

**EXHIBIT NO. \_\_\_(SML-5T)  
DOCKET NO. UE-060266/UG-060267  
2006 PSE GENERAL RATE CASE  
WITNESS: SUSAN MCLAIN**

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**PUGET SOUND ENERGY, INC.,**

**Respondent.**

**Docket No. UE-060266  
Docket No. UG-060267**

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF  
SUSAN MCLAIN  
ON BEHALF OF PUGET SOUND ENERGY, INC.**

**AUGUST 23, 2006**

**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF  
SUSAN MCLAIN**

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1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF**  
3 **SUSAN MCLAIN**

4 **I. INTRODUCTION**

5 **Q. Are you the same Susan McLain who submitted direct testimony in this**  
6 **proceeding on February 15, 2006, on behalf of Puget Sound Energy, Inc.**  
7 **("PSE" or "the Company")?**

8 **A. Yes.**

9 **Q. Please summarize the purpose of your rebuttal testimony.**

10 **A. Commission Staff and intervenors have not disputed my testimony regarding the**  
11 **significant capital expenditures the Company faces over the next several years in**  
12 **order to maintain system reliability and replace aging infrastructure. Although**  
13 **they do not dispute this need, the financial relief they propose fails to provide a**  
14 **viable mechanism for the Company to pay for the investments that benefit**  
15 **customers. Specifically, my rebuttal testimony responds to the assertions made**  
16 **by Commission Staff witness James M. Russell regarding PSE's proposed**  
17 **depreciation tracker, his proposed Spirit Ridge disallowance, his allegations that**  
18 **there are operations and maintenance ("O&M") cost reductions associated with**  
19 **asset replacements and his comments to PSE's storm deferral mechanism.**

1           Additionally, my testimony responds to arguments made by FEA witness Ralph  
2           C. Smith and Public Counsel witness Michael L. Brosch that the proposed  
3           depreciation tracker should be rejected because it could remove or reduce  
4           incentives to prudently control the cost of plant additions.

5           My testimony also responds to assertions made by Kroeger’s witness Kevin  
6           Higgins and NWIGU's witness Donald W. Schoenbeck regarding alleged O&M  
7           cost reduction associated with asset replacements. Additionally, I will address  
8           Mr. Schoenbeck’s assertions regarding the “low” inflationary climate in which  
9           PSE is providing utility service to customers.

10          My rebuttal also reiterates the necessity, importance and benefits to customers of  
11          PSE’s energy delivery infrastructure work and the need for PSE to receive  
12          adequate and timely cost recovery of these investments. If PSE is restricted in its  
13          ability to recover its costs, the Company will be forced to scale back planned  
14          transmission and distribution system investments, system maintenance and  
15          inspections. This will negatively impact the system reliability experienced by  
16          PSE customers and will cause PSE to be more reactive and less proactive in its  
17          transmission and distribution asset management practices. Ultimately PSE  
18          customers will likely experience higher costs in the long term if the Company is  
19          forced to take this approach.

1                                   **II.     PSE FACES INCREASED OPERATIONS AND**  
2                                   **MAINTENANCE COSTS IN ADDITION**  
3                                   **TO HIGH CAPITAL INVESTMENT**

4     **Q.     Do you agree with Mr. Schoenbeck’s statement that PSE is facing "times of**  
5                                   **low inflation?"<sup>1</sup>**

6     A.     No. In the U.S. economy, overall inflation rates may have been low in recent  
7                                   times; however, PSE has experienced substantial price increases for materials,  
8                                   labor and other expenses. These increases have substantially impacted our cost of  
9                                   providing service to PSE customers. In PSE’s efforts to address aging  
10                                  infrastructure, to maintain and strengthen gas and electric system reliability, and  
11                                  to serve increased customer energy demands, PSE is required to replace assets  
12                                  that have been in service for decades. We have experienced substantial cost  
13                                  increases as originally detailed in my prefiled testimony. *See Exhibit*  
14                                  No. \_\_\_(SML-1CT) at page 15.

15                                  For example, PSE has experienced substantially higher gasoline and diesel prices.  
16                                  Increases in raw materials (metals, resins, concrete, wood products and petroleum  
17                                  products) have impacted the costs associated with commodity prices for  
18                                  commonly used transmission and distribution materials (poles, wire, pipe and  
19                                  transformers).

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<sup>1</sup> Exhibit No. \_\_\_(DWS-1T) at page 4.

1 Examples of price increases PSE has experienced for commonly used  
2 transmission and distribution materials (when comparing current to 2003 prices)  
3 include:

- 4 • The cost of 2 and 4-inch plastic gas main has increased by 48%,
- 5 • The cost of 45-foot wood poles has increased by 32%,
- 6 • Electrical conductor costs have increased by 58%, and
- 7 • The cost of single phase transformers has increased by 48%.

8 Growing U.S. and international demand for these commodities is contributing to  
9 inflationary pressure. As the utility industry steps up spending on transmission  
10 and distribution infrastructure systems, which adds more demand for these  
11 products, we expect even higher material prices. As discussed in a June 2006  
12 report by the Edison Electric Institute entitled *Why Are Electricity Prices*  
13 *Increasing?*, increased electric utility spending is driven by the need to address  
14 storm damage, meet increased governmental requirements to underground electric  
15 lines, meet load growth, and respond to increased customer demands for  
16 reliability due to the “digitalization of society” that now requires a higher level of  
17 power quality and reliability.

18 Additionally, PSE has experienced increases in the cost of labor. As mentioned in  
19 my pre-filed testimony, PSE, along with the entire industry, has an aging work  
20 force and faces challenges in retaining qualified skilled craft, technical, and

1 professional personnel. *See* Exhibit No. \_\_\_(SML-1CT) at page 10. PSE expects  
2 that the labor market for these skills will remain very competitive for years to  
3 come. Based upon a recent market rate evaluation, PSE, with ratification by  
4 applicable members of International Brotherhood of Electrical Workers Local 77,  
5 increased hourly labor rates from 4.6% to 8.6% for certain segments of its electric  
6 journeyman field staff. These increases, which go into effect August 28, 2006,  
7 were made in order to compete with neighboring utilities' labor rates – so that the  
8 Company will not be disadvantaged in its ability to attract and retain qualified  
9 skilled craft personnel. This wage adjustment is discussed in more detail in the  
10 rebuttal testimony of Thomas Hunt. *See* Exhibit No. \_\_\_(TMH-8CT) at pages 5-  
11 6.

12 **Q. Will an increase in capital spending result in the Company spending less on**  
13 **operations and maintenance as stated in the testimony of Mr. Higgins, Mr.**  
14 **Russell and Mr. Schoenbeck?**

15 A. No. Although it is true that a failure to replace aging infrastructure may increase  
16 operations and maintenance expenditures, it does not necessarily follow that these  
17 expenses will significantly decrease as capital spending increases. This is true for  
18 a number of reasons. First, increased capital expenditures drive additional  
19 spending associated with Operations & Maintenance Related to Construction  
20 “OMRC” (such as gas system “service test and ties” and conductor relocations  
21 when poles are replaced). OMRC is further explained in my prefiled testimony.  
22 *See* Exhibit No. \_\_\_(SML-1CT) at page 16. Second, as additional assets are

1 added to PSE's systems there are more assets to be operated, maintained and  
2 inspected. In many asset replacement projects, the ongoing O&M costs  
3 associated with locating, inspecting and maintaining remain similar after  
4 replacement. For example, in the case of the replacement of a bare steel gas main  
5 with a plastic gas main, the ongoing periodic leak surveying, locating, and valve  
6 inspections continue. Any O&M savings are minimal and greatly outweighed by  
7 the approximate \$12.3 million increase in revenue requirements for O&M as  
8 shown on Exhibit No. \_\_\_(JHS-25).

9 Moreover, although Mr. Higgins and Mr. Schoenbeck assert that the Company  
10 will spend less on O&M due to the increased capital spending,<sup>2</sup> they have not  
11 produced any evidence to support this premise.

12 **III. THE COMPANY'S SIGNIFICANT CAPITAL**  
13 **EXPENDITURES BENEFIT PSE CUSTOMERS AND**  
14 **REQUIRE EITHER THE DEPRECIATION TRACKER**  
15 **OR SOME OTHER MEANS TO ADDRESS REGULATORY LAG**

16 **Q. Have the other parties disputed your testimony regarding the significant**  
17 **capital expenditures necessary over the next several years for PSE's**  
18 **transmission and distribution system?**

19 A. No they have not. Although they do not dispute the significant capital  
20 expenditures PSE plans to make for transmission and distribution system

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<sup>2</sup> See Exhibit No. \_\_\_(KCH-1T) at page 5; Exhibit No. \_\_\_(DWS-1T) at page 3.



1 improvements discussed in my direct testimony, the financial relief they propose,  
2 including their rejection of PSE's proposed depreciation tracker, will hinder the  
3 Company's ability to make the investments required to maintain a safe, reliable  
4 and robust gas and electric system.

5 **Q. Do you agree with Mr. Higgins' testimony that "the depreciation tracker**  
6 **would add to [the] customer burden without a corresponding benefit?"<sup>3</sup>**

7 A. No I do not. Mr. Higgins overlooks the fact that PSE customers will directly  
8 benefit from the tracker via a safer, more reliable, more robust, and better  
9 performing energy delivery system that will meet current and future customer  
10 energy needs.

11 Recent headlines show that, for the second time in three weeks, U.S. electricity  
12 demand hit an all-time record. As described in an August 9, 2006, Edison  
13 Electric Institute press release, during the week of August 5, 2006 Americans  
14 consumed 98,583 gigawatt hours (GWh) of electricity. PSE also set a  
15 summertime peak load record of 3,175 megawatt hours on July 24, 2006.

16 Based upon recent media coverage, many utilities' energy delivery systems have  
17 been severely tested and in some cases were not able to meet customer demands.  
18 Customers of some utilities suffered extended outages. As stated in my pre-filed  
19 testimony, I believe that an increased level of investment is essential to

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<sup>3</sup> Exhibit No. \_\_\_(KCH-1T) at page 8.

1 continuing to adequately meet our customers' service and energy demands. *See*  
2 Exhibit No. \_\_\_\_ (SML-1CT) at page 8. I am concerned that the effects of  
3 "regulatory lag" will soon impact PSE's ability to provide needed system  
4 upgrades.

5 **Q. Mr. Ralph Smith testifies for FEA and Mr. Brosch testifies for Public**  
6 **Counsel that PSE's proposed depreciation tracker should be rejected**  
7 **because it could remove or reduce incentives to prudently control the cost of**  
8 **plant additions.<sup>4</sup> Do you agree?**

9 A. No, this argument should be rejected. As discussed in Mr. Story's testimony, the  
10 depreciation that would be recovered by the proposed tracker results from the  
11 additional investment in transmission and distribution that is required to maintain  
12 a safe, reliable and robust gas and electric system. For the reasons discussed in  
13 Mr. Story's testimony, the depreciation tracker would facilitate investment in  
14 needed transmission and distribution plant. Failure to provide for timely recovery  
15 of depreciation results in a financial disincentive to make this type of investment  
16 and is not in the customers' best interest.

17 **Q. Mr. Smith testified that, instead of the depreciation tracker, the Commission**  
18 **could address post-test year plant additions through a "known and**  
19 **measurable adjustment to recognize non-revenue producing, non-expense**

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<sup>4</sup> See Exhibit No. \_\_\_\_ (RCS-1T) at page 5; Exhibit No. \_\_\_\_ (MLB-1CT) at page 17.

1 **reducing transmission and distribution plant additions."**<sup>5</sup> **Have you**  
2 **quantified such plant additions that have been placed in service since the test**  
3 **year?**

4 A. Yes. PSE made non-revenue producing investments of approximately \$127  
5 million (net of retirements) during the nine month period (October 1, 2005 to June  
6 30, 2006) after the test period. These are investments in infrastructure that are  
7 already being used by and benefiting customers today through increased  
8 reliability. *See* Exhibit No. \_\_\_\_ (SML-6).

9 **Q. Please provide an example of non-revenue producing capital investments**  
10 **that have benefited PSE customers.**

11 A. PSE customers are benefiting now from the Novelty Substation and associated  
12 line work that was constructed to improve electrical service in the Sammamish,  
13 Redmond, and Snoqualmie Valley areas. This \$23 million project was placed  
14 into service on November 30, 2005, after the test period, and it increased  
15 reliability to over 32,000 existing customers. In the near future, Novelty  
16 Substation will also provide additional 230-115 kV transformation for the north  
17 King County area, relieving possible overloads at other PSE facilities.  
18 Specifically, the Novelty Substation project improved reliability by reducing the  
19 number of customers affected by each electrical fault on the Snoqualmie-

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<sup>5</sup> Exhibit No. \_\_\_\_ (RCS-1T) at page 14.

1 Stillwater and the Sammamish-Lake Tradition transmission lines. The substation  
2 allows the Company to split each of the two existing transmission lines. PSE has,  
3 in effect, made two transmission lines perform like four lines. With this new  
4 configuration, an electrical fault will cause an outage on a smaller portion of the  
5 system and as a consequence, fewer customers will be affected. Novelty  
6 Substation also reduces the duration of outages. The new circuit breakers allow  
7 for improvements in automatic switching and reclosing that can restore service for  
8 some faults automatically.

9 Again, this substation is in service--used and useful--today, yet the Company is  
10 not recovering its costs for such infrastructure.

11 **Q. What is the impact of these investments with regard to PSE's revenue**  
12 **requirement?**

13 A. These known and measurable investments result in an additional revenue  
14 deficiency of approximately \$12.3 million per year including \$1.6 million of  
15 additional depreciation expense as detailed in Mr. Story's testimony. *See Exhibit*  
16 *No. \_\_\_(JHS-25).* Customers who are currently receiving the benefits of these  
17 investments will not be paying for the investments until they are added to rates in  
18 PSE's next general rate case. In the meantime, these investments must be funded  
19 by PSE shareholders. If the Commission does not approve PSE's proposed  
20 depreciation tracker, PSE proposes that the Commission instead approve addition

1 of this known and measurable amount of additional infrastructure investment in  
2 the revenue requirement for this case.

3 **IV. OTHER STAFF TESTIMONY AND**  
4 **PROPOSED ADJUSTMENTS**

5 **Q. Do you agree with Mr. Russell's proposed adjustment G.22 (Spirit Ridge**  
6 **Adjustment)?**

7 A. No. These costs should not be removed from the test period since these costs  
8 were necessary to provide a complete and comprehensive response and  
9 investigation to a tragic incident. Responses and investigations to incidents of  
10 this nature are an integral part of PSE's responsibilities as a natural gas provider.  
11 The Commission's investigation into the incident did not attribute cause to PSE's  
12 operations. In addition, the funds used to perform this response and investigation  
13 were a part of existing budgets. That is, resources were used for the Spirit Ridge  
14 response and investigation in lieu of being spent on other work, and performance  
15 of the Spirit Ridge work had no increased net effect on PSE's test year  
16 expenditures. Additionally, some of the inspection processes developed and  
17 knowledge learned, such as the wrapped steel assessment program, will provide  
18 future benefits to PSE customers and enhance the continued safe operations of  
19 PSE's energy delivery systems.

1 **Q. In response to Mr. Russell’s testimony and concerns regarding PSE’s ability**  
2 **to spend the entire \$2 million of annual TreeWatch expenditures, please**  
3 **provide the status of PSE’s plan to fully utilize the \$2 million.**

4 A. PSE plans on spending as close to the \$2 million of TreeWatch expenses already  
5 included in rates as possible each year. It is difficult to manage programs and  
6 projects to come in exactly at \$2 million, but PSE’s implementation plans for  
7 TreeWatch are to spend within plus or minus 5% of the \$2 million.

8 **Q. In response to Mr. Russell’s testimony regarding PSE’s storm cost deferral**  
9 **mechanism,<sup>6</sup> please explain why PSE requires such a mechanism when other**  
10 **Washington utilities do not have such a mechanism.**

11 A. I would like to refer back to my 2004 general rate case rebuttal testimony for this  
12 explanation. An excerpt from this prior testimony is provided below:

13 PSE’s service territory experiences more frequent, coastal weather-  
14 related impacts than either Avista or PacifiCorp. On the west side  
15 of the Cascades, we experience more precipitation and heavier,  
16 wetter snow and ice conditions than those experienced east of the  
17 mountains. That, in conjunction with the tree density west of the  
18 Cascades, results in greater potential damage to our system from  
19 weakening trees and limbs. Also, much of PSE’s most densely  
20 populated service territory lies in the middle of the Puget Sound  
21 convergent zone resulting from strong winds coming off the Straits  
22 of Juan de Fuca. Utilities with service territory east of the  
23 Cascades rarely experience storm events causing widespread  
24 damage to their infrastructure. For example, we understand that  
25 Avista has not had a significant storm event in 8 years, since their  
26 1996 ice storm, and have no money earmarked for storm

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<sup>6</sup> See Exhibit No. \_\_\_(JMR-1T) at page 23.

1 restoration in their annual operating budgets. We understand that  
2 PacifiCorp typically has one or two major events per year in its  
3 six-state service territory. Similarly, in PSE's own experience east  
4 of the Cascades, catastrophic storm events rarely have significant  
5 impact in our Kittitas County service area.<sup>7</sup>

6 To characterize the Company's storm deferral as a regulatory mechanism that is  
7 an advantage that other companies in this region do not have is misleading. It is a  
8 mechanism tracks a significant volatile cost to which PSE has exposure and the  
9 other companies do not.

## 10 V. CONCLUSION

### 11 Q. Please summarize your testimony.

12 A. In order for PSE to continue to provide its customers with safe and reliable energy  
13 delivery systems and high quality service, it must be permitted to recover its costs  
14 for energy delivery, customer service, and energy system infrastructure  
15 investments in a timely manner. It is in the best interest of our customers, our  
16 region and our nation to have safe and reliable energy delivery systems in place to  
17 meet energy needs. We have seen the impacts in other parts of the United States  
18 where energy delivery systems have not met the demands, and customers and  
19 entire regions have suffered greatly.

20 PSE does not see any near term relief from higher material and fuel prices on the  
21 horizon, and we anticipate that construction and O&M costs will continue to

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<sup>7</sup> Exhibit No. \_\_\_(SML-9T) at pages 6-7, *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UG-

1 increase. Moreover, an increased level of transmission and distribution system  
2 investment is unavoidable and will be ongoing for many years. It is inevitable  
3 that future system investments will come at a higher cost. PSE is extremely  
4 sensitive to the impacts of increasing customer rates and we are working hard to  
5 minimize these impacts. However, PSE is also sensitive to our customers' and  
6 region's need for safe and reliable energy delivery systems and the impacts of  
7 service disruptions. I would be remiss if I did not vigorously advocate for the  
8 critical investment needs of our customers' energy delivery systems and the need  
9 to adequately recover these costs.

10 PSE is committed to providing delivery systems and high quality service in a cost  
11 effective and efficient manner, and asks that fair, adequate and timely rate  
12 recovery of our costs be granted in this filing.

13 **Q. Does that conclude your prefiled rebuttal testimony?**

14 A. Yes.