Exhibit No T-116 (KRK-T)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Application of PUGET SOUND ENERGY, INC. for (1) Approval of the Proposed Sale of PSE's Share of the Centralia Facilities, and (2) Authorization to Amortize Gain Over a Five-Year Period.	Docket No. UE-991409 APPLICATION

REBUTTAL TESTIMONY OF KARL R. KARZMAR

December 22, 1999

PUGET SOUND ENERGY, INC.

Rebuttal Testimony of Karl R. Karzmar

Q. Please state your name.

A. Karl Karzmar.

Q. What topics will you be covering in your rebuttal testimony?

A. I address issues raised in the testimony of Ken Elgin, Roland Martin and Alan Buckley.

The Opposition Mistakenly Equates Paying Rates With Ownership

Q. Public Counsel, Staff and others all argue that simply by paying rates under traditional cost of service ratemaking, customers became the "owners" of the facilities and thus are entitled to any gain on the sale. Why isn't this analysis correct?

A. It is incorrect for several reasons, none of which are addressed by the opposition parties. Public Counsel, Commission Staff, ICNU and others all make the mistaken assumption that because cost of service ratemaking takes account of the actual costs of running the plant – which includes depreciation expense and a reasonable return on invested capital – customers own the plant. In other words, the opposition parties insist that under traditional cost of service ratemaking, merely paying the cost of receiving electric service vests all ownership rights in customers. From this position, the opposition parties argue that customers must receive the entire gain on any sale. The argument ignores several facts. Most important, it is the shareholders, not the customers that invest the capital to purchase the facilities. The customers do not "buy" the facility; the

shareholders do and it is the shareholders, through the company, that own it. Customers then buy service from the facilities, but they do not buy the facilities themselves. The Commission ensures that the rates the customers pay for the service are fair by reviewing and approving all costs, including depreciation rates, associated with providing that service. As the customer has paid a fair rate for the service they have received they are not more entitled to receive the gain from the sale of an operating unit than the real owner, which is the Company and its shareholders. There is nothing in the law, nor in the regulations that grants PSE's customers ownership rights in the facilities, and paying rates entitles PSE's customers to service, not to ownership rights.

For all these reasons, it would be a mistake to accept the opposition cases' argument that PSE's customers have somehow "paid" for the facility and thus are entitled to ownership rights, including the rights to all of the gain on the sale.

Other Accounting Issues

Q. Do you agree with Mr. Martin's proposal that PSE defer the entire gain on the sale, accrue interest on it, and pass it through to customers in some future rate proceeding?

A. No. Mr. Martin's suggested accounting treatment is flawed in several respects. Most important, it violates the fundamental premise of the merger order, i.e., that PSE should continue to conduct its business during the rate plan period without applying special accounting rules or procedures. Under normal

accounting procedures, PSE would set a reasonable amortization period to account for the gain on the sale and begin the amortization upon closing the sale. Instead of applying this straightforward and well-accepted means of accounting for the sale, Mr. Martin suggests instead applying a non-standard procedure designed solely to capture benefits that should accrue to PSE during the rate plan period. This ties closely with my second point: as part of the negotiations that led up to settlement of the merger proceeding, I was well aware of the nature of the bargain struck between customers and the company in the rate plan. Customers received rates lower than otherwise would have been possible – they received their benefits "up front" – and in return PSE was granted the freedom to operate its business aggressively for a five-year time period, capturing all benefits that accrued from its management practices. If PSE had known then that special rules would be applied to prevent it from realizing those benefits when Commission Staff considered the transaction at issue to be one that it did not anticipate, I question whether PSE would have agreed to the settlement. In other words, I believe Mr. Martin's proposed accounting methodology is a violation of the merger order.

Q. Do you agree with Mr. Martin's characterization of the merger rate plan's treatment of gains associated with the sale of property?

A. No. Mr. Martin suggests that the only gains PSE may account for during the rate plan period are gains flowing from the sale of property sold to achieve merger synergies. That is not the bargain set forth in the merger rate plan. The parties were very specific in their stipulation: sales of non-depreciable property

require a deferral of the gain. The stipulation specifically refers to the settlement agreement entered into by Public Counsel, Commission Staff and Puget in Washington Court of Appeals No. 29404-1. *See* Stipulation at 9. That agreement specifically limited the application of the rule requiring deferral to non-depreciable property. Mr. Martin ignores this distinction and instead argues that under the Stipulation the gain must be deferred. Mr. Martin's proposed approach is a violation of the bargain struck between customers and PSE as part of the merger order.

Q. Do you agree with Mr. Buckley's suggested methodology for accounting for "power cost savings"?

A. No. Commission Staff took the same position in the Colstrip proceedings as Mr. Buckley takes here, i.e., that PSE should have to defer some hypothetical amount for power cost savings rather than actual power cost savings. The Commission rejected this approach in the Colstrip proceedings and should reject it here, for the same reasons. As the Commission recognized in the Colstrip proceedings, commodity electricity prices are highly variable – which means that PSE's power cost savings also will be highly variable during this time period. Even putting aside the impropriety of confiscating any power cost savings, it would be inappropriate to impose an accounting methodology that fails to take account of this market variability. That is exactly what Mr. Buckley is proposing.

It is even more troubling in this case, where current projections show no power cost savings during the rate plan period.

Q. Does this conclude your testimony, Mr. Karzmar?

A. Yes.