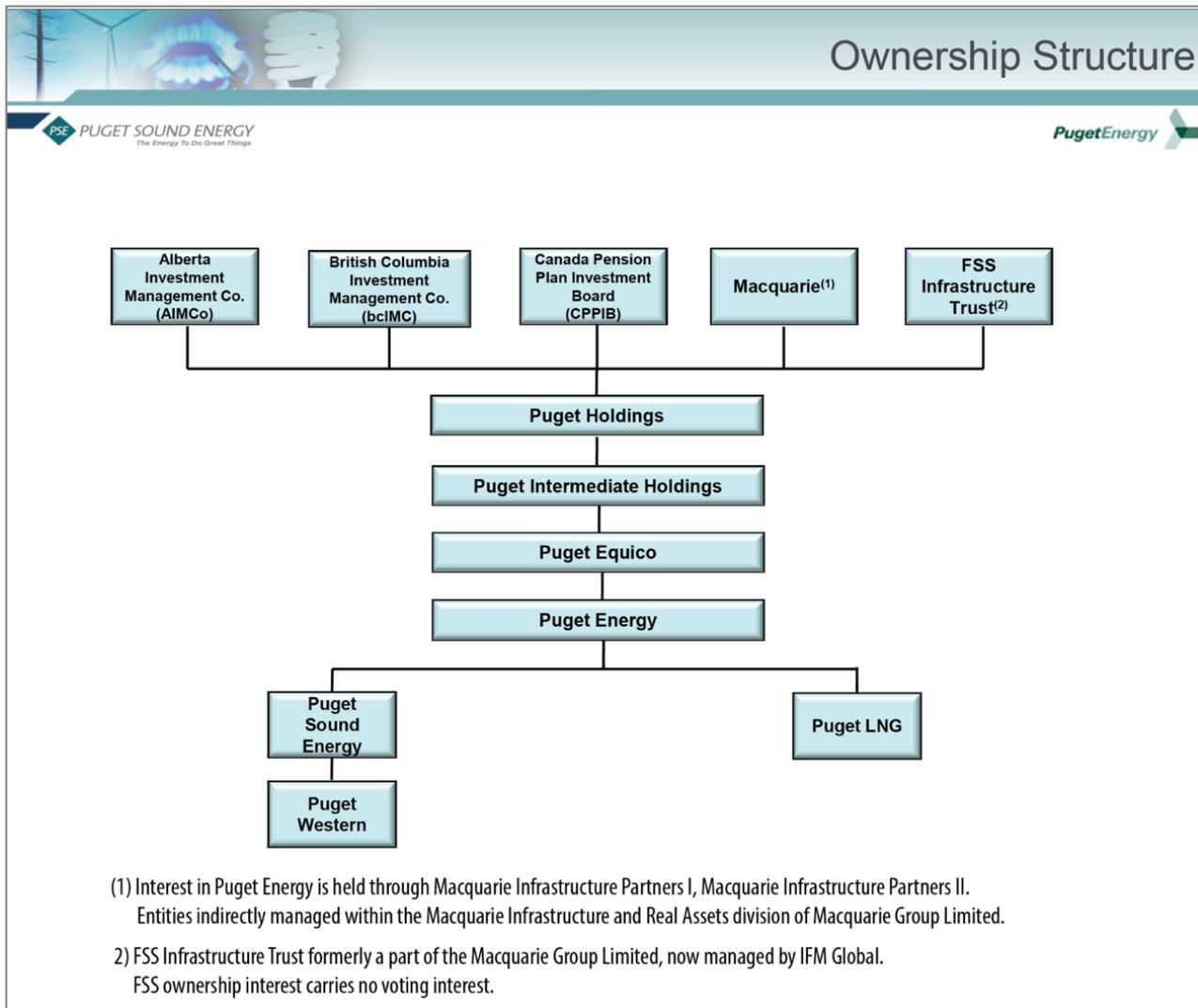
In 2019 the WUTC approved Macquarie Infrastructure Partners, Inc., and Macquarie-owned Padua MG Holdings LLC sale of its 43.99% ownership to four investment firms: Alberta Investment Management Corporation (Canada), British Columbia Investment Management Corporation (Canada), OMERS Administration Corporation (Canada) and PGM Vermogensbeheer B.V. (Holland).<sup>2</sup>

The figures below show the 2018 ownership structure. The new ownership structure has not yet been disclosed. Puget Sound Energy will remain wholly foreign-owned.

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<sup>1</sup> <https://archive.is/20130204065221/http://www.thenewstribune.com/2008/12/31/581321/puget-sound-energy-sold-to-foreign.html> (<https://archive.is/lffcC>)

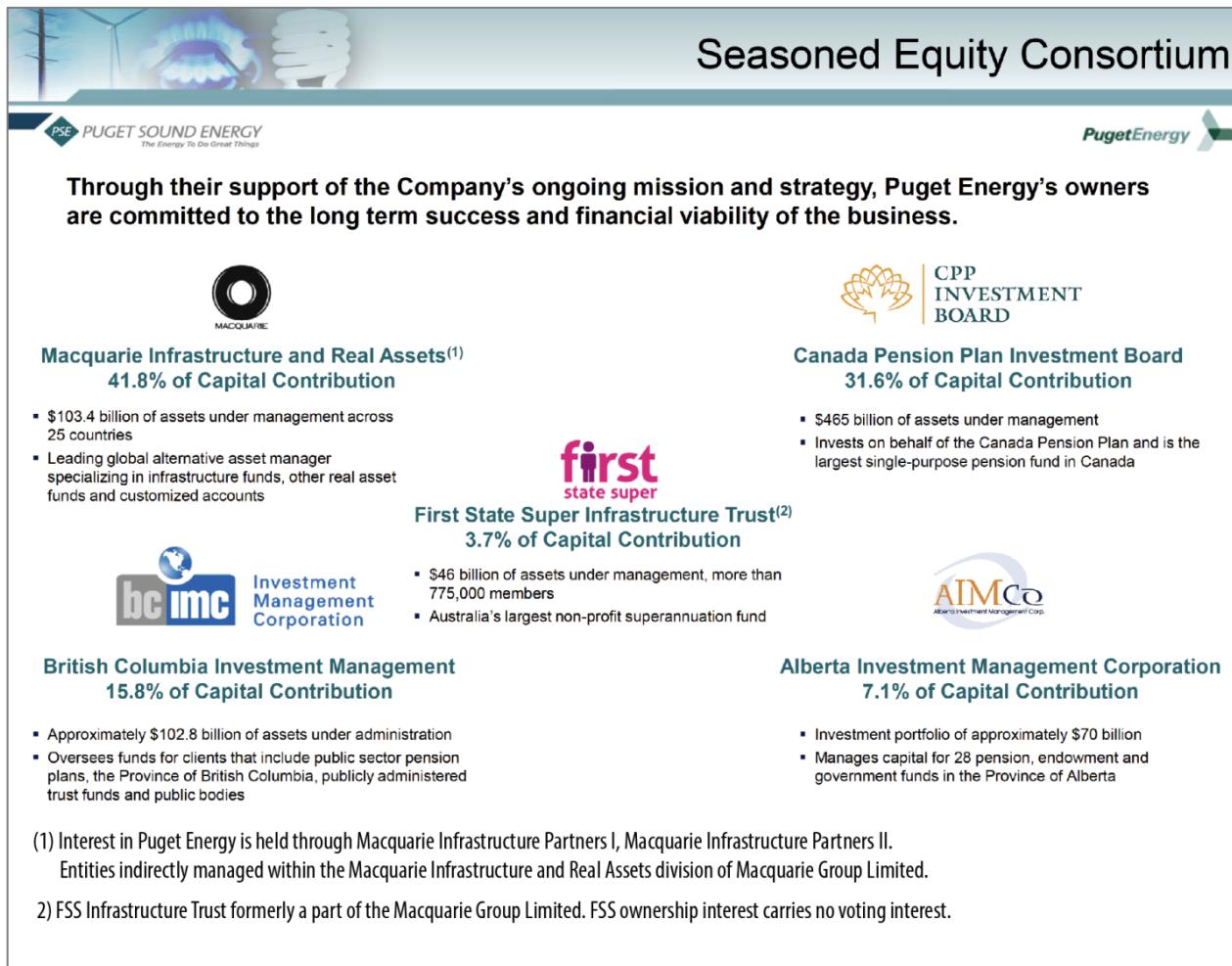
<sup>2</sup> <https://www.pggm.nl/english/who-we-are/press/Pages/Puget-Sound-Energy-welcomes-new-investment.aspx>



**Figure 1: Puget Sound Energy Ownership Structure <sup>3</sup>**

<sup>3</sup> [http://www.pugetenergy.com/past\\_events\\_pdfs/2017\\_April\\_Bondholder\\_Presentation.pdf](http://www.pugetenergy.com/past_events_pdfs/2017_April_Bondholder_Presentation.pdf) (page 40)

The precise ownership structure of the new shareholders has not been publicly announced. The assets and activities of each of the five current consortium members and the percentage of Puget Energy held by each are summarized in Figure 2. Nevertheless, the new shareholders will all have a primary fiduciary duty to their investors, none of whom are locally-based. They serve the ratepayers of Washington State insofar as it benefits their investors.



**Figure 2: Investment consortium members: Assets, activities and percent Puget Energy Ownership<sup>4</sup>**

<sup>4</sup> [http://www.pugetenergy.com/past\\_events\\_pdfs/2017\\_April\\_Bondholder\\_Presentation.pdf](http://www.pugetenergy.com/past_events_pdfs/2017_April_Bondholder_Presentation.pdf) (page 41)

New members of the Board of Directors, representing the new shareholders, have not been announced. Of the twelve board members currently serving on both the Puget Energy and Puget Sound Energy Boards, six represent consortium investors.

Representing Macquarie:

- *Christopher Leslie, Senior Managing Director of Macquarie Infrastructure and Real Assets' U.S.-based private infrastructure funds and Chief Executive Officer of MIP Inc. (since 2009)*
- *Karl Kuchel, chief executive officer at Macquarie Infrastructure Partners, Inc. (since 2016)*
- *Andrew Chapman, Senior Managing Director in the Macquarie Infrastructure and Real Assets (since 2009)*

Representing Canadian Pension Funds:

- *Christopher Hind, senior principal, private infrastructure with Canada Pension Plan Investment Board (CPPIB)*
- *Etienne Middleton, senior principal, private infrastructure of Canada Pension Plan Investment Board (CPPIB)*
- *Chris Trumpy, former chair of the British Columbia Investment Management Corporation (bcIMC).*<sup>5</sup>

Of the 6 board members not directly representing consortium investors, Paul McMillan is a Canadian, with diverse energy-related interests. Of the 5 board members with ties to Washington State, only Kimberly Harris, PSE President and CEO has a utility industry background. The other 4 have the following backgrounds:

- *Steven W. Hooper (Chair), co-founder and partner of Ignition Partners, a venture capital firm focusing on enterprise software and technology.*
- *Scott Armstrong, former President and CEO of Group Health Cooperative.*
- *Barbara J. Gordon, retired VP and Chief Customer Officer, Apptio, technology business management software.*
- *Mary O. McWilliams, former Executive Director of Washington Health Alliance, a health care community collaborative non-profit.*

It is hard to imagine these 4 non-industry, local directors having substantial influence on the decisions of the consortium investor directors.

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<sup>5</sup> <https://pse.com/aboutpse/CorporateInfo/Pages/Board-of-Directors.aspx>

## *2. Regulated by the Washington Utilities and Transportation Commission (WUTC)*

The Regulatory Services Division of the WUTC describes its regulatory scope as it relates to electric providers as, “Energy Section Staff review rates, revenues, expenses and programs of investor-owned electric companies. In a rate-setting process, Staff may act as a litigant in the proceedings, seeking a fair balance between corporate needs, ratepayer needs, and the public interest.”<sup>6</sup>

The WUTC also has a legal responsibility to be involved in the utility’s planning process and requires each utility to develop an “Integrated Resource Plan” or IRP.<sup>7</sup> For the first time in 2017, long after the beginning of planning for Energize Eastside, PSE’s recently completed IRP has a descriptive chapter concerning transmission planning. The WUTC had the following criticisms of PSE’s transmission planning efforts relative to Energize Eastside:

*“In describing the status of the Energize Eastside Project with respect to its 2017 IRP, PSE states, “the needs assessment and solution identification phases of this project have been completed. Currently, the project is in the route selection and permitting phases.” (footnote #40 in UTC document Page 8-30 of PSE’s 2017 IRP). WAC 480-100-238(3)(d) requires an integrated resource plan to include “[a]n assessment of transmission system capability and reliability, to the extent such information can be provided consistent with applicable laws.” The Company has an obligation to bring major transmission investments into the IRP for examination. The Company complied with the letter of the law in Chapter 8 where it provided a history of its Needs Assessment Reports. However, the Plan did not answer many questions that are needed for determining if the Company’s conclusions are justified. For instance, it is still not clear if a joint utility analysis of all available transmission and potential interconnections in the Puget Sound region might solve the Energize Eastside reliability issues. Whether PSE has engaged in such analysis or discussions remains unclear and would have been better answered in the IRP.”<sup>8</sup>*

It is important to note that these criticisms relate only to the original proposed Energize Eastside project. The truncated THLTL was not discussed at any time during the IRP process, nor has it been presented in any of the Columbia Grid planning documents, discussed in Section 7 of this document.

Unfortunately, the WUTC cannot compel PSE to take any action in response to its criticisms of the 2017 IRP. The WUTC has no regulatory or legal ability to analyze, assess, evaluate, permit, approve or deny transmission or other infrastructure projects prior to their construction by utilities, as described by Simon J. ffitch, Senior Assistant Attorney General, Public Counsel Division in a 2014 letter regarding Energize Eastside:

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<sup>6</sup> <https://wwwpre.utc.wa.gov/aboutUs/Pages/divisions.aspx>

<sup>7</sup> <http://apps.leg.wa.gov/wac/default.aspx?cite=480-100-238>

<sup>8</sup> Acknowledgment Letter Attachment, Puget Sound Energy’s 2017 Electric and Natural Gas Integrated Resource Plan, Dockets UE-160918 and UG-160919, page 10.

*"Under Washington's regulatory framework, the UTC does not pre-approve construction of utility plants or facilities...In a situation such as the "Energize Eastside" project, the UTC regulatory function is triggered when PSE seeks cost recovery from customers. This normally takes place in a rate case after the investment has been made and the utility plant has been placed in service."*<sup>9</sup>

Their entire ability to exercise any control over utility infrastructure projects is through rate-setting rulings. The WUTC has the power to set the cost recovery and rate of return allowed on a specific project via rates charged to consumers, or to dis-allow cost recovery and profit on a particular project.

However, during a City of Bellevue City Council Study Session in 2014 Councilmember Chelminiak "questioned whether anyone has ever built a transmission line and had the WUTC question the ability of the utility to get their money back."<sup>10</sup> Mark Vasconi, Director of Development Services Department of the WUTC, responded that, "he was not aware of such a situation."<sup>11</sup>

Under the current regulatory structure Energize Eastside, or the shorter THLTL, is a multi-million or billion-dollar regional project that will be built with only ordinary land use permit approvals by local jurisdictions who have no electric utility specialists on staff, and without any outside analysis, evaluation, or approval by any state, regional or federal utility regulatory agency.

### ***3. Energize Eastside intended for profit***

#### **3.a. Energy conservation reducing PSE profit (10K report)**

PSE recognizes that increasing efficiency and conservation efforts are reducing electricity consumption, and profits are at risk, and these decreases are not recoverable through increased rates or the recently developed decoupling mechanism:

*"Washington state law also requires PSE to pursue electric conservation that is cost-effective, reliable and feasible. PSE's mandate to pursue electric conservation initiatives may have a negative impact on the electric business financial performance due to lost margins from lower sales volumes as variable power costs are not part of the decoupling mechanism"*<sup>12</sup>

Attempting to install more transmission capacity in a stable or declining electricity consumption environment is like a gas station owner who, facing declining gasoline sales, invests in new pumps.

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<sup>9</sup> <http://e-dataevidence.com/simon%20ffitch%20letter.pdf>

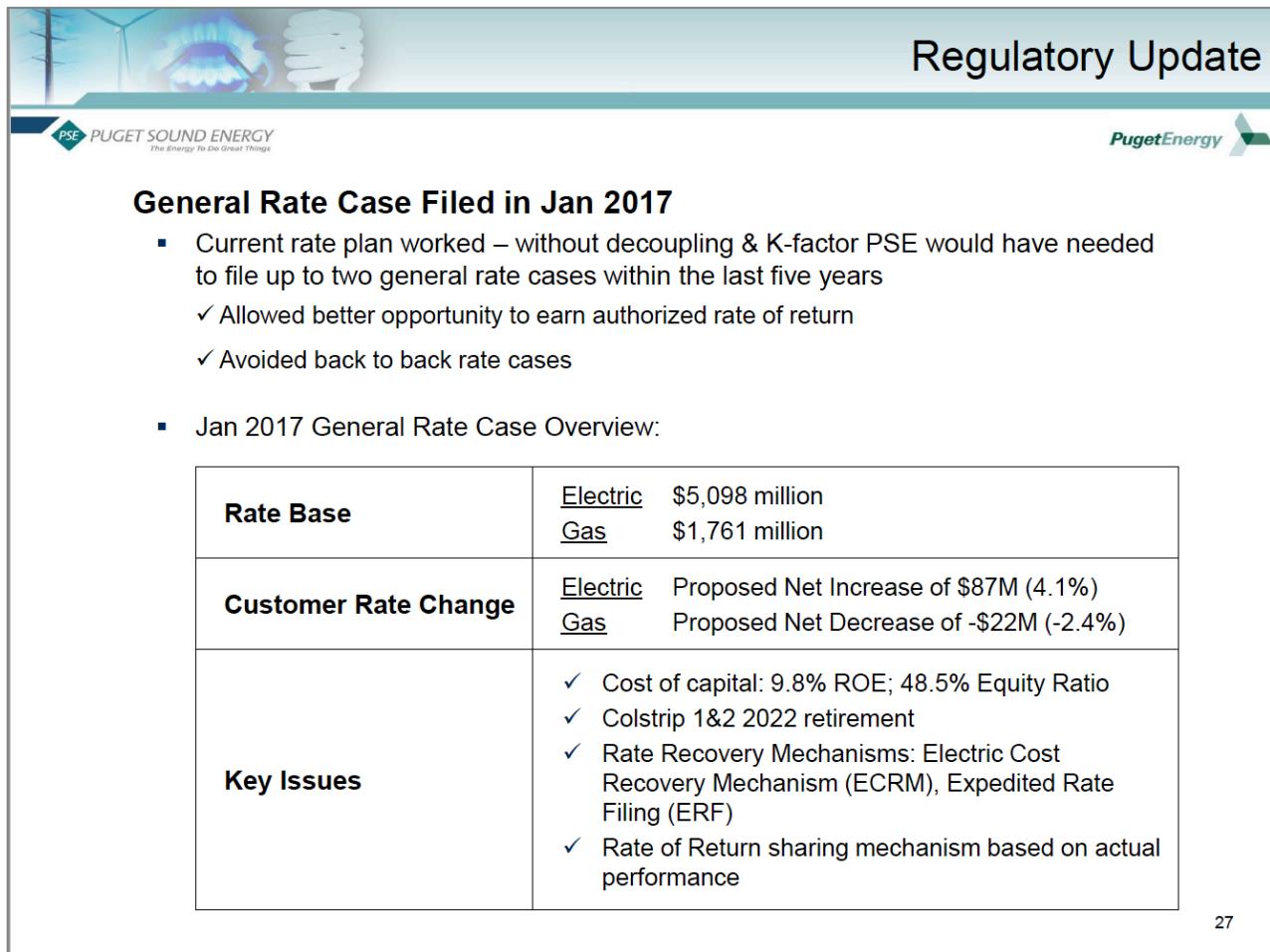
<sup>10</sup> City of Bellevue, City Council, Summary Minutes of Study Session, July 7, 2014, page 5.

<sup>11</sup> City of Bellevue, City Council, Summary Minutes of Study Session, July 7, 2014, page 5.

<sup>12</sup> PSE United States Securities and Exchange Commission Form 10-K Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, for the fiscal year ended December 31-20176. Page 35.

### **3.b. Energize Eastside Potentially Profitable because of 9.8% annual return on infrastructure investment from ratepayers.**

Puget Sound Energy (PSE) as an investor-owned utility operating in the State of Washington, requests rate adjustments from the Washington Utilities and Transportation Commission (WUTC); for this proposal PSE would request WUTC to enable a 9.8% profit, or 'return on equity (ROE)'. The fact that PSE intends to request this 9.8% ROE is indicated by PSE's April 2017 Bondholder Presentation, entitled, "Puget Energy and Puget Sound Energy 2016 Year End Update, April 2017, on page 27 (see *Figure 3*).



The slide is titled "Regulatory Update" and features the Puget Sound Energy logo at the top left. The main content is titled "General Rate Case Filed in Jan 2017". It includes a bulleted list of key points and a table summarizing rate base, customer rate changes, and key issues.

### General Rate Case Filed in Jan 2017

- Current rate plan worked – without decoupling & K-factor PSE would have needed to file up to two general rate cases within the last five years
  - ✓ Allowed better opportunity to earn authorized rate of return
  - ✓ Avoided back to back rate cases
- Jan 2017 General Rate Case Overview:

<b>Rate Base</b>	<u>Electric</u> \$5,098 million <u>Gas</u> \$1,761 million
<b>Customer Rate Change</b>	<u>Electric</u> Proposed Net Increase of \$87M (4.1%) <u>Gas</u> Proposed Net Decrease of -\$22M (-2.4%)
<b>Key Issues</b>	<ul style="list-style-type: none"><li>✓ Cost of capital: 9.8% ROE; 48.5% Equity Ratio</li><li>✓ Colstrip 1&amp;2 2022 retirement</li><li>✓ Rate Recovery Mechanisms: Electric Cost Recovery Mechanism (ECRM), Expedited Rate Filing (ERF)</li><li>✓ Rate of Return sharing mechanism based on actual performance</li></ul>

**Figure 3: PSE Return on Equity <sup>13</sup>**

<sup>13</sup> [http://www.pugetenergy.com/past\\_events\\_pdfs/2017\\_April\\_Bondholder\\_Presentation.pdf](http://www.pugetenergy.com/past_events_pdfs/2017_April_Bondholder_Presentation.pdf) (page 27)

Given that PSE is promoting the 9.8% prospective return on equity (profit) to bondholders (investors), it can be safely assumed PSE intends to ask the WUTC to approve this level of ROE.

In fact, in the Frequently Asked Questions (FAQ) segment of the PSE Energize Eastside website, PSE confirms its intent to include the project in future annual capital budgets and cover the cost “like most transmission and distribution projects.”

*“Will I see an increase in my bill or “line item” charge on my bill to pay for Energize Eastside?”*

*No. Customers will not see an increase in their monthly bill or “line item” charge on their bills as a direct result of Energize Eastside. PSE funds electric infrastructure upgrades and additions through its annual capital budget, which is already covered in current customer rates. PSE plans its capital investments several years in advance and spreads them out so the annual capital budget covers numerous projects each year.*

PSE will include the cost of Energize Eastside in future annual capital budgets. Once the project is built and added to the annual capital budget, we expect that \$1 to \$2 of the average monthly bill for residential customers will go towards paying for the project.<sup>14</sup>

In spite of PSE’s initial denial that customers will see an increase in their monthly bills, it is clear that PSE anticipates the cost of the project will be covered by ratepayers, via the 9.8% return on equity rate increase “like most transmission and distribution projects.” The Energize Eastside project is specifically envisioned as one of PSE’s “Major Strategic Capital Projects.” (See Figure 4)

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<sup>14</sup> <https://energizeeastside.com/faqs>



**Figure 4** Energize Eastside is a major strategic capital project<sup>15</sup>

The Bondholder Presentation highlights Puget Energy's compounded annual Earnings Before Interest, Taxes, Depreciation and Amortization (EBITA) growth of 5% between 2007-2016<sup>16</sup> and predicts growth from strategic investments in "strategic capital projects focused on customers, core operations and system reliability," including Energize Eastside. The importance of this project to Puget Energy's revenue forecasts is evident, and there is considerable incentive to build expensive projects to increase revenue from the allowed 9.8% ROE, rather than to seek the most economical solution.

<sup>15</sup> [http://www.pugetenergy.com/past\\_events\\_pdfs/2017\\_April\\_Bondholder\\_Presentation.pdf](http://www.pugetenergy.com/past_events_pdfs/2017_April_Bondholder_Presentation.pdf) (page 13)

<sup>16</sup> [http://www.pugetenergy.com/past\\_events\\_pdfs/2017\\_April\\_Bondholder\\_Presentation.pdf](http://www.pugetenergy.com/past_events_pdfs/2017_April_Bondholder_Presentation.pdf) (page 33)

### **3.d. Why PSE needs EE**

At the time of the purchase, staff at the WUTC expressed concern that, “the bid offered by Macquarie-led consortium to buy Puget Sound Energy through debt financing was too highly leveraged. He warned that the deal would significantly lift the debt level of the utility’s books to an unacceptable level of \$4.2 billion.”<sup>17</sup> The Public Counsel Section of the Attorney General’s Office recommended that the WUTC not approve the acquisition, saying that the deal,

*“Simply exposes PSE’s customers to an undue level of financial risk by undertaking too much debt,” Public Counsel Chief Simon ffitch said. “At the same time, customers have no assurance that capital for infrastructure will be any more available or affordable than without the merger. Consumers appear to get little or nothing in return for the increased financial risk.*

*“Macquarie and PSE commit to provide customer benefits related to service quality, environmental impacts, local presence and other areas. However, these commitments don’t provide new benefits, but simply restate existing PSE obligations,” ffitch added.”<sup>18</sup>*

2019 is a pivotal year for PSE finances. The urgency to complete Energize Eastside is driven by the need to recognize revenue from this project by [the end of] 2019:

- PSE’s credit facility expires in 2019. The cost of borrowing for PSE will increase dramatically
- In PSE’s 2009 IRP, PSE set forth a plan to retire the Colstrip coal-burning power plant in stages – 2 older units would go offline in 2019. In more recent IRPs, PSE has backtracked on Colstrip retirement – pushing out to 2022.
- Macquarie’s acquisition of PSE was via a 10-yr closed fund, in 2009. On June 15, 2017 Macquarie announced plans to sell a 42% stake in PSE.<sup>19</sup> Macquarie will be required to return funds to equity holders by 2019 or seek a fund extension from its investors. Who will be PSE’s new owners, along with the Canadian Pension Plan?
- PSE is pushing an aggressive schedule to get Energize Eastside approved. Construction was to begin in 2018, with the goal to generate revenue by 2019.
- Of late, CIPPIB and Canadian Provincial investment funds have been increasing their stake in PSE, while Macquarie has been trimming their stake. On June 15, 2017 Macquarie announced their desire to sell their 42% stake in PSE.

PSE’s Balance Sheet reveals the following:

- Short Term Debt \$53.8 Million.
- Long Term Debt \$3.8 BILLION (51.3% debt ratio).

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<sup>17</sup> [https://www.forbes.com/2008/06/20/puget-energy-macquarie-markets-equity-cx\\_vk\\_0620markets03/](https://www.forbes.com/2008/06/20/puget-energy-macquarie-markets-equity-cx_vk_0620markets03/)

<sup>18</sup> [https://www.forbes.com/2008/06/20/puget-energy-macquarie-markets-equity-cx\\_vk\\_0620markets03/](https://www.forbes.com/2008/06/20/puget-energy-macquarie-markets-equity-cx_vk_0620markets03/)

<sup>19</sup> <https://www.pionline.com/article/20170616/ONLINE/170619905/canadian-funds-part-of-consortium-ready-to-sell-stake-in-puget-energy>

- Macquarie is the 5th most highly leveraged energy owner in the U.S.<sup>20</sup>
- PSE's Debt Financing is Credit Negative (credit rating is "junk bond" status, Baa3).<sup>21</sup>
- PSE's credit facility expires in 2019.<sup>22</sup> The cost of borrowing for PSE will dramatically increase by 2019.
- PSE is unable to refinance variable-rate debt now, because their terms are unattractive to investors.<sup>23, 24, 25</sup>
- Macquarie's acquisition of PSE was via a 10-yr closed fund. June 15, 2017 Macquarie announced desire to sell 42% stake in PSE.<sup>26</sup>
- The WUTC needs PSE to be financially viable to provide service to 1.1 million Washington customers.
- PSE's Energize Eastside project will result in approximately \$1.5 Billion in revenue for PSE over 40 years or more, garnering a guaranteed rate of return of approximately 10% annually.

The critical importance of this project to PSE is demonstrated by the massive promotional campaign they have undertaken to sell it to the public, discussed in Section 5 of this document.

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<sup>20</sup> <http://www.zerohedge.com/news/2014-12-10/heres-americas-most-levered-energy-companies>

<sup>21</sup> [https://www.moodys.com/research/Puget-Energy-Debt-Financing-is-Credit-Negative--PR\\_324799](https://www.moodys.com/research/Puget-Energy-Debt-Financing-is-Credit-Negative--PR_324799)

<sup>22</sup> <http://www.sec.gov/Archives/edgar/data/81100/000108539214000021/p-2014630x10q.htm#sECEFE0B0BBD3EE26F216FC9CD7981795>

(pg. 32: "PSE's credit facilities expire in 2019 and Puget Energy's senior secured credit facility expires in 2018.")

<sup>23</sup> <https://www.prnewswire.com/news-releases/puget-sound-energy-inc-announces-tender-offer-300265861.html>

<sup>24</sup> <http://www.bloomberg.com/news/articles/2016-05-19/puget-sound-said-facing-investor-pushback-on-debt-buyback-deal>

<sup>25</sup> <http://www.bloomberg.com/news/articles/2016-06-09/puget-sound-said-to-drop-buyback-deal-as-investors-withhold>

<sup>26</sup> <https://www.bloomberg.com/news/articles/2017-06-15/macquarie-said-to-explore-sale-of-stake-in-utility-puget-energy>

## **4. Conclusion**

PSE is a wholly-foreign-owned utility whose purchase was highly leveraged and whose debt level was a concern to state regulators at the time of purchase. The lead investor, Macquarie, has just agreed to sell their current 43.99% share to two current and two new foreign-owned investors. The profits from Energize Eastside are featured as a major selling point in shareholder communications filed with the SEC, as conservation and other trends show that electricity consumption is flat or declining. Thus, Energize Eastside's future profits provide an enormous incentive to build the project. Where else in the US, Canada or the European Union, could an investor make a guaranteed 10% annual profit on a capital investment? And all this profit will flow to the foreign pension fund investors. The WUTC has raised serious questions about the need for the project in their comments on PSE's most recent Integrated Resource Plan, although the WUTC does not have the authority to approve or deny infrastructure projects prior to construction. The newly-truncated 8.78-mile Talbot Hill to Lakeside Transmission Line proposal was not presented to the WUTC in the most recent IRP process. Until questions about the underlying need for the original project, the new, shorter project and possible alternative solutions for both projects are answered, permits for Energize Eastside or the shorter Talbot Hill to Lakeside Transmission Line should be denied.