Exhibit No. KHB-1TC
Dockets UE-090704/UG-090705
Witness: Kathryn H. Breda
REDACTED VERSION

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondent.	DOCKET UE-090704 DOCKET UG-090705 *(Consolidated)*

TESTIMONY OF

KATHRYN H. BREDA

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Electric and Natural Gas Revenue Requirements; Company Accounting Proposal For Major Maintenance Activities; Ratemaking Adjustments for Power Cost O&M, and Major Plant Additions

November 17, 2009

CONFIDENTIAL PER PROTECTIVE ORDER

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LIST OF EXHIBITS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Kathryn Breda. My business address is The Richard Hemstad Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504. My e-mail address is kbreda@wutc.wa.gov.

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

A. I am employed by the Washington Utilities and Transportation Commission ("Commission") as a Regulatory Analyst.

Q. How long have you been with this agency?

A. I have been employed by the Commission since 2008.

Q. Please state your educational and professional background?

A. I graduated from the University of Washington in 1980 receiving a Bachelor of Arts in Business Administration with a major in accounting. I am a licensed Certified Public Accountant in the State of Washington.

My responsibilities at the Commission generally comprise financial, accounting and other analyses in general rate cases, accounting petitions, other tariff filings, and compliance filings. I participated in the Staff review of PacifiCorp Dockets UE-080220 and UE-090205, and NW Natural Docket UG-080546. My responsibilities in these dockets included the review of major plant additions along with various other adjustments and accounting issues.

Prior to my employment with the Commission, I held various corporate accounting and regulatory management positions from 1980 through 2000 with Qwest Communication and Pacific Gas and Electric Company. My corporate accounting responsibilities included accounting policy and procedures, and internal and external reporting including SEC reporting. As a regulatory manager for Qwest Communications, I was responsible for regulatory accounting support for six jurisdictions, including revenue requirement in rate case filings and compliance reporting. I participated in internal state planning and review processes. I also analyzed and monitored state accounting issues, reviewed new accounting pronouncements, and proposed initial policy or practice for various accounting issues.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. Please describe the purpose of your testimony.

A. In Sections III and IV of this testimony, I present Staff's overall recommendation regarding the electric and natural gas revenue requirements of Puget Sound Energy, Inc. ("PSE" or "the Company"). The starting point for all Staff witnesses for the development of these recommendations was the Company's Supplemental Testimony and Exhibits, filed September 28, 2009.

In Section V of my testimony, I present the Staff recommendation that the Commission reject the Company's proposed changes in accounting for planned major maintenance activities.

In Section VI, I sponsor several ratemaking adjustments recommended by Staff to develop the Company's electric revenue requirement. These adjustments address: 1) the operation and maintenance expense portion of Adjustment 10.03, Power Costs; and 2) major plant additions such as the Mint Farm Energy Center and the expansion of the Wild Horse Wind Farm.

Q. Please summarize Staff's overall revenue requirement recommendation in these consolidated electric and natural gas dockets.

A. Staff recommends that the Commission:

1. Increase the Company's electric service revenues by $ 5,826,516, or 0.3 percent, based on the overall rate of return of 7.89 percent recommended by Staff witness Parcell.
2. Increase the Company's gas service revenues by $ 7,130,348, or 0.6 percent, based on the same overall rate of return of 7.89 percent.

Q. Do you sponsor any exhibits in support of your recommendations?

A. Yes, I sponsor the following exhibits in support of my testimony:

- Exhibit No. KHB-2, Electric Results of Operations and Revenue Requirement

- Exhibit No. KHB-3, Gas Results of Operations and Revenue Requirement
- Exhibit No. KHB-4C, PSE Maintenance Under Long-Term Service Agreements From 2010 to 2015
- Exhibit No. KHB-5C, Maintenance Expense Comparison, Company Proposed Change Versus Current Accounting Method
- Exhibit No. KHB-6C, Comparison of Staff Versus Company Adjustment 10.03 Power Costs – Operations and Maintenance.

III. ELECTRIC REVENUE REQUIREMENT

Q. Please describe Exhibit KHB-2, Electric Results of Operations and Revenue Requirement.

A. Exhibit No. KHB-2 develops the Staff recommended revenue increase for the Company's electric operations. Page 1 of Exhibit No. KHB-2, the first column entitled "Actual Results of Operations," reflects the test year (January through December 2008) amounts and indicates that PSE earned a total rate of return of 6.51 percent on its electric operations in the test period. The second column entitled "Total Adjustments" is the sum of all the restating and pro forma adjustments shown on pages 2.2 through 2.7. The adjustment numbers used in my exhibit, and by all other Staff witnesses, correspond to PSE's presentation in its supplemental September 28, 2009 filing. The column entitled "Revenue Requirement Deficiency" shows the impact of Staff's recommended $ 5,826,516 electric revenue increase, given the 7.89 percent overall rate of return recommended by Staff witness Parcell.

Q. Are you responsible for all of the adjustments shown on Exhibit No. KHB-2?

A. No. On page 1 Exhibit No. MPP-2, Staff witness Parvinen lists each Staff witness and the contested and uncontested adjustments for which each witness is responsible.

Q. Did you review any adjustments on Exhibit No. KHB-2 that are uncontested as between Staff and PSE?

A. Yes. I sponsor Adjustment 10.13, Bad Debts, which is uncontested.

Q. Please list the adjustments on Exhibit No. KHB-2 that you sponsor that are contested as between Staff and the Company.

A. I sponsor the following contested adjustments, as discussed in Section VI of my testimony:

Adjustment 10.03, Power Cost – Operations and Maintenance Expenses Only
Adjustment 10.06, Hopkins Ridge Infill Project
Adjustment 10.07, Wild Horse Expansion Project*
Adjustment 10.08, Mint Farm Energy Center*
Adjustment 10.09, Sumas Cogeneration Station
Adjustment 10.10, Whitehorn Generating Station
Adjustment 10.11, Baker Hydroelectric Project Relicensing
Adjustment 10.31, Regulatory Assets
Adjustment 10.33, Fredonia Power Plant*

* Staff does not contest the prudence of these new generation resource additions, as explained by Staff witness Nightingale. Staff's challenge to these adjustments stems from other accounting issues that I explain in Section VI of my testimony.

Q. Does Staff agree with the Company's electric conversion factor of 0.621262?

A. Yes, the conversion factor used to convert electric net operating income to a revenue requirement level is appropriate and is not an issue.

IV. GAS REVENUE REQUIREMENT

Q. Please describe Exhibit No. KHB-3, Gas Results of Operations and Revenue Requirement.

A. Exhibit No. KHB-3 develops the Staff recommended increase in revenue for the Company's gas operations. Page 1 of Exhibit No. KHB-3, the first column entitled "Actual Results of Operations", reflects the test year (January through December 2008) amounts and indicates that PSE earned a total rate of return of 7.55 percent on its gas operations in the test period. The second column, entitled "Total Adjustments" is the sum of all the restating and pro forma adjustments shown on pages 3.2 through 3.5. The adjustment numbers correspond to PSE's presentation in its supplemental filing dated September 28, 2009. The column entitled "Revenue Requirement Deficiency" shows the impact of Staff's recommended $ 7,130,348 revenue increase, given the overall rate of return requirement of 7.89 percent recommended by Mr. Parcell.

Q. Did you review any adjustments on Exhibit No. KHB-2 that are uncontested as between Staff and PSE?

A. Yes. I sponsor Adjustment 9.08, Bad Debts, which is uncontested.

Q. Are you responsible for any of the contested adjustments included on Exhibit No. KHB-3?

A. No. On page 2 of Exhibit No. MPP-2, Staff witness Parvinen lists the other Staff witnesses and the contested and uncontested adjustments for which each is responsible.

Q. Does Staff agree with the Company's natural gas conversion factor of .621891?

A. Yes, the conversion factor used to convert natural gas net operating income to a revenue requirement level is appropriate and is not an issue.

V. COMPANY PROPOSED CHANGE IN ACCOUNTING FOR PLANNED MAJOR MAINTENANCE ACTIVITIES

Q. Please explain the Company's proposal to adopt a new method of accounting for planned major maintenance activities.

A. The Company states that it is required to change the way it accounts for major maintenance expense for ratemaking purposes because the method it *claims* to use, the "accrue-in-advance" method, is not allowed for financial reporting purposes. Exhibit No. JHS-1T at pages 12-13. The accrue-in-advance method has been disallowed for financial reporting purposes since 2006, but that has no bearing on how the Company accounts for major maintenance expense for ratemaking purposes.

The accounting method the Company actually currently uses to account for major maintenance is the "deferral method". Under the deferral method, major maintenance expense is amortized from completion of the maintenance event to the next occurrence of similar maintenance. For example, if major maintenance is completed in January 2010 and the next major maintenance is scheduled for January 2020, one tenth would be recorded as expense each year from 2010 through 2019. This method is an acceptable method under generally accepted accounting principles ("GAAP").

For rate making purposes, the Company proposes to abandon the deferral method of accounting and replace it with a "hybrid" self-developed method that is not required or suggested by any authority. PSE's proposal arbitrarily creates two categories of maintenance expense:[1]

1. Expenses under $2 million would be expensed directly when the major maintenance is completed, instead of amortized to the next occurrence of similar maintenance; and
2. Expenses over $2 million, where a regulatory asset would be created and amortized over five years with carrying costs. PSE suggests it would seek

[1]The Company defines its proposed method in its response to Staff Data Response No. 155(a): "Less than $2 million per occurrence would be accounted for on the Direct expensing methodology and greater than $2 million per occurrence would be accounted for following the Deferral methodology. The Direct expensing would be used for relatively consistent, predictable occurrences while the Deferral methodology would be used on the larger, less constant occurrences."

recovery of these expenses in the next general rate case,[2] therefore providing the expectation of total recovery, with interest, while the decision is delayed.

Staff recommends that the Commission should reject the Company's proposed changes in accounting for maintenance expense for the following reasons:

1. There is no accounting authority or Commission order that requires or even suggests the proposed changes;
2. The deferral method PSE currently uses for planned major maintenance provides superior accounting and test year presentation for rate making purposes.

A. The Proposed Accounting Method is Not Required By Accounting Authority Or Commission Order

Q. Please explain the current accounting authority for planned major maintenance activities.

A. The guidance on accounting for planned major maintenance activities is provided in the American Institute of Certified Public Accountants ("AICPA") Guide for Airlines, which has been applied by correlation to electric power plants, as well as oil refineries, ships and heavy-manufacturing equipment and facilities. This guide has been incorporated into the current authoritative GAAP, Financial Accounting Standards Board ("FASB") Accounting Standards Codification.

[2]Exhibit No. JHS-1T at 14:18-19.

Q. How is planned major maintenance defined by the AICPA Guide?

A. Planned major maintenance means a significant overhaul or maintenance of plant and equipment.

Q. What are the acceptable expensing methods for planned major maintenance, per the AICPA Guide?

A. The Airline Guide provides three acceptable methods for accounting for planned major maintenance activities:

> *Expense as incurred method.* Under this method, all maintenance costs are expensed in the period incurred because maintenance activities do not represent separately identifiable assets or property units in and of themselves; rather, they serve only to restore assets to their original operating condition.
>
> *Deferral method.* Under this method, the actual cost of each planned major maintenance activity is capitalized and amortized to expense in a systematic and rational manner over the estimated period until the next planned major maintenance activity.
>
> *Built-in overhaul method.* Under this method, costs of activities that restore the service potential of airframes and engines are considered a component of the asset. This method cannot be applied to leased aircraft. The cost of airframes and engines (upon which the planned major maintenance activity is performed) is segregated into those costs that are to be depreciated over the expected useful life of the airframes and engines and those that represent the estimated cost of the next planned major maintenance activity. Thus, the estimated cost of the first planned major maintenance activity is separated from the cost of the remainder of the airframes and engines and amortized to the date of the initial planned major maintenance activity. The cost of that first planned major maintenance activity is then capitalized and amortized to the next occurrence of the planned major maintenance activity, at which time the process is repeated.[1]

The accrue-in-advance method used to be an acceptable method to account for planned major maintenance according to the AICPA Airline Guide. However, FASB

Staff Position AUG AIR-1 eliminated the accrue-in-advance method effective in 2006.[3]

Q. You stated earlier that the Company claims to be currently recovering major maintenance expense in rates under the "accrue-in-advance" method of accounting. Please explain.

A. Company witness Story states on page 12 of Exhibit No. JHS-1T, "PSE calculated rate year maintenance costs based upon actual test year costs plus normalized rate year major maintenance costs." Furthermore, he states, "Normalized major maintenance for PSE's own simple-cycle gas and oil-fired combustion turbines ("SCCTs") represented an average annual cost of the *expected* major maintenance over a *ten year forecast* period." (Emphasis added). On page 13, he defines the rate year calculation: "For financial accounting purposes this calculation is defined as an accrue-in advance method."

Q. Please explain what Company witness Story means by "actual test year costs plus normalized rate year major maintenance costs."

A. In past rate cases, the Company's stated approach to rate year maintenance expense was to forecast maintenance costs ten years into the future.[4] PSE then would take a simple average of those costs and replace test year actual expense with that average.

[3]PSE's Response to Public Counsel Data Response No. 109(a).
[4]Exhibit JHS-1T page 12.

This method does not consider normalization of actual maintenance expense. It considers only future expense based on forecasts.

Q. Can the Company's accounting method for ratemaking purposes rely on changes made to the accrue-in-advance method for financial reporting purposes?

A. No. As stated earlier, the accrue-in-advance method was discontinued for financial reporting purposes in 2006. PSE is trying to claim that a method it used only for rate making purposes should be discontinued because it is not allowed for financial reporting purposes. However, ratemaking does not drive financial reporting. PSE does not book for accounting purposes what it claims to be using for ratemaking purposes. Even if it did use the accrue-in-advance method for financial reporting purposes, that method was discontinued in 2006 despite PSE's claim to be using it for ratemaking purposes through the last general rate case.

Q. Did PSE receive Commission approval to use the accrue-in-advance method for ratemaking purposes?

A. No. Recent PSE rate case orders have not specifically adopted the method Mr. Story describes as "accrue-in-advance".

Q. What conclusions can one make about the accrue-in-advance method used by PSE for this rate proceeding?

A. PSE seems to rely on the discontinuance of the accrue-in-advance method for financial reporting purposes to justify its proposed method for determining maintenance costs for ratemaking purposes. That method was permitted for accounting purposes for years prior to 2006, but has not been prescribed for ratemaking purposes by any authority, including this Commission. Therefore, the accrue-in-advance method has no bearing in this case and is irrelevant to the Company's proposal for planned major maintenance expense.

B. The Company's Current Adopted Accounting Method Is Superior For Rate Making Purposes To The Proposed Change

Q. Has the Company adopted a method to account for planned major maintenance activities?

A. Yes, the Company has adopted the deferral method of accounting for planned major maintenance activities.[5] This method recognizes maintenance expense over the period until the next major maintenance. For instance, if major maintenance occurs every ten years, one tenth is recognized each year until the next major maintenance.

Q. What effect does the deferral method of accounting for planned major maintenance have on maintenance expense over time?

[5] PSE Response to Staff Data Request 60(a) at paragraph 2, "PSE has applied the Deferral Methodology pursuant to FASB Staff Position AUG AIR-1 on all major maintenance long-term service agreements ("LTSA") since mid-2008. All capital and operation and maintenance ("O&M") costs under LTSAs, regardless of their total dollar amount, are accounted for under the Deferral Method in accordance with FASB."

A. The deferral method essentially spreads the expense of major maintenance over the maintenance interval or until the next major maintenance occurs. It essentially normalizes expense and provides for a consistent expense level over time.

Q. Have you prepared an analysis of the Company's planned major maintenance under the current deferral method?

A. Yes. Exhibit No. KBH-4C, PSE Maintenance Under Long-Term Service Agreements From 2010 to 2015, provides an analysis of major maintenance by plant as provided in Company witness Mills' work papers. This exhibit demonstrates how the deferral method spreads the significant cost of major maintenance over time. Most of the maintenance has a 10-year period between occurrences, which spreads the cost over time. The average maintenance expense from 2011 through 2015 is $3.2 million within a range of $2.5 million to $3.8 million.

Q. Does the deferral method of accounting for planned major maintenance provide a reasonable basis for ratemaking?

A. Yes. This method provides for the recovery of expenses consistently over the maintenance period and decreases the potential for extreme fluctuations than if the maintenance were, instead, recognized when incurred.

Q. What is the effect of PSE's proposed method for major maintenance compared to the deferral method?

A. Under the Company's proposed method, the ratepayer has the burden of providing recovery of the expense in half the time, five years, based on projected future maintenance expense including carryings cost at the cost of capital.

Q. Does the Company compare the current deferral method to its proposed new method?

A. Yes and no. Company witness Mills' work papers include a comparison of what the Company's purports the proposed changes would be, compared to what it suggests has been included previously in rates. He compares the total expense to the suggested method with major maintenance over $2 million removed.

However, his approach does not provide a consistent and meaningful comparison. To correct his error, the Company would need to include the effect of maintenance over $2 million it proposes to defer as a regulatory asset. PSE is proposing a delay in the recognition of this expense, not its entire removal, as it reflects in this comparison.

Q. Has Staff compared the Company's proposed accounting practice for maintenance and the current accounting practice using the deferral method?

A. Yes. Exhibit No. KBH-5C, Maintenance Expense Comparison, Company Proposed Change Versus Current Accounting Methods, provides this comparison. For the Company's proposed category of major maintenance under $2 million, this exhibit compares the difference by year and for the total period to the current deferred accounting method. Based on this comparison, under the proposed method the Company would include $3.2 million more expense for recovery, or $9.6 million, compared to $6.4 million based on the current accounting method. In addition, this exhibit reflects the variation in expense by year resulting from the Company's proposed method compared to its actual accounting practice that normalizes expense over time. This exhibit confirms that, for maintenance expense under $2 million, the current deferred accounting practice is superior to the proposed method.

For the Company's proposed category of major maintenance expense over $2 million, this exhibit reflects the deferral of $19.7 million consistent with the Company's presentation, including the accrual of carrying charges at the authorized rate of return, with a rate year ending May 2012. The resulting amortization for the five-year period is $4.4 million per year for a total of $22.0 million. This compares to the Company's current accounting under the deferral method, which results in $14.6 million over the five-year period. This again clearly demonstrates that the current accounting practice used by the Company is far superior to the accounting change the Company is requesting.

Q. Please summarize your conclusion that the Company's current accounting method is superior for ratemaking purposes to the Company's proposed change.

A. Under the deferral method already adopted by PSE for financial reporting purposes, all expenses are amortized until the next maintenance, which provides for greater consistency over time and a superior basis for ratemaking purposes. This is preferable to the Company's proposal to direct expense maintenance, which causes peaks and valleys in the under $2 million category. The direct expense method, as the Company has applied it, also shifts expenses from the future period to current periods since it does not reflect the deferral over time.

The deferral method is also preferable to the Company's proposal for major maintenance expense over $2 million, which includes the creation of a regulatory asset subject to carrying costs and an amortization period of five years. Planned maintenance activities over $2 million have, on average, a 10-year interval between maintenance events, which would be used under the deferral method to spread costs, compared to the five year period the Company proposes. The five year amortization period PSE proposes allows, on average, recovery of significant maintenance costs by ratepayers in half the time than would be recognized for financial reporting purposes without considering the carrying charges PSE is requesting.

Q. Will the Company encounter an increase in maintenance in the future?

A. Yes. The Company has acquired significant generation facilities in recent years. In 2005, the Company added the Hopkins Ridge Wind Facility, in 2006 the Wild Horse Wind Facility, in 2007 the Goldendale Facility, and in 2008 both the Sumas and Mint Farm facilities. With these new facilities, PSE has reduced risk from the need to acquire purchase power agreements and has acquired commitments to maintain these complex facilities.

Q. Should an increase in maintenance in future years be addressed in this rate case?

A. No. Rates are set based on a historic test year. Pro forma adjustments are allowed for "known and measurable changes that are not offset by other factors."[6] This relates to the "matching principle" of rate making. Staff witness Parvinen discusses the matching principal and its significance in detail.

Q. Please summarize the reasons for your recommendation that the Commission reject PSE's proposed changes to the accounting for planned major maintenance.

A. The Commission should clearly reject the Company's proposal because there is no accounting authority or Commission order requiring this change. Moreover, the deferral method the Company uses currently is far superior and normalizes the cost over time. The Company has not provided any reasonable justification for the proposed change.

VI. CONTESTED ELECTRIC ADJUSTMENTS

A. Adjustment 10.03, Power Cost – Operations And Maintenance Expenses Only

Q. Please explain your responsibility for Adjustment 10.03, Power Costs?

[6] WAC 480-07-510(3)(e)(iii).

A. I will discuss Staff's adjustment for O&M included in Adjustment 10.03, Power Cost. Staff witness Buckley addresses the balance of this adjustment.

Q. Please describe the Company's Power Cost adjustment for O&M expense.

A. PSE includes pro forma adjustments to power cost O&M based on budget projections and forecast levels for certain facilities through the rate year. For maintenance on thermal plants, PSE uses a forward forecast based on average annual maintenance expense for 2010 through 2014.[7] PSE also applies the proposed change for planned major maintenance activities, as discussed above.

Q. Please summarize the flaws in PSE's approach to base the O&M portion of its Power Cost adjustment on budgeted and forecast levels of expense.

A. The flaws to PSE's approach are numerous:

1. The use of a forecast, budget or projection does not meet the definition of a pro forma adjustment.
2. The Company may include costs in a budget that could be revealed in an audit of actual results to be inappropriate and removed for rate making purposes.
3. The Company's accounting proposal for maintenance is included in this adjustment.

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[7] Exhibit No. JHS-1T at 15 and Exhibit No. LEO-1T at 22.

I will address each of these deficiencies and then present Staff's Power Cost adjustment for O&M expense that corrects these deficiencies.

1. Use Of Forecasts, Budgets, And Projections Violates The Definition Of A Pro Forma Adjustment

Q. Please define a Pro Forma Adjustment.

A. WAC 480-07-510(3)(e)(iii) defines pro forma adjustments as adjustments that "give effect for the test period to all known and measurable changes that are not offset by other factors." The work papers must identify dollar values and underlying reasons for each proposed pro forma adjustment. Staff witness Parvinen provides a detailed discussion of the theory and regulatory policy underlying this definition.

Q. Does the use of a forecast, budget or projection, as proposed by PSE for the O&M element of its Power Cost adjustment, meet the definition of a known and measurable change?

A. No. A forecast, budget or projection by its very nature is not known. It might be based on historical information, but with a forward looking estimate of a future event that may or may not materialize.

Q. Are there other reasons to reject the Company's use of forecasts, budgets and projections in the O&M portion of its Power Cost adjustment?

A. Yes. Forecasts, budgets or projections are based on assumptions that, by definition, are unknown or of unspecified determinants. Each assumption can be interpreted differently and arguably supported by documentation. As a result, different outcomes can result based on different underlying assumptions. Moreover, the estimated timing of the event can be incorrect. For instance, a planned addition to plant can be forecast to occur within the rate year, but, once it becomes known and measurable, it may actually occur beyond the rate year. History proves that forecasts can be significantly different from actual results.

Q. Has PSE provided a consistent approach in its use of forecasts for the Power Cost adjustment in this case?

A. No. The Company uses different assumptions in its calculations of the adjustment. PSE's Response to Staff Data Request No. 143(b) states:

[redacted]

This response exemplifies how different assumptions can result in different outcomes. It also illustrates how actual results can vary considerably from a forecast.

Q. Are the assumptions used by the Company in its forecasts and budgets of power cost O&M supported in testimony or work papers?

A. Not usually. Many of these calculations are embedded in the work papers without any reasoning as to why an assumption was used, or the outside source or basis for the assumption.

Q. Does the O&M portion of PSE's Power Costs adjustment overlap with other known and measurable changes addressed by other adjustments?

A. Yes. This adjustment provides forecasts and budgets of wage increases and related items for which the known and measurable portions are already included in the wage-related adjustments. To this extent, the Company's Power Cost adjustment double recovers wage-related expenses.

2. Inherent Audit Issues Reflected In Forecasts

Q. Please explain how budgeted costs, if provided as actual results, can be revealed in an audit as inappropriate and removed for rate making purposes.

A. Typically, a budget or forecast does not provide the level of detail that actual results provide to enable Staff to audit the information. Costs are included in categories and do not reveal their true character until they become actual expenditures. Even though Staff is not supporting forecast or budget data, it is worth pointing out that the Company did include questionable information in the expense budgets for some plant facilities. For instance, the [redacted]

3. Application Of The Company's Proposed Change In Planned Major Maintenance Activities

Q. Does the Company include its proposed change to planned major maintenance in the O&M portion of its Power Cost adjustment?

A. Yes. One of the embedded pro forma adjustments in Company witness Mills' work papers reflect this change. Staff has provided an alternate presentation, described below, for Adjustment 10.03, Power Costs, that is consistent with the Company's current accounting method for planned major maintenance activities.

Q. Please summarize the Company's O&M expense portion of Adjustment 10.03, Power Costs.

A. The Company adjusts test year maintenance expense for its proposed change in accounting for major maintenance. It also includes budget projections for O&M expense [redacted] Other restating adjustments are consistent with Staff's presentation.

Q. Please discuss Staff's overall approach to the O&M portion of its Adjustment 10.03, Power Costs.

A. Staff uses a five year normalized level of expense for thermal facilities to represent an appropriate test year level of expense. For O&M on plant that has only a partial year in the test year, or plant that was brought in to service during the test year, Staff includes an annual level of expense based on actual expense through August 2009. Staff has removed all forecast and budget information included by the Company.

Q. Have you compared Staff's O&M expense portion of Adjustment 10.03, Power Costs to the Company's?

A. Yes. That comparison is included in Exhibit No. KHB-6C, Comparison of Staff Versus Company Adjustment 10.03 Power Costs – Operations and Maintenance. The first section of this exhibit summarizes the differences between Company and Staff adjustments. Following that summary is a detailed discussion of those differences. Staff's adjustment for O&M decreases the Company's amount by $17,791,888. The difference can be attributed to the following:

1. *Thermal Facilities*. As stated above, Staff's adjustment for maintenance on thermal facilities is based on a five year normalized level of historic expense for established facilities and an average annual expense level based on August 2009 actual expense for new facilities. The Company's proposed accounting change for maintenance is removed in the Staff adjustment. Staff's adjustment for thermal facilities reduces the Company's adjustment by $4,512,931.

2. *New facilities with partial results in the test year.* Staff included an annual expense level based on August 2009, as compared to the Company's inclusion of a budget level of expense. This results in a decrease of $3,309,550 for Staff's adjustment, as compared to the Company's expense level.

3. *Additional Rate Year Budget.* The Company provided an additional budget for [redacted]. Staff's removal of the budget amounts accounts for a decrease of $9,969,407 from the Company adjustment.

Q. What conclusion can be made about the Company's O&M portion of Adjustment 10.03, Power Costs?

A. The Company has inflated its presentation of O&M costs with projected budget levels of expenses and the new accounting proposal for maintenance, which forecasts costs five years into the future.

Q. What is Staff's recommendation for O&M expenses?

A. Staff recommends that the Commission reject the Company's accounting proposal for major maintenance that is incorporated in this adjustment, reject the Company's use of forecasts, projections and budgets, and reflect a normalized level of expense, as proposed by Staff.

B. Pro Forma Adjustment For Major Plant Additions

Q. Please explain the issues common to all adjustments for major plant additions included in this section.

A. The issues common to all the adjustments for major plant additions are similar to the issues I discussed earlier regarding power cost O&M:

1. The Company's plant addition adjustments are based on forecasts, budgets and projections, which do not meet the requirement of a proper pro forma adjustment. Staff has assumed the burden of replacing the forecasts, budgets and projections with actual dollars from beyond the test year. Staff does not feel comfortable choosing a "cut-off" date for adjustments of this nature that fall between the test year and rate year. That being said, Staff has used information as of August 2009, which is the most current information available at the time this testimony was prepared. Staff witness Parvinen discusses this issue further in his testimony.
2. The Company did not use a consistent date for its adjustments. For instance, some adjustments included plant balances through the end of the test year with expenses forecasted through the rate year, while another adjustment includes projected plant balances through the end of 2009. Staff has consistently used the most current actual dollar information for August 2009.

1. Adjustment 10.06, Hopkins Ridge Infill Project

Q. Please summarize the Company's Adjustment 10.06, Hopkins Ridge Infill Project.

A. This pro forma adjustment involves the installation of four 1.8 megawatt ("MW") Vestas turbines at the Company's existing 149.4 MW Hopkins Ridge Wind Project. This expansion was placed in service in August 2008. The Company's adjustment is an example of an addition that is reflected in the test year at a partial level and the Company proposes a pro forma adjustment to include the expansion through the rate year. The actual rate base from the test year was used and depreciated through the rate year. Operations and maintenance expense was budgeted through the rate year and included in Adjustment 10.03, Power Costs. A forecast of property tax and property insurance for the rate year were also included by the Company.

Q. Please summarize Staff's pro forma adjustment for the Hopkins Ridge expansion.

A. Staff has removed the forecast and budgeted amounts for O&M expense, and property tax and property insurance, consistent with the proper application of a pro forma adjustment. A pro forma adjustment for property insurance has been included by Staff based on the premium notice effective April 1, 2009 through April 1, 2010. Staff has also adjusted the rate base for actual results through August 2009.

Staff's adjustment decreases net operating income by $204,970 and increases rate base by $4,075,268. The calculation of this adjustment is shown on my Exhibit No. KHB-2, page 2.13.

2. Adjustment 10.07, Wild Horse Expansion Project

Q. Please summarize the Company's Adjustment 10.07, Wild Horse Expansion.

A. This pro forma adjustment relates to a 44 MW, 22 Vestas turbine expansion to the existing 228.6 MW Wild Horse Wind Generating Facility. The expansion became operational on November 9, 2009. Both rate base and expense calculations were projected by PSE and presented through the end of the rate year.

Q. Please summarize Staff's proposed Adjustment 10.07, Wild Horse Expansion.

A. Staff removes all forecasts, budgets, and projections to meet the requirements of a proper pro forma adjustment. Actual dollars are provided through August 2009. O&M expense included in this adjustment reflects only [redacted].[8] The Company's projected property tax dollars were also removed. Property insurance projections were removed since the latest premium information did not separate the expansion from the total Wild Horse facility. However, Staff's pro forma adjustment for property insurance, Adjustment 10.32, includes the entire Wild Horse facility.

[8]Company in Response to Staff Data Response No. 180.

Staff's Adjustment 10.07 decreases net operating income by $3,289,703 and increases rate base by $63,260,836. The calculation of this adjustment is shown on my Exhibit No. KHB-2, page 2.14.

3. Adjustment 10.08, Mint Farm Energy Center

Q. Please summarize the Company's Adjustment 10.08, Mint Farm Energy Center.

A. This pro forma adjustment presents the Company's forecast of the Mint Farm Energy Center through the rate year. This facility was purchased by PSE on December 5, 2008 and included in the test year. The Company forecast plant additions through December 2009 and applied them to the rate year. In addition, rate year forecasts were used for O&M expense, property tax and property insurance. Projections for fuel and wheeling were also included.

Q. Please summarize Staff's proposed Adjustment 10.08, Mint Farm Energy Center.

A. Consistent with all Staff pro forma adjustments for plant additions, Staff has eliminated all forecasts, budgets and projections. Actual dollars through August 2009 are used, instead. O&M forecasts were replaced with annualized August 2009 expense. Projections for property tax were removed because they are not known and measurable. Property insurance was updated to the latest premium information.

Staff's proposed adjustment decreases net operating income by $46,387,881 and increases rate base by $217,569,921. The calculation of this adjustment is shown on my Exhibit No. KHB-2, page 2.15.

4. Adjustment 10.09, Sumas Cogeneration Station

Q. Please summarize the Company's Adjustment 10.09, Sumas Cogeneration Station.

A. The Sumas Cogeneration Station was placed in service on July 25, 2008. The Company's adjustment includes actual plant balances through February 2009, adjusted through the rate year for accumulated depreciation and amortization, and accumulated deferred taxes. Fuel costs and forecasts for O&M expense are included by PSE in Adjustment 10.03, Power Costs, and have been addressed previously in this testimony. Property tax and insurance premiums were projected by PSE through the rate year.

Q. Please summarize Staff's proposed Adjustment 10.09, Sumas Cogeneration Station.

A. Once again, Staff has eliminated all forecasts, budgets and projections consistent with all pro forma adjustments for plant additions. Again, Staff uses actual dollars through August 2009 for this adjustment. Projections for property tax were removed and property insurance was updated to the latest premium information.

Staff's proposed adjustment decreases net operating income by $593,802 and increases rate base by $7,583,822. The calculation of this adjustment is shown on my Exhibit No. KHB-2, page 2.16.

5. Adjustment 10.10, Whitehorn Generating Station

Q. Please summarize the Company's Adjustment 10.10, Whitehorn Generating Station.

A. In February 2009, PSE acquired the Whitehorn Generating Station. The Company's adjustment includes the purchase transaction based on February 2009, adjusted through the rate year for accumulated depreciation and amortization, and accumulated deferred taxes. Fuel costs and forecasts for O&M expense are included in Adjustment 10.03, Power Costs, and have been addressed previously in this testimony. Property tax and insurance premiums were projected through the rate year by the Company.

Q. Please summarize Staff's proposed Adjustment 10.10, Whitehorn Generating Station.

A. Consistent with all pro forma adjustments for plant additions, Staff has eliminated all forecasts and budgets, and included actual dollars through August 2009.

Staff's proposed adjustment decreases net operating income by $2,025,047 and increases rate base by $16,776,280. The calculation of this adjustment is shown on my Exhibit No. KHB-2, page 2.17.

6. Adjustment 10.11, Baker Hydroelectric Project License

Q. Please summarize the Company's Adjustment 10.11, Baker Hydroelectric Project License.

A. The Company includes a pro forma adjustment for the cost of obtaining a new license for the Baker Hydroelectric Project. PSE used the actual balance capitalized in rate base as of February 2009, adjusted through the rate year for accumulated depreciation and amortization, and accumulated deferred taxes. Projected expenses through the rate year were included in Adjustment 10.03, Power costs.

Q. Please summarize Staff's proposed Adjustment 10.11, Baker Hydroelectric Project License.

A. Staff has included only known and measurable adjustments based on August 2009.

Staff's proposed adjustment decreases net operating income by $855,481 and increases rate base by $33,112,870. The calculation of this adjustment is shown on my Exhibit No. KHB-2, page 2.18.

7. Adjustment 10.31, Regulatory Assets and Liabilities

Q. Please summarize the Company's Adjustment 10.31, Regulatory Assets.

A. This adjustment brings forward to the end of the rate year all regulatory assets and liabilities previous authorized by the Commission. In addition, the Company proposes the following adjustments:

1. West Coast Pipeline Capacity
2. Colstrip Settlement Payment
3. Over Recovery of Major Maintenance

Q. Does another Staff witness provide testimony on the West Coast Pipeline Capacity element of the adjustment?

A. Yes. Staff witness Martin provides testimony on this subject.

Q. Please explain the background of the Colstrip Settlement Payment.

A. This lawsuit was originally filed in 2003. There are three types of claims at issue: differential settlement claims, contamination claims, and emotional distress claims.

The Company accrued a reserve of $700,000 in 2004. Approximately $479,173 is PSE's share of the cost to extend the city's water to 13 plaintiffs and $220,827 was accrued as a reserve. In the 1st Quarter of 2008, the Company expensed $10,487,159 reflecting its portion of the pending payment of $10,707,986 per the settlement. The Company and other defendants plan to seek recovery from applicable insurance carriers. PSE has an estimated insurance recovery of $2,083,590 per the settlement.

Q. Please explain the Company's proposed adjustment for the Colstrip Settlement Payment.

A. The Company has established a regulatory asset for the full payment made in 2008 of $10,487,159, amortized over five years including carrying costs at the authorized rate of return.

Q. Please explain Staff's proposed inclusion of the Colstrip Settlement Payment in the test year.

A. Staff has reserved to Account 186, Miscellaneous Deferred Debits, the amount identified in the settlement to be recovered from insurance, or $2,083,590. The remaining $8,404,396 was included in O&M expense. Staff includes this settlement payment in expense.

Q. Turning to the portion of Adjustment 10.31 related to over recovery of major maintenance expense, has the Company calculated the amount of major maintenance that was over-collected?

A. Yes. Company witness Story includes a regulatory liability in this adjustment that reflects the Company's calculation of an over-collection of maintenance expense since 2002.

Q. How does that adjustment affect O&M expense for this proceeding?

A. It confirms that the approach the Company has used to compile O&M expense in past proceedings is not reasonable for this proceeding.

Q. The Company demonstrated an over-collection due to the method it employed when determining rates. Would this problem exist under Staff's proposed method for recognizing maintenance costs?

A. No, since rates would be set on actual expenditures that are booked or recorded in a normalized fashion.

Q. How does Staff address this liability?

A. Staff removes this liability because it is retroactive rate making.

Q. What is the overall impact of Staff's Adjustment 10.31, Regulatory Assets and Liabilities?

A. Staff's proposed adjustment decreases net operating income by $4,659,619 and decreases rate base by $105,539,454. The calculation of this adjustment is shown on my Exhibit No. KHB-2, page 2.38.

8. Adjustment 10.33, Fredonia Power Plant

Q. Please summarize the Company's Adjustment 10.33, Fredonia Power Plant.

A. This adjustment reflects PSE purchase of the Fredonia Power Plant in January 2010. This facility had previously been leased by the Company. The Company's adjustment includes an estimated purchase transaction based on January 2010, adjusted through the rate year for accumulated depreciation and amortization, and accumulated deferred taxes. Fuel costs and forecasts for O&M expense are included in Adjustment 10.03, Power Costs, and have been addressed previously in this testimony. Property tax and insurance premiums were projected through the rate year by the Company.

Q. Please state Staff's issues regarding this adjustment.

A. This adjustment is based on projected information. The Company's response to Staff Data Request No. 146 indicates that the Company does not have any updated information. Staff is left with only projected dollars for the actual purchase transaction, which does not meet the requirement of a pro forma adjustment. Therefore, Staff has removed the projected purchase and reinserted the lease for Fredonia.

Staff's proposed adjustment decreases net operating income by $3,441,784. The calculation of this adjustment is shown on my Exhibit No. KHB-2, page 2.40.

Q. Does this conclude your testimony?

A. Yes, it does.