BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

Complainant,

v.

PUGET SOUND ENERGY, INC.

Respondent.

DOCKET NOS. UE-090704 AND UG-090705

DIRECT TESTIMONY OF JAMES R. DITTMER (JRD-1T)

ON BEHALF OF

PUBLIC COUNSEL

November 17, 2009

REDACTED

DIRECT TESTIMONY OF JAMES R. DITTMER (JRD-1T)

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DITTMER EXHIBIT LIST

Exhibit No. ___ JRD-2C	PSE Electric Accounting Exhibits
Exhibit No. ___ JRD-3C	PSE Gas Accounting Exhibits
Exhibit No. ___ JRD-4	PSE's Response to Public Counsel Data Request No. 439
Exhibit No. ___JRD-5	PSE's Response to Public Counsel Data Request No. 234
Exhibit No. ___ JRD-6	PSE's Response to Public Counsel Data Request No. 58
Exhibit No. ___ JRD-7	September 2009 Producer Price Indexes News Release issued by the Bureau of Labor Statistics
Exhibit No. ___ JRD-8	PSE's Response to Public Counsel Data Request No. 434
Exhibit No. ___ JRD-9	PSE Weather Normalized Energy Sales (MWh) Revenue Class 2003 through 2008

DITTMER EXHIBIT LIST-CONTINUATION

Exhibit No. ___JRD-10	PSE Weather Normalized Sales (Therms) by Customer Class 2003 through 2008
Exhibit No. ___JRD-11C	PSE's Response to Public Counsel Data Request No. 414
Exhibit No. ___JRD-12	Actual NonFuel Production Operations and Maintenance Expense for PSE Generating Units in Service for the Entire Historic Test Year
Exhibit No. ___JRD-13	PSE's Response to Public Counsel Data Request No. 59

I. INTRODUCTION AND SUMMARY

Q. Please state your name and address.

A. My name is James R. Dittmer. My business address is Post Office Box 481934, Kansas City, Missouri 64148.

Q. By whom are you employed?

A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc., a consulting firm engaged primarily in utility rate work. The firm's engagements include review of utility rate applications on behalf of various federal, state and municipal governmental agencies as well as industrial groups. In addition to utility intervention work, the firm has been engaged to perform special studies for use in utility contract negotiations.

Q. On whose behalf are you appearing?

A. Utilitech, Inc. has been retained by the Public Counsel Section of the Office of the Attorney General of the State of Washington (Public Counsel) to review certain aspects of the recent rate application of Puget Sound Energy, Inc.'s (PSE or Company). Additionally, our responsibility included the incorporation of the rate of return recommendation of Public Counsel witness Mr. Stephen Hill as well as jurisdictional power supply and other production cost adjustments sponsored by Public Counsel's witness Mr. Scott Norwood. Thus, the testimony and exhibits I am presenting herein as a result of such review and analysis is offered on behalf of the Public Counsel Section of the Office of the Attorney General.

II. QUALIFICATIONS

Q. Before discussing in greater detail the issues and various recommendations that you will be addressing, please state your educational background.

A. I graduated from the University of Missouri - Columbia, with a Bachelor of Science Degree in Business Administration, with an Accounting Major, in 1975. I hold a Certified Public Accountant Certificate in the State of Missouri. I am a member of the American Institute of Certified Public Accountants.

Q. Please summarize your professional experience.

A. Subsequent to graduation from the University of Missouri, I accepted a position as auditor for the Missouri Public Service Commission. In 1978, I was promoted to Accounting Manager of the Kansas City Office of the Commission Staff. In that position, I was responsible for all utility audits performed in the western third of the State of Missouri. During my service with the Missouri Public Service Commission, I was involved in the audits of numerous electric, gas, water and sewer utility companies. Additionally, I was involved in numerous fuel adjustment clause audits, and played an active part in the formulation and implementation of accounting staff policies with regard to rate case audits and accounting issue presentations in Missouri. In 1979, I left the Missouri Public Service Commission to start my own consulting business. From 1979 through 1985 I practiced as an independent regulatory utility consultant. In 1985, Dittmer, Brosch and Associates was organized. Dittmer, Brosch and Associates, Inc. changed its name to Utilitech, Inc. in 1992.

My professional experience since leaving the Missouri Public Service Commission has consisted primarily of issues associated with utility rate, contract and acquisition matters. For the past thirty years, I have appeared on behalf of clients in utility rate proceedings before various federal and state regulatory agencies. In representing those clients, I performed revenue requirement studies for electric, gas, water and sewer utilities and testified as an expert witness on a variety of rate matters. As a consultant, I have filed testimony on behalf of industrial consumers, consumer groups, the Missouri Office of the Public Counsel, the Missouri Public Service Commission Staff, the Indiana Utility Consumer Counselor, the Mississippi Public Service Commission Staff, the Arizona Corporation Commission Staff, the Arizona Residential Utility Consumer Office, the Nevada Office of the Consumer Advocate, the Washington Attorney General's Office, the Hawaii Consumer Advocate's Staff, the Oklahoma Attorney General's Office, the West Virginia Public Service Commission Consumer Advocate's Staff, municipalities and the Federal government before regulatory agencies in the states of Arizona, Alaska, Maine, Michigan, Missouri, Oklahoma, Ohio, Florida, Colorado, Hawaii, Iowa, Kansas, Mississippi, New Mexico, Nevada, New York, Oregon, West Virginia, Washington and Indiana, as well as the Federal Energy Regulatory Commission.

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III. EXHIBIT ORGANIZATION AND SPONSORSHIP

Q. Have you prepared schedules which summarize the adjustments and positions being sponsored by you and other Public Counsel witnesses?

A. Yes. I have attached schedules which reflect the cost of capital recommendations sponsored by Mr. Stephen Hill, the power supply/production cost adjustments sponsored by Mr. Scott Norwood, as well as the miscellaneous rate base and income statement adjustments that I am sponsoring. I have prepared separate sets of schedules, identically organized, for PSE's Washington jurisdictional electric and gas operations. The electric schedules are included in Exhibit No.__ (JRD-2C), and the gas schedules are included in Exhibit No.__ (JRD-3C).

Q. Please explain how your schedules are organized.

A. I would first note that my starting point is the Company's "as adjusted" Washington jurisdictional revenue requirement calculation. Schedule A is the Revenue Requirement Summary, which reflects the cumulative impact of the various revenue, operating expense, rate base and cost of capital recommendations being sponsored by Mr. Norwood, Mr. Hill and me. As previously noted, I have prepared identically organized schedules for PSE's Washington jurisdictional electric and gas operations. Thus, I have prepared a separate Schedule A-Electric Revenue Requirement Summary contained within Exhibit No.__(JRD-2C) as well as a separate Schedule A-Gas Revenue Requirement Summary found within Exhibit No.__(JRD-3C). As described in greater detail below, I have prepared similar supporting schedules "B," "C," and "D" which also include an "Electric" or "Gas" trailer to designate calculations for each utility operation.

Also shown on each Schedule A are the values of the various components underlying the Company's revenue requirement recommendation which were developed utilizing the Company-proposed "as adjusted" Washington jurisdictional operating results and rate base, as well as the Company's proposed cost of capital. Thus, on a summary level basis one can observe from each utility operation's Schedule A how the various components of Public Counsel's revenue requirement recommendation contrast with that being proposed by PSE.

Schedule B included within Exhibit No.__(JRD-2C) and Exhibit No.___(JRD-3C) for electric and gas operations, respectively, is the Rate Base Summary. In developing Public Counsel's proposed retail rate base I have started by showing PSE's proposed jurisdictional rate base by detailed component (i.e., Column b). Columns (c) through (f) of Schedule B-Electric and Columns (c) and (d) of Schedule B-Gas show Public Counsel's individual rate base adjustments. Immediately following each Schedule B – Rate Base Summary are a number of supporting schedules which set forth each individual Public Counsel rate base adjustment. Each individual rate base adjustment has a separate designation such as B-1, B-2, etc. Thus, each rate base adjustment identified and presented with a separate "B-__" Schedule designation becomes a reconciling item between PSE's and Public Counsel's rate base recommendation.

Schedule C, included within Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C) for electric and gas operations, respectively, is the Net Operating Income Summary. In a manner similar to the rate base schedules, I begin on Schedule C, Column (b) by showing the Company's "proposed" or "as adjusted" net operating income by major component. The individual Public Counsel adjustments to net operating income are also summarized within individual columns shown on Schedule C, with the support for each income statement adjustment developed on separate schedules. Thus, like the rate base schedules, each "C-__" Schedule reflects a reconciling component or adjustment between PSE's proposed net operating income and Public Counsel's proposed net operating income. Through the remainder of my testimony I will use the terms "Adjustment B-__" and "Schedule B-__" as well as "Adjustment C-__" and "Schedule C-__" interchangeably.

Schedule D included within Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C) reflects the Company's as well as the Public Counsel's proposed capital structure, including the weighted cost of debt, preferred stock and recommended return on common equity. As previously noted, Public Counsel's proposed capital structure and component cost recommendations are sponsored by Mr. Stephen Hill on behalf of Public Counsel.

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IV. SUMMARY OF PUBLIC COUNSEL'S ADJUSTMENTS

Q. What is Public Counsel's recommendation regarding changes to PSE's Washington jurisdictional retail electric and gas rates?

A. At this time, I have calculated a recommended electric reduction – which considers all of the Public Counsel witnesses' recommendations – of $43,374,000. Further, I have calculated a recommended gas reduction – which again considers all of the Public Counsel witnesses' recommendations – of $330,000. The noted overall decreases being recommended incorporate the recommendations of Public Counsel's cost of capital witness Mr. Stephen Hill as well as the power supply recommendations being sponsored by Public Counsel's power cost witness Mr. Scott Norwood.

V. OVERVIEW OF COMPANY'S APPROACH TO DEVELOPING PROFORMA ADJUSTMENTS

Q. Please state your understanding of the approach typically undertaken when developing Washington retail utility rates utilizing an adjusted test year cost of service.

A. First, I note that within the Washington Administrative Code (WAC) 480-07-510**,** this Commission has set forth the method to be employed when utilizing test year data for establishing rates. Specifically, WAC 480-07-510(3), "Workpapers and Accounting Adjustments," identifies the following criteria for making adjustments to the test year:

> (e)(ii) "Restating actual adjustments" adjust the booked operating results for any defects or infirmities in actual recorded results that can distort test period earnings. Restating actual adjustments are also

> used to adjust from an as-recorded basis to a basis that is acceptable for rate making. Examples of restating actual adjustments are adjustments to remove prior period amounts, to eliminate below-the-line items that were recorded as operating expenses in error, to adjust from book estimates to actual amounts, and to eliminate or to normalize extraordinary items recorded during the test period.
>
> (e)(iii) "Pro forma adjustments" 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.
>
> (h) A representation of the actual rate base and results of operation of the company during the test period, calculated in the manner used by the commission to calculate the company's revenue requirement in the commission's most recent order granting the company a general rate increase.

My interpretation of the above regulations is that the WUTC expects rates to be established by considering:

- As a starting point a historical test year – as evidenced by the language that indicates that adjustments are to be made to “actual recorded results.”
- “Restating” or “normalizing” adjustments are expected to be made to adjust for extraordinary or abnormal items, to eliminate prior period events that may have been recorded within the historic test year, remove costs that are improper for recovery from retail ratepayers, as well as to adjust for other accounting aberrations.
- “Proforma” adjustments are permitted and expected for “all known and measurable changes.” Importantly, the allowance for reflecting “all known and measurable changes” is accompanied by the limiting language that

states that such adjustments are only permitted if they "are not offset by other factors."

Second, I note that PSE, the WUTC Staff, the Public Counsel, as well as several other intervenors entered into a stipulation that was approved by this Commission within Docket Nos. UE-011570 and UG-011571 that establishes a Power Cost Adjustment (PCA) mechanism. The PCA stipulation provides, among other things, for the reflection in rates the cost of new power supply resources concurrent with the new resources going into commercial service. It is my understanding that implementation of the PCA mechanism occurs via consideration of "rate year" energy loads as well as reflection of the costs of new resources that become available through the "rate year" period. Further, my understanding is that the "rate year" consists of the first twelve month period following the date that new rates resulting from a given rate case docket are expected to go into effect. If the new resource is only scheduled to be available for a portion of the rate year, the cost of the new facility is only reflected for that portion of the rate that it is available to provide electric service. For new resources an estimate has been allowed for both commodity fuel costs of the new unit, return and depreciation on new plant investment, as well as non-fuel production operations and maintenance expense.

Q. Please describe generally how you understand PSE has developed its revenue requirement request in this docket.

A. PSE begins by presenting actual operating results for electric and gas operations for the twelve months ending December 31, 2008. The 2008 operating results are calculated and presented utilizing the “average” rate base investment experienced throughout calendar year 2008. For costs other than power supply costs PSE proposes adjustments to consider items such as removal of non-recurring events, to reflect revenues based upon “normal” weather conditions and to normalize a number of expense components that tend to fluctuate over time, as well as to reflect “price changes” for a number of expense components. Notably, the “price change” adjustments are, in some cases, presented within direct testimony on an “estimated” basis but with accompanying language that indicates the Company’s intent to true up or update the original estimates with “actual” price changes that may become known during the course of this proceeding. Also noteworthy is the fact that some expense components are adjusted for changes in price through the “rate year” which runs from April 2010 through March 2011. Presumably PSE takes the position that each of the “price” change adjustments represent “known and measurable changes that are not offset by other factors” as provided for by this Commission’s regulations, though I do not observe PSE witnesses’ testimony explicitly stating such assumption. I would also note that in some instances Mr. John Story’s testimony suggests that the price-change adjustments made to capture changes through the rate year are prepared consistent with prior rate cases.

Power supply costs for new resources such as the Mint Farm and Sumas Combined Cycle Generating Units have been included within PSE’s proposed rate base by reflecting the average investment costs calculated for each unit during the rate year. Additionally, PSE reflects a full year of related depreciation expense for the units as well as a forecasted amount of non-fuel operations and maintenance expense. The reflection of an annual level of investment and attendant returns as well as operating costs for Mint Farm and Sumas as well as certain other recently acquired or expanded production facilities appears to be consistent with the PCA stipulation entered into in 2002.

In addition to reflecting production operations and maintenance expense for new or expanded generating units on a forecast basis, PSE is also proposing to reflect production operations and maintenance expense on a forecast basis for a number mature existing generating units. Finally, I note PSE is proposing in this case to adopt a new methodology to account for, and recover, production maintenance expense for its gas generating units for maintenance events that individually will exceed $2 million.

Q. Before addressing individual adjustments that you are proposing, do you have an overall opinion as to the various approaches that PSE has utilized to derive its proposed electric and gas revenue increase request?

A. First, the Company appears to have liberally interpreted the "known and measurable" standard included within WAC 480-07-510(3) to reflect "price changes" for a number of expense items all the way through the end of the rate year (i.e., twelve months ending March 2011). The Company testimony alludes to the fact that some of these adjustments are made consistent with prior rate cases. As a relatively infrequent participant in Washington retail utility rate reviews, and given the fact that the last PSE rate case was settled, I am not in a position to deny that such testimony is totally or even partially inaccurate. What I would state, however, is that at least for purposes of this case, for specific reasons which I shall set forth, I do not believe that all of PSE's "price change" adjustments that capture actual or estimated changes through March 2011 are appropriate for developing rates within this docket. More specifically, even if some of the PSE-proposed "price change" adjustment are contractually or for some other reason believed to be "known and measurable," they are not appropriate for reflection in rate development because there are "offsets" that can be expected to counterbalance in whole or in part the impact of a given price change. As the above-quoted Washington regulation clearly indicates, only known and measurable changes *that are not offset by other factors* are permissible.

Second, I note that it appears that PSE has taken some of the forward looking elements of the PCA stipulation, that permit reflection and cost recovery of specific new resources in rates concurrent with their commercial operations, as a basis to adopt a much broader use of budgets or forecasts to reflect production operations and maintenance expense for existing and mature generating units. Again, PSE testimony references suggest that perhaps some use of production budgets may have been used in the past – which I can neither accept nor deny. But it appears that past movements toward reflecting budgeted or forecasted data for existing generating units is being proposed by PSE to be expanded within this docket. As delineated in greater detail in ensuing sections of testimony, I submit that such movement is not authorized pursuant to the PCA stipulation and is inconsistent with the guidelines set forth within (WAC) 480-07-510.

VI. RATE BASE ADJUSTMENTS

A. Eliminate Investment in Corporate Aircraft from Rate Base – Electric and Gas Operations Adjustment.

Q. If that concludes your introductory comments regarding the Company's overall development of adjusted test year operating results, please continue by discussing your first adjustment to rate base that affects both electric and gas operations.

A. The adjustment reflected on Schedule B-1 of Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C) removes from rate base the investment in the Company's corporate aircraft. The merits of this electric and gas operations rate base adjustment are discussed in detail within a following section of testimony wherein a corollary income statement adjustment (Schedule C-12) is described.

B. Eliminate Colstrip Settlement Regulatory Asset from Rate Base – Electric Operations Adjustment.

Q. Please continue by discussing your second adjustment to PSE's electric operations rate base.

A. The second electric rate base adjustment reflected on Schedule B-2 of Exhibit No.__(JRD-2C) removes from rate base PSE's proposed recognition of a regulatory asset referred to as the "Colstrip Settlement." I describe a related adjustment to proforma amortization expense, reflected on Schedule C-19 of Exhibit No. __(JRD-2C), in conjunction with a broader discussion of production operations and maintenance expense. Thus, the merits of this electric rate base adjustment are included with my discussion of the corollary income statement adjustment set forth within Schedule C-19 of Exhibit No. __(JRD-2C).

C. Eliminate Regulatory Liability for Over Collected Production Maintenance Expense – Electric Operations.

Q. Please describe your next electric rate base adjustment.

A. The third electric rate base adjustment reflected on Schedule B-3 of Exhibit No.__(JRD-2C) removes from rate base PSE's proposed recognition of a regulatory liability that represents the amount of maintenance expense that PSE has calculated to have been over collected from ratepayers since 2002. I also describe a related adjustment to proforma amortization expense, reflected on Schedule C-20 of Exhibit No. __(JRD-2C), in conjunction with a broader discussion of production operations and maintenance expense. Thus, the merits of this electric rate base adjustment are included with my discussion of the corollary income statement adjustment set forth within Schedule C-20 of Exhibit No. __(JRD-2C).

D. Tax Adjustment Related to White River Asset Sale – Electric Operations Adjustment.

Q. Please discuss your next adjustment to PSE's calculated proforma rate base.

A. The adjustment shown on Schedule B-4 of electric operations Exhibit No __(JRD-2C) is posted to reflect a net reduction in rate base attributable to the tax ramifications of the anticipated sale of White River assets and water rights to the Cascade Water Alliance. As a component of its Regulatory Assets and Liabilities electric adjustment found on Page 4.31 of Exhibit No.__(JHS-10), PSE posts a net reduction to rate base in the amount of $16,250,000. The net reduction to rate base was calculated by considering the gross proceeds from the anticipated White River asset sale in the amount of $25,000,000, and reducing such gross proceeds by an expected tax liability of $8,750,000. The tax liability offset amount was calculated with an implicit assumption that *all* of the gross proceeds amount would be taxed at the corporate federal tax rate of 35% (i.e., $25 million proceeds times 35% corporate federal tax rate of 35% equals the tax liability offset amount of $8,750,000). Also implicit in this Company calculation is an assumption that the tax basis of the White River facilities is zero – which would cause *all* of the sales proceeds to be taxable.

In fact, the tax basis of the White River facilities is *greater* than the proceeds anticipated from the sale – thus yielding an expected *tax loss* on the transaction. As a result, instead of the sales transaction yielding a tax gain with a related taxes payable amount as the Company's proforma rate case calculations suggests, the transaction is expected to result in a tax loss with a related recognition of a taxes receivable – or an offset to other taxable income generated by electric operations. This outcome is confirmed within the Company's response to Public Counsel Data Request No. 439 which has been affixed to this testimony as Exhibit No.__(JRD-4).

The rate base adjustment reflected on Schedule B-4 therefore reverses the rate base addition in the form of a taxes payable amount that was reflected within PSE's rate base development, with the expected taxes receivable amount that is actually expected to be realized from the tax loss on the White River sale.

E. Remove Mint Farm Deferrals from Rate Base – Electric Operations.

Q. Please discuss your next rate base adjustment.

A. On Schedule B-5 of Exhibit No.__(JRD-2C) I reflect an adjustment eliminating from rate base the Regulatory Asset, net of related accumulated deferred income taxes, related to PSE's request to defer certain fixed costs associated with the acquisition of the Mint Farm Generating Unit. This adjustment, as well as the corollary income statement adjustment reflected on Schedule C-22, are sponsored by Public Counsel's witness Mr. Scott Norwood.

F. Conservation Adjustment – Rate Base Impact – Electric Operations.

Q. Please continue by describing your next rate base adjustment.

A. I am recommending rejection of PSE's proposed conservation adjustment, which I discuss within an ensuing section of testimony. The adjustment shown on Schedule B-6 of Exhibit No.__(JRD-2C) simply reflects the roll out effect of eliminating the Company's conservation adjustment. A rate base adjustment results from eliminating the Company's conservation adjustment vis-à-vis the impact of revaluing production function rate base for the difference between rate year and test year normalized sales.

G. Production Rate Base Adjustment – Electric Operations.

Q. Please discuss your final electric operations rate base adjustment.

A. The rate base adjustment shown on Schedule B-7 of Exhibit No.__(JRD-2C) is the "Production Adjustment" required to revalue all of Public Counsel's production function rate base adjustment – all of which have been initially developed on a total-company basis – for the difference in rate year versus test year normalized electric energy sales. It is a "matching" rate base adjustment comparable to what the

Company undertook with its Adjustment No. 10.37 found within Exhibit No.__(JHS-10).

H. Jackson Prairie Project – Gas Operations Adjustment.

Q. Please describe your next adjustment to PSE's gas operations rate base.

A. The adjustment reflected on Schedule B-2 of gas operations Exhibit No.__(JRD-3C) reflects a reduction in plant cost related to the Jackson Prairie Project. **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXX. **[End Confidential]**

VII. A NUMBER OF PSE'S PROPOSED PROFORMA ADJUSTMENTS SHOULD BE REJECTED IN WHOLE OR IN PART INASMUCH AS THEY ARE NOT "KNOWN AND MEASURABLE CHANGES THAT ARE NOT OFFSET BY OTHER FACTORS" AS IS PERMITTED BY WAC 480-07-510

Q. Within earlier testimony you broadly addressed PSE's overall development of its adjusted test year cost of service, and specifically PSE's liberal interpretation of WAC 480-07-510. Which of PSE's proposed proforma adjustments do you

believe go beyond the criteria of a "known and measurable" change permitted by WAC 480-07-510?

A. PSE proposes within Exhibit No. __(JHS-4.25) to reflect anticipated wage increases through the end of the first year that rates in this proceeding are expected to be in effect – or through the period ending March 2011. Some of the increases are "known" in the sense that they are already authorized pursuant to bargaining unit contracts currently in effect. However, the Company has included a 3.00% "estimated" increase for union workers effective January 1, 2011 as well as annual estimated 3.5% increases for non-union workers effective March 1 of 2010 and 2011.

PSE proposes within Exhibit No.__(JHS-4), page 4.27 to include an estimated 8.00% increase in Flex Credit costs effective January 1, 2010. Flex Credits consist of the monthly amount the Company agrees to contribute to each employee's self-directed fund for employee benefits such as health insurance, dental insurance, life insurance, accidental death and dismemberment insurance, and long-term disability insurance. The PSE-estimated increase was based upon a historical trend of cost increases for Flex Credits authorized over the past five years. Within discovery PSE has indicated that the actual agreed upon increase has now been established at 4.75%.[1]

Within Exhibit No. __(JHS-4), page 4.23 PSE proposes to reflect estimated increases in property and liability insurance through the rate year. For this

[1] Response to Public Counsel Data Request No. 319.

adjustment, PSE proposes within the direct testimony of Mr. John Story that it is the Company's intention to update this adjustment for actual premium changes that become known during the course of this proceeding.

Finally, as one element of the Company's proforma adjustment found on Exhibit No. __(JHS-4), page 4.14, PSE proposes to reflect estimated increases for transmission and distribution service contract increases. I submit that all of the "estimated" increases embodied in the Company adjustments described above do not meet the "known and measurable" standard, and even some of the increases authorized by union contract or contracts with other entities occurring well beyond the end of the historic test year do not fully meet the known and measurable standard.

Q. Why do believe that the noted adjustments do not fully meet the "known and measurable" criteria of WAC 480-07-510?

A. By PSE's own characterization, some of the noted proforma increases are merely estimates – sometime based upon "cost trends" – that simply do not meet what I would consider even the most liberal interpretation of an appropriate standard to accept as a "known and measurable" change or event. The Company has indicated for a number of the proforma adjustments wherein they have initially used an "estimate," that it is the Company's intention to update such "estimate" with an actual price change authorized pursuant to contracts expected to be known through the pendency of this proceeding. However, even for items which may be trued up by a contractual price obligation at some time during this proceeding, I do not believe they are properly considered a "known and measurable change" inasmuch as some of the "known" contractual price increase can be expected to be "offset by other factors."

Q. Please discuss some of the "factors" that can be expected offset some known price changes.

A. Change in the price of a unit of a given good or service (i.e., price paid for an hour of an employee's time) can be offset in whole or in part by productivity or efficiency gains, or can be expected to be offset by the fall in the purchase price of other goods or services. Also, a significant and widespread decline in a number of commodity prices occurring in 2009 is a unique event that has not been experienced in any recent historical period. Further, in this particular economic environment wherein PSE is now forecasting an actual decline in electric sales, it is reasonable to expect PSE to react as a company operating in an competitive environment would do by working harder to trim costs and possibly defer programs or activities that do not have longer run safety or "catch up" cost implications.

Q. Please expand upon how and why price cost increases for a unit of a given good or service being purchased would be expected to be offset to some degree by efficiency or productivity gains.

A. Productivity or efficiency gains can serve to offset "price" increases for a given unit of a good or service being purchased. For instance, an employee group may negotiate for a 3.00% annual wage increase. *All other things being held constant*, a 3.00% increase in the employee group's wages would translate into a 3.00% increase in the cost of the good or service being produced by the employee group. However, if the employee group can in some way become 3.00% more efficient than it has been previously, the cost to the purchaser of the goods or service provided by the employee work group would remain constant notwithstanding the 3.00% wage increase per hour worked that was authorized for the employee group.

Q. How do utilities achieve efficiency or productivity gains?

A. Efficiency or productivity gains are often achieved through technology advances or simply the better use of existing technology, substitution of capital for labor, and simply better and "smarter" business practices.

Q. Please expand upon each of the items you have noted to contribute to efficiency or productivity gains.

A. Computerization of new processes and advances in processes that have been computerized for a number of years contribute significantly to efficiency gains. Just as virtually all of us have experienced greater efficiencies in personal communications, personal financial tracking and planning, ability to organize and manage our time, and in achieving more value for our purchasing dollars through easier research and easier access to a broader group of goods and services providers facilitated by computerization of processes and access to the Internet, similarly utilities have achieved efficiencies by capturing and quickly analyzing data that reduces mistakes, avoids or limits duplication of efforts, and simply provides the means to determine the optimal timing and level of efforts required to operate and maintain utility plant and equipment with a lower overall cost.

Capital additions can sometimes facilitate efficiencies for utilities. For generating facilities, breakthroughs in technology in conjunction with new equipment can allow utilities to achieve more energy output utilizing the same amounts of fuel input (i.e., improvements in heat rate efficiencies). Similarly, often acquisitions of machinery or equipment will allow given work requirements to be accomplished with fewer number of employees or fewer worker hours. In other words, labor productivity can often be improved through employment of more or better equipment.

Finally, utilities are typically striving to find better strategies and methods to accomplish any given required process or task. In recent years it has become common place for utilities to hire outside experts to assist them in defining "best practices" at other utilities that facilitate productivity and efficiencies improvements in a whole host of tasks required in the various utility functional areas. Adoption of the "best practices" of top performing utilities in given subsets of tasks often involves the already-noted harnessing of technology and the enhanced employment of capital. But in addition, utilities strive to achieve efficiencies and productivity by simply finding better and "smarter" ways to accomplish any number of ongoing processes and activities.

Q. During your review, have you observed instances wherein PSE has embraced technology advances in order to achieve efficiencies?

A. Like other utilities whose operations have become more efficient through technology gains, I am aware of recent PSE purchases of new software or software upgrades acquired in the interest of gaining efficiencies. Specifically, in 2008 PSE activated two new software additions and one enhanced upgrade to the Company's SAP software system. As reported with PSE's employee newsletter, PSE implemented a Human Resources/Payroll Enhancement to its existing SAP software system that has been designed to reduce manual transactions, support security enhancements, and achieve continued compliance with state and federal standards. As also reported within the Company newsletter, PSE began using a new Generation Work Management System at its Goldendale Generating Unit to track and schedule maintenance activities and provide reporting capabilities to help evaluate maintenance performance and costs. PSE intends to continue to implement the new SAP system through 2010 for all PSE generating facilities. Also noted within the employee news letter was the 2008 enhancement to an existing SAP software system designed to ensure compliance with reliability standards of the North American Electric Reliability Corporation and the Western Electricity Coordinating Council. In response to Public Counsel Data Request No. 233 PSE provided the feasibility studies underlying the decisions to purchase a new SAP system and enhance two existing SAP system. Inasmuch as the studies provided, which contain the specifics of the economics of the systems being acquired or enhanced, have been designated by PSE as "confidential," I have not attached a copy of such documents to this testimony, nor will I will elaborate in this testimony on the specifics of the costs or anticipated savings or "pay backs" from such new/enhanced systems. Suffice it to say, the capital and any other upfront costs of the new/enhanced software systems are justified by expected efficiencies or savings in ensuing months and years as the systems create process improvements and cost savings.

Q. During your review did you observe instances wherein PSE purchased or installed new equipment designed to save resources as well as time in performing activities?

A. Yes. In April 2008 PSE installed a new state-of-the-art bill processing equipment that doubled the rate of processing customers' bill payments from 300 to 600 payments per minute. The new processor consolidated a number of tasks that had previously been undertaken as individual steps, thus not only reducing labor input hours, but also speeding up the processing of bills. In response to Public Counsel Data Request No. 232 PSE provided the feasibility study underlying the decision to install the new payment processing equipment. Elements of the feasibility study provided were deemed confidential by PSE. It is unnecessary to discuss the specific details of the anticipated cost savings from installation of the new equipment to underscore how this acquisition results in the substitution of capital for labor to achieve *overall* economies and efficiencies, but suffice it to say this is a specific recent example wherein PSE has employed capital in anticipation of achieving efficiencies and savings.

Additionally, starting with gas operation in 2007 and continuing with electric operations in 2008, PSE rolled out a Mobile Workforce Project. This new system entails mounting laptop computers in PSE vehicles that allow field employees to have immediate access to job locations, service orders and other information that facilitates efficiencies, reduces response times and reduces paper work. The feasibility study underlying the decision to implement the new system was provided in response to Public Counsel Data Request No. 234 and has been affixed to this testimony as Exhibit No.__(JRD-5). As discussed within the noted feasibility study, this project was envisioned at its inception to cost roughly $10 million, but will result in net present value savings of $22 million over 15 years. This project is a good example of capital acquisition of a new technology designed to facilitate operational savings as well as better customer service. This project was completed for gas operations in 2007, and thus full annual costs and offsetting savings from the project for gas operation are included within in the 2008 test year. However, the program was installed in the April/May 2008 time frame for electric operations, so the full annual impact of expected savings would not be reflected within unadjusted test year electric operating results.

Q. Have you observed instances wherein PSE has adopted new or altered business practices in the interest of saving time or money – or simply to improve customer service without increasing costs?

A. Yes. I would first note that PSE witness Mr. Bertrand Valdman discusses within direct testimony the organization of a new team established specifically to identify and implement the types of process changes I have described as being prevalent in the utility industry. Specifically, at page 57 of his direct testimony Mr. Valdman states:

Q. What is performance excellence and why is it important?

A. The Performance Excellence Team was formed by PSE in 2008. The Team is charged with identifying opportunities, developing, and implementing end-to-end process improvement initiatives that enhance service, reliability, and productivity. The two main functions of the group are to drive sustainable process improvements across the organization and to make performance visible. The Team utilizes a collaborative approach in certain areas of PSE's operations such as gas and electric operations, new customer connection times, timeliness of gas leak repair, and KEMA storm recommendations/implementations. The Team provides process improvement and root cause analysis skills development to several PSE work teams and also provides rotation opportunities for PSE staff so that they gain experience with, and oversee, process improvement work. As noted below, these process improvements allow PSE to provide better service customers and also help to provide efficient, safe and reliable operation of PSE's system.

Q. Please provide an update on PSE's performance excellence efforts?

A. During 2008, PSE's Performance Excellence Team saw improvements in the following areas:

- 11% improvement in overall CCS customer satisfaction levels;
- 93% improvements in billing backlog since June 30, 2008 and reduced average age of back billing issues by 37% from June 30, 2008 to December 31, 2008;
- Nearly 200 storm operations, logistics, technology, and communication recommendations from KEMA have been put in place; and
- 85% improvement in timely gas leak repair compared to 2007

In response to Public Counsel Data Request No. 108 PSE provided "representative examples of the reports, studies and/or analyses prepared for the period January 2008 to date by or for the Performance Excellence Team that was formed by PSE in 2008." The response provided was designated as "confidential" by PSE

Finally, in response to Public Counsel Data Request No. 58 PSE lists examples of cost savings programs. This has been affixed to this testimony as Exhibit No.__(JRD-6). As reflected on the noted response, PSE has provided representative examples of cost savings programs implemented since 2007 in several areas that are designed to produce annual savings in 2009 and beyond.

Q. In an earlier answer you also stated that the price increases that PSE proposes to reflect in proforma adjustments for items such as wages, benefits, insurance costs and contractor costs could be expected to be offset to some degree by price changes for other materials being purchased. Please elaborate upon this claim.

A. For the first time in recent history there has been a significant decline in the price of a number of commodities. Most obvious to all of us is the dramatic fall in oil prices which have in turn reduced significantly the price being paid at the pumps for gasoline in 2009 versus what was experienced in the 2008 test period. Even with the run up in crude oil prices in recent weeks, current prices remain little more than half of crude oil price experienced during the peak of 2008 – or the mid-point of the historic test year.

A combination of the low input price of petroleum products, as well as weakened demand for any number of goods during the current economic climate, have combined to dramatically lower the price of other commodities. As reported within the September 2009 Producer Price Indexes new release issued by the Bureau of Labor Statistics, there has been widespread and significant reductions in the price of a number of finished goods categories, a number of categories of intermediate materials, supplies and components employed in the production of finished goods, as well as crude material inputs employed at the front end of the production process of finished goods. The September 2009 BLS News Release is attached in its entirety as Exhibit No.__(JRD-7) to this testimony. I would direct the reader's attention to page 17 of the noted exhibit wherein one can observe the following seasonally unadjusted percent price reductions from September 2008 through September 2009 for the following metal products:

Table I Examples of Commodity Price Deflation	
Product	**% *Reduction* in Price from Sept 2008 thru September 2009**
Steel mill products	32.8%
Primary nonferrous metals	26.0%
Aluminum mill shapes	17.2%
Copper and brass mill shapes	2.2%
Titanium mill shapes	6.9%
Nonferrous wire and cable	7.8%
Fabricated structural metal products	9.4%
Fabricated ferrous wire products	6.0%

Q. How can these significant price declines be expected to offset price increases for labor, benefits and other cost of service components for which PSE has proposed "price change" proforma adjustments?

A. The expectation is that at least certain materials and supplies expensed during the 2008 historic test year will cost less in 2009, as well as within the so-called rate year ending March 2011. I expect that the noted price declines could have a greater impact upon on the purchased price of items capitalized to plant in service, but as noted, I believe it can be expected that materials expensed during the 2008 test year will also be reduced prospectively. And clearly, gasoline and diesel purchased during the 2008 test year, and charged to operations and maintenance expense, are significantly less costly in 2009, and can also be expected to be significantly lower during the rate year ending March 2011.

Q. Please expand upon your comment that it would be reasonable to expect PSE to work harder within this particular economic environment to "trim costs and possibly defer programs or activities that do not have longer run safety or 'catch up' cost implications?"

A. Within supplemental testimony filed in late September 2009 PSE is now forecasting a 1.2% *decline* in electric sales for the twelve month rate period ending March 2011 from the normalized 2008 test year sales level. On its face, a 1.2% *decline* in sales may not appear that significant. However, such a decline is significant when one considers 1) within its original direct testimony filed just a few short months ago in May 2008 PSE was forecasting a 2.7% *increase* in rate year electric sales, and 2) year-over-year percentage increases in PSE electric sales have been between 1.0% and 3.0% for years 2003 through 2008.

The 1.2% decline in forecasted electric sales represents a very recent phenomena that stands in contrast to all recent history and all recent PSE forecasts for electric sales growth. Further, because production and transmission planning involves longer lead times to acquire or construct facilities, and often the commitment to significant fixed cost investment well in advance of the forecasted energy demand, the recent drop in forecasted electric energy sales will have the impact of spreading the fixed costs of recently acquired generating facilities over a smaller number of sales units – thus driving up the rates of PSE's retail electric rate payers in this proceeding. This outcome is evidenced by the fact that PSE's "Production Adjustment" included within PSE's original direct filing that was prepared with the assumed 2.7% increase in rate-year-over-test-year sales had the effect of reducing power supply costs. However, within PSE's supplemental direct filing wherein rate year sales are forecasted to decline by 1.2% from test year sales levels, the Company's revised "Production Adjustment" actually increases power supply costs. Again, this outcome occurs as rate year fixed production costs are being spread over a lower forecasted number of rate year sales units.

In this depressed economic environment, I believe it is reasonable to expect PSE to explore ways to cut costs and defer activities that do not have longer term safety implications. I would also emphasize that I am not advancing the position that activities and programs be deferred that can be expected to have punitive "catch up" cost implications. Specifically on this latter point, I am not advocating the deferment of maintenance activities for a period of time when such deferment can be expected to result in higher cost "catch up" maintenance programs. Rather, I am simply advocating that PSE be expected to work hard to prudently trim costs wherever reasonably possible to do so.

Q. Have companies selling goods and service in competitive environments been forced to cut costs in the current economic environment?

A. Very much so. The financial media is replete with references to cost cutting efforts undertaken in 2009 to avoid further earnings deterioration stemming from a significant decline in demands for goods and services. Just as it is reasonable to expect companies selling products in a competitive environment to cut costs in the face of significantly declining sales, similarly I believe it is reasonable to expect utilities to undertake efforts to trim costs when faced with declining sales.

Q. Are there fundamental differences between utilities selling essential utility services in designated service territories and other companies selling non-essential or perhaps less-essential goods and services in a competitive environment?

A. Yes. Utilities have an obligation to provide safe, non-discriminatory utility services within their service territories. As already previously noted, production and transmission function services require relatively long lead times in advance of the forecasted need for additional energy resources in order to acquire or construct facilities that require long periods to procure or construct. In addition to not being able to refuse to offer service, utilities cannot control demand by simply unilaterally and expeditiously raising prices as can companies selling unregulated goods and services in a competitive environment. Thus, there are acknowledged business differences between utilities providing essential regulated services and other companies providing unregulated goods and services in a competitive environment.

That having been stated, it is frequently suggested that regulation is intended to be a surrogate for competition. Just as competition drives unregulated firms to lower costs through achieving efficiencies, economies and strict cost containment, similarly regulators can be expected to put reasonable pressures on the utility companies which they regulate. With regard to relevance in this particular case, such reasonable pressure can materialize in the form of rejecting PSE-proposed price-change-only adjustments. More specifically, I believe it is reasonable that this Commission reject PSE's proforma adjustments that are made to reflect estimated or even in some cases actual known "price" changes occurring approximately two years beyond the end 2008 historic test year, endorsing in part the concept that it is reasonable to expect PSE to cut costs in light of its recently and significantly revised downward adjustment to forecasted electric sales.

Q. Has PSE initiated any actions responsive to the current economic conditions of the nation, and more specifically, its designated service territory?

A. As discussed with PSE witness Mr. Eric Markell's direct testimony, in light of "these difficult economic times" PSE froze officers' salaries in 2008. Further, while not actually cutting officers' annual incentive pay, PSE has removed all annual incentive pay for officers from the development of retail rates in this docket. These two noted events were both acknowledged within the Company's direct testimony filed originally on May 8, 2009 – well in advance of the recently revised downward sales forecast.

Additionally, with Public Counsel Data Request No. 434 PSE was asked to:

> Please provide the following regarding any steps *implemented* to curtail growth in costs, or to actually reduce costs, as a result of the revised 2008 load forecast or general economic conditions of PSE's service territory (such steps would include, without limitation, reductions in travel and training budgets, layoffs or hiring freezes, changes to incentive compensation targets or expected pay outs, reductions in company overtime, reduced use of outside contractors, restricted use of outside professional services, deferred maintenance, rebidding of material purchases, etc.):
>
> a. A detailed discussion/description of steps undertaken and/or activities curtailed.
> b. Any written management directives addressing cutbacks or program changes issued to divisions, departments, work groups, other subsets of affected employees or contractors.
> c. Estimates of cost reductions or savings, including all underlying calculations and other support for each such estimated reduction or cost containment program/activity.
> d. Implementation date of each step/activity.

The non-confidential portions of the Company's response have been attached to this testimony as Exhibit No. ___(JRD-8). Included in the Company's response to Public Counsel Data Request No. 434 are the references to the officers' pay freezes as well as the Company's voluntary removal of all annual incentive pay in the development of retail rates. However, the response also refers to leaving unfilled certain employees positions that have opened during 2009, limiting travel as much as practical, and "judiciously" using external consultants. The Company's testimony as well as the Company's response to the noted Public Counsel data request acknowledges a need to attempt to prudently or "judiciously" reduce or control costs in these difficult economic times.

Q. Please summarize why you believe a number of PSE's proposed proforma "price change" adjustments should be rejected as not meeting the "known and measurable" criteria established under WAC 480-07-510.

A. WAC 480-07-510 is clear; only proforma adjustments for known and measurable changes *that are not offset by other factors* are permitted. PSE has proposed a number of proforma adjustments that attempt to include estimates of certain price increases per some test year units of purchase (i.e., labor hours, benefits cost, insurance, etc.). In some instances the Company's proforma adjustments are based purely on estimates rather than any "known" changes. Some of the proforma adjustments attempt to measure price changes all the way through March 2011 – the end of the first twelve month period following implementation of new rates stemming from this docket.

Ongoing advances in achieving productivity and efficiency gains can be expected to mitigate or "offset" some of the "price change" adjustments proposed by PSE even during more normal economic times. In addition to gains in productivity that can be expected even in more robust economic times, there are additional "offsets" to PSE's proposed proforma "price change" adjustment for wages, benefits, insurance expense and certain contractor costs that should be considered during these unique and difficult economic conditions. Specifically, there is considerable evidence of *deflation* for a number of items for which PSE has not proposed "price change" adjustments. Most obviously, gasoline and diesel prices used in PSE's fleet transportation have declined since 2008. Additionally, as evidenced by the BLS report attached as Exhibit No. ___(JRD-7), prices have fallen precipitously for numerous metal commodities since 2008. The fall in the prices of oil products as well as numerous other commodities can be expected to result in reductions in prices paid for at least some materials purchased in 2008 that can be expected to offset at least part of the "price change" adjustments that PSE has calculated.

Further, it is reasonable to expect PSE to trim costs in light of its recently revised significant reduction in forecasted electric energy sales, just as a firm operating in a competitive environment would do in the face of declining sales. In sum, many of PSE's proforma adjustments should be rejected, at least in part, inasmuch as there can be expected to be "offsets" to the price-change calculation underlying PSE's proforma adjustments.

VIII. REVERSAL OF SPECIFIC ELEMENTS OF PSE'S PROPOSED PROFORMA ADJUSTMENTS THAT FAIL TO MEET THE "KNOWN AND MEASURABLE" STANDARD

A. Reversal of PSE's Proposed Electric and Gas Conservation Adjustments.

Q. Please describe your first adjustment to PSE's proposed level of adjusted net operating income.

A. On Schedule C-1 of both Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C) I reflect an adjustment that reverses the conservation element that the Company had "annualized" as a component of its general revenues adjustments for electric and gas operations (PSE Adjustment 4.02 for both electric and gas operations).

Q. Please state your understanding of the annualization of the conservation element of the Company's proforma revenue adjustment.

A. For both electric and gas operations, PSE has implemented WUTC-approved Demand Side Management (DSM) conservation measures. The conservation measures entail offering various incentives for customers to install equipment intended to curtail existing energy usage. The program costs of the various incentive measures are separately tracked and recovered from ratepayers through the Schedule 120 Electricity Conservation Service rider and Schedule 120 Gas Conservation Service tracker.

The implementation of the various conservation measures occurs throughout any given years. Further, it is my understanding that the various conservation programs are designed to achieve a targeted estimated average energy savings per customer for any given program. Thus, if a given electric conservation program had a targeted *annual* energy savings of 120 kWhs per customer, and the equipment were installed on the customer's premises in the middle of the year, PSE's ratemaking assumption is that one-half of the targeted annual 120 kWhs would have been saved in the last half of the year. Using the example described, PSE's conservation adjustments for electric operations "annualizes" the lost kWh sales and attendant margins by reducing test year sales for this customer by the 60 kWhs that the electric customer consumed in the first half of the 2008 test year that, *all other things held* *constant*, would not again occur in the first half of 2009. In other words, the concept behind the Company's conservation annualization adjustment is to reflect the energy savings or "lost energy sales" and attendant margins associated with conservation programs that were implemented by 2008 test year end as if those measures had been in effect throughout the entire historic 2008 test year rather than only for a portion of the test year.

Q. Are utility-sponsored DSM measures the only drivers of changes in electric KWH sales?

A. No. There are a multitude of factors that influence KWH sales levels. These include:

- The number of customers being served by the utility.
- The average usage per customer being served, which in turn can be impacted by:
    - Selected end-uses of the customer, such as heat, water heat, air conditioning and other appliance choices.
    - Home/building sizes and changes in building codes.
    - Economic conditions
    - Price elasticity
    - Replacement of equipment/appliances with newer and more efficient devices.
    - Additional appliances/devices such as extra televisions, refrigerators, freezers, etc.

- Customer-financed conservation measures.
- Utility-sponsored DSM measures.

Q. Why have you reversed the Company's proposed annualization of lost energy sales and attendant margins stemming from conservation measures implemented throughout the 2008 test year?

A. It is wholly unreasonable to select only one driver of changing sales volumes from this list of events that influence energy consumption, while making none of the other adjustments that would be needed to account for the other variables that influence sales. Further, assuming one were to conclude that conservation resulting from DSM programs was occurring exactly as estimated within PSE's electric conservation adjustment, such adjustment would still not be proper and would not meet the "known and measurable" criteria of WAC 480-07-510(3) inasmuch as it fails to consider "offsets" in the form of increasing usage per customer from other events and conditions that clearly appear to be occurring.

Q. What have you observed regarding average energy usage per customer with implementation of the various DSM measures?

A. First addressing the Company's electric conservation adjustment, one would expect to observe declining usage per average electric customer if the conservation programs were the only relevant factor impacting sales trends. However, there is clearly much more going on beyond conservation due to utility-sponsored DSM programs when actual usage per customer is analyzed. I note that overall electric weather normalized sales to the Residential and Commercial customer classes *increased* each year 2003 through 2008 in spite of PSE's increasing conservation expenditures. During this same time period the total number of Residential and Commercial customers also increased each year, which clearly contributed most significantly to the overall increase in electric energy sales to these classes of customers. That stated, even on a weather-normalized-usage-per-average-customer basis, there is not a compelling case to be made that overall the conservation measures have significantly reduced average usage per customer. In Exhibit No.__(JRD-9) I show 2003 through 2008 total weather normalized electric energy sales by revenue class, average number of customers by revenue class, and average weather normalized usage per customer by revenue class. For convenience, I summarize within the table below the more relevant data of weather normalized average usage per Residential and Commercial electric customer for years 2003 through 2008:

Table II
Weather Normalized Annual Average
kWh Usage per Customer
Years 2003 through 2008

Year	Residential	Commercial
2003	11,550	75,800
2004	11,518	77,724
2005	11,581	77,372
2006	11,704	79,185
2007	11,572	79,752
2008	11,609	80,217

Source for data in table: PSE Response to Public Counsel Data Request No. 306, Attachment A

As can be observed from the data on the chart above as well as Exhibit No.__(JRD-9), weather normalized usage per Residential and Commercial customer has remained relatively flat, if not slightly increasing over time, notwithstanding the electric conservation measures authorized by the Commission. In light of the fact that 1) overall electric energy sales continue to increase, and 2) electric usage per customer is remaining relatively flat, I believe it is inappropriate to annualize just the estimated impact of usage per customer expected from the conservation measures.

Q. Does the data indicate that the electric conservation measures are failing?

A. No. The fundamental problem with the Company's adjustment is its unreasonable focus upon only the utility-sponsored DSM impacts upon sales, while completely ignoring all other sales-impacting variables and the fact that overall electric sales are <u>not</u> declining. While I have not studied what elements or events are influencing PSE's energy usage per customer, it would not surprise me to find that increases in usage per customers resulting from more/larger high definition televisions, more computers – and more computers staying on close to 24/7, as well as simply the continuing purchase and usage of additional electrical appliances has caused electric usage per customer to remain relatively flat *notwithstanding some kWh savings successes with electric conservation programs.* In effect, I believe the Company's conservation adjustment attempts to annualize one element of usage per customer while ignoring equal and offsetting elements of usage per customer that appear – for whatever undefined reasons – to be increasing.

Q. Has electric usage per customer remained flat through 2009 – consistent with the yearly trends shown in the table above?

A. In response to Public Counsel Data Request No. 431 PSE provided total weather normalized electric sales as well as weather normalized usage per residential customer by month for the period January 2007 through July 2009. The data in that response revealed that total weather normalized usage as well as weather normalized usage per customer, remained fairly flat for the first three to four months of 2009 before beginning to decline in a more observable fashion thereafter.

Q. In light of the recent declines in overall electric energy sales as well as the decline in the weather normalized usage per customer, are you persuaded to reconsider your position on the Company's proposal to annualize electric conservation measures?

A. No. I am very much aware that within supplemental direct testimony filed on September 28, 2009 PSE significantly lowered its electric sales forecast. According to the supplemental direct testimony of Mr. Donald Gaines, PSE specifically calculates and includes within its sales forecast the estimates of load loss resulting from conservation efforts. However, the dramatic decline in forecasted sales appears to be primarily a product of other updated forecasted economic data that is used by PSE to prepare the Company's long range forecast. The input data used in preparing the Company's load forecast that I am referring to include a forecasted regional Consumer Price Index CPI, unemployment rate, total employment, construction employment, manufacturing employment, income per capital, and population in households.[2]

[2] Per Company response to Public Counsel Data Request No. 427.

I am informed that Public Counsel does not have the resources to analyze the Company's new, significantly reduced, electric load forecast developed with a complex econometric forecast. While Public Counsel witnesses are not proposing any adjustments to PSE's rate year load forecast, which in turn affects the "Production Adjustment" in this docket, it should be emphasized that no one from the Public Counsel is specifically endorsing the revised electric load forecast.

It should also be emphasized that, to the extent the Company's various conservation measures have been more fully reflected within the Company's revised load forecast included within the supplemental direct testimony filed in late September 2009, the impact of such conservation efforts will result in higher production costs being incorporated into rates being developed in this proceeding. In other words, as a result of production function costs developed for the rate year ending March 31, 2011 being effectively spread over a forecasted number of electric sales units that is *lower* than test year normalized electric sales, rates being designed within this docket will be increased over what would occur if a stricter historic test year cut off had been employed. As a result of the fact that Public Counsel witnesses are not proposing any adjustments to the Company's new downwardly-revised sales forecast that purportedly captures the impact of specific conservation measures it might be concluded that the I am indirectly accepting a portion of the Company's "conservation adjustment." Arguably failure to adjust the Company's new load forecast and rejection of the Company's "conservation adjustments" results in an inconsistency. In response I would merely emphasize that 1) the fact that the Public

Counsel witnesses have not addressed the Company's load forecast is as a result of resource constraints and does not constitute full endorsement of the downwardly revised forecast, and 2) as a result of the fact that Public Counsel witnesses have not adjusted the Company's load forecast, my testimony indirectly has accepted an element of the Company's electric conservation adjustment albeit not to the full extent requested within Company Adjustment 4.02 for electric operations.

Q. Thus far you have discussed loads for PSE's electric operations. What growth has PSE experienced for its gas operations?

A. On Exhibit No.__(JRD-10) I have provided five years of weather normalized gas sales by revenue class, average number of gas customers by revenue class, as well as weather normalized usage per average gas customer – similar to what was provided for electric operations on Exhibit No.__(JRD-9). Again for convenience, I summarize within the table below the more relevant data of weather normalized average usage per residential and commercial gas customer for years 2003 through 2008:

Table III
Weather Normalized Annual Average
Therm Usage per Gas Customer
Years 2003 through 2008

Year	Residential	Commercial
2003	886.00	4,581.02
2004	865.60	4,509.21
2005	848.71	4,515.20
2006	830.44	4,596.24
2007	800.38	4,504.99
2008	820.21	4,600.81

Source for data in table: PSE Response to Public Counsel Data Request No. 307, Attachment A

As can be observed from the data on the chart above, weather normalized usage per Residential customer had been declining consistently between 2003 and 2007 before moving up between calendar years 2007 and 2008. Weather normalized usage per Commercial customer has fluctuated slightly over the past five years, but has generally remained flat.

Q. Are you also proposing to reject the gas conservation element of PSE's revenue adjustment?

A. Yes. Based upon the consistent downward trend in usage per Residential customer for the years 2003 through 2008, it might appear that the Company's conservation efforts are not being offset by growth in usage per customer from other events – as was more prevalent when viewing electric operations' Residential usage per customer. However, the trend of declining Residential usage per customer reversed itself in 2008. Further, it can be observed from the table above that there is no discernable downward trend in usage per Commercial gas customer. In light of these facts, as well as the fact that overall gas sales increased by close to two percent per year throughout the 2003 through 2008 time period, I am recommending rejection of the Company's conservation element of its revenue adjustment as summarized on page 9.02 of PSE Exhibit No. __(MJS-9).

B. Wage Costs – Electric and Gas Operations Adjustment.

Q. Please continue by discussing your second specific adjustment wherein you have reversed in whole or in part a PSE-proposed proforma adjustment.

A. First, as reflected on Schedule C-2 of Exhibit No. __(JRD-2C) and Exhibit No. __(JRD-3C), I am proposing to reverse a portion of PSE's proposed proforma wage increase adjustment as reflected on Company Exhibit No. __(JHS-10), Adjustment 10.25, page 31 for electric operations, and Company Exhibit No. ___(MJS-9), page 9.18 for PSE gas operations. As discussed within the testimony of John Story, PSE has prepared its wage proforma adjustments with the following assumptions:

- International Brotherhood of Electrical Workers union employees
  - Contractual 3.25% increase effective April 1, 2008
  - Contractual 3.25% increase effective April 1, 2009
  - Contractual 3.00% increase effective January 1, 2009
  - *Estimated* 3.00% increase effective January 1, 2010
- United Association of Plumbers and Pipefitters (UA) union employees
  - Contractual 3.00% increase effective October 1, 2008
  - Contractual 3.00% increase effective October 1, 2009
  - *Estimated* 3.00% increase effective October 1, 2010
- Non-union wage increases
  - Actual average 3.50% increase effective March 1, 2008
  - Actual average 3.5% increase effective March 1, 2009
  - *Estimated* average 3.50% increase effective March 1, 2010

In preparing the wage adjustment reflected on Schedule C-2, I have rejected the IBEW 3.00% wage increase *estimated* to be effective in January 1, 2010, the actual UA wage increase that became effective October 1, 2009, as well as the UA 3.00%

wage increase *estimated* to be effective on October 1, 2010. Further, I have rejected all non-union wage increases *estimated* to become effective following the March 1, 2009 actual increase granted. In addition to rejecting a number of the various noted wage increases included within the Company's proforma adjustment, I have also included the roll-out impact of those reversals upon related employer's payroll taxes and the cost of the 401-K Investment Plan that had been included as part of PSE's proforma adjustments.

Q. Why have you rejected the various PSE-proposed estimated, and in some instances, actual wage increases included in the development of PSE's adjusted test year cost of service?

A. First, as indicated, most of the increases rejected were "estimated" increases included within the Company's proforma wage adjustment. These should be rejected by definition as clearly such estimates are not "known and measurable." However, I am also recommending that the UA 3.00% increase that became effective on October 1, 2009 pursuant to a union contract also be rejected as a "known and measurable" change. This UA contractual increase became effective nine months beyond the end of the test year and fifteen months beyond the mid-point of the 2008 test year. As set forth in some detail in the previous section of testimony, I believe that "offsets" to this perhaps "known" price change exists in the forms of productivity increases, deflation in the cost of other materials that are also components of PSE's cost of service, as well as an expectation that PSE should strive to cut costs within this economic downturn.

Q. You have accepted actual wage increases granted through March 2009. Aren't the noted "offsets" you discuss applicable to the March 2009 increases that you have accepted?

A. I believe an argument could be made that these post- test year wage increases authorized in March 2009 should also be rejected in whole or in part given the "offsets" noted, and the Commission may in fact choose to make such finding. However, I have somewhat conservatively included such post-test year wage increases actually granted through March 2009 in deference to that fact that these wage increases granted were in close proximity to the end of the historic test year. Further, the noted offsets will, in some instances, likely take a few months to materialize.

C. Flex Credit Increases – Electric and Gas Operations Adjustment.

Q. Please discuss your next adjustment wherein you are rejecting at least a portion of a PSE-proposed price-change proforma adjustment.

A. The adjustment posted on Schedule C-3 reverses the PSE-proposed reflection of an estimated 8.00% increase in 2010 Flex Credit Plan employer contribution payments. PSE reflected the 8.00% estimated 2010 Flex Credit Plan increase as an element of the adjustments found on Exhibit No. __(JHS-10), Adjustment 10.27, page 33 for electric operations and on Exhibit No. __(MJS-9), page 9.20 for gas operations.

Q. Has the *actual* 2010 Flex Credit Plan contribution been established subsequent to the filing of the Company's original direct testimony?

A. Yes. In response to Public Counsel Data Request No. 319 PSE indicated that the actual 2010 Flex Credit contribution would increase by 4.75% over the 2009 actual Flex Credit contribution rates rather than the originally predicted 8.0% increase included within the Company's filing.

Q. If the 2010 "actual" Flex Credit contribution is now "known" to be 4.75% rather than the originally estimated 8.0% amount, why do you not simply reflect the now "known" 2010 increase?

A. For the same reason that I have rejected reflection of the October 1, 2009 union contract wage increase for UA workers, I am similarly proposing to reject a January 1, 2010 "known" Flex Credit contribution increase. In short, it is inequitable to reflect such a price change adjustment occurring so far beyond the end of the historic test year when there are expected "offsets" in the form of efficiency gains, deflation for other cost of service components, as well as expected cost containment efforts on behalf of PSE in the current economic environment.

Q. Have you made any other adjustments to the Company's proforma Flex Credit adjustment beyond eliminating the estimated 2010 increase?

A. Yes. In response to Public Counsel Data Request No. 319 PSE identified a problem with the average employee count utilized within its proforma Flex Credit electric and gas operations proforma adjustments. Accordingly, in addition to eliminating the 2010 estimated Flex Credit increase, my adjustments shown on Schedule C-3 also reflect the average employee count correction that was identified by PSE within its response to Public Counsel Data Request No. 319.

D. Property Insurance Premiums – Electric and Gas Operations Adjustment.

Q. Please describe your next adjustment addressing PSE's proposal to reflect estimated price increases.

A. Within PSE's electric operations' Adjustment 10.23 found on Exhibit No. __(JHS-10) and within PSE's gas operations' Adjustment 9.16 found on Exhibit No. __(MJS-9) the Company includes an estimate of property insurance premium increases expected to go into effect for portions of 2010 and 2011. Within his direct testimony PSE witness Mr. John Story indicates the Company's intention to update estimated insurance premium increases reflected within its original filing with actual premium rates as they become known.

On Schedule C-4 I eliminate the 2010 estimated property insurance increases included within PSE's proforma electric and gas expense adjustments. Further, I oppose any PSE proposal to update the estimates included within PSE's original insurance adjustment with actual premiums that may be become known throughout this proceeding. As previously stated, I believe it is inappropriate reflect increases occurring so far beyond the end of the historic test year for which there are probable offsets.

E. Transmission and Distribution Contractor Increases – Electric and Gas Operations Adjustment.

Q. Please describe your last price-change adjustment.

A. As an element of its electric operations Adjustment 10.14 and its gas operations Adjustment 9.09 PSE has incorporated changes in prices expected to be paid for transmission and distribution contractor charges. In addition to the previous "offset" arguments with regard to wages, benefits and insurance proforma levels discussed above, I note that this contract is being renegotiated, and therefore the ultimate price to be agreed upon, as well as the level of services required, are not known. Accordingly, the adjustment I reflect on Schedule C-5 of Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C) is made to reverse the "Service Contract Baseline Charges" element of PSE's adjustments found on gas operations Exhibit No.__(MJS-9), page 9.09 and electric operations Exhibit No. __(JHS-10), Adjustment No. 10.14.

IX. OTHER INCOME STATEMENT ADJUSTMENTS

A. Normalize Injuries and Damages Expense – Electric and Gas Operations Adjustment.

Q. Please discuss your next adjustment to operating expense.

A. The adjustments reflected on electric and gas Schedules C-6 are proposed to reflect a normalized level of Injuries and Damages Expense calculated utilizing a three-year historical average of accruals plus payments in excess of accruals recorded. The concept of utilizing a multi-year average of historical experience to normalize Injuries and Damages Expense is comparable to PSE's employment of multi-year averages to normalize bad debts expense and pension expense.

Q. Why is it appropriate to normalize Injuries and Damages Expense?

A. A multi-year review of all operations and maintenance expenses by FERC account revealed a somewhat significant spike to FERC Account No.926 (Injuries and Damages Expense) during the historic test year – particularly for PSE electric operations. Further discovery and analysis regarding Account 926 revealed the fact that a considerably higher level of expense for accruals and payments for Injuries and Damages claims occurred for electric operations in 2008. Specifically, the total Injuries and Damages Expense accruals for claims, and payments of claims in excess of accrual amounts, for electric and gas operations for the last three years were:

Year	Electric Operations Accruals & Payments in Excess of Accruals	Gas Operations Accruals & Payments in Excess of Accruals
2006	$2,475,968	$465,804
2007	2,205,721	473,145
2008 (test year)	3,847,528	769,674

In light of the significantly higher level of Injuries and Damages Expense incurred in 2008 for accruals and claims payments, I have normalized this expense by reflecting a three year average of such payments and accruals.

B. Qualified Pension Cost – Electric and Gas Operations Adjustment.

Q. Please discuss your next adjustment to PSE operating expense.

A. On Schedule C-7 of Exhibit No.__(JRD-2C and Exhibit No.__(JRD-3C) I reflect an adjustment to pension expense for PSE's qualified retirement plan which I have calculated based upon a four year average of contributions for the four calendar years ending December 2008. This calculation differs from the Company's calculation in that PSE utilized a four-year average of pension contributions that included *projected* pension contributions through the period ending September 30, 2009.

Q. In your experience, is it unusual for regulators to set pension expense for rate setting purposes on the basis of pension *contributions* rather than upon *actuarially determined* pension costs?

A. Yes. The Employee Retirement Income Security Act of 1974 (ERISA) and Internal Revenue Code (IRC) provisions dictate minimum and maximum *contributions*, respectively, that must be adhered to so that a defined benefits retirement plan can meet required standards to remain "qualified." Specifically, it is very desirable that defined benefits pension plans be tax efficient by meeting certain requirements that allow them to be "qualified" plans. With a "qualified" plan, contributions are tax deductible for the employer while the earnings on the external trust are never taxable to the employer (the distributions to retirees, which actually consist of a combination of employer contributions and earnings on funds invested in the external trust will be taxable to the employee, but the earnings from the trust are never taxable to the employer so long as the plan remains "qualified"). Thus, it is very desirable to make sure a defined benefits plan remains "qualified" and correspondingly tax efficient. Failure to make minimum funding contributions could lead to the termination of the plan, while making contributions in excess of the maximum allowed can result in the assessment of excise taxes on contributions made above the maximum tax deductible limitation. Importantly, the range for permissible contributions between the ERISA minimum and IRC maximum is quite broad – providing companies much latitude as to how much contributions should be and when contributions can be made for a given plan year.

Q. Does the amount that companies *contribute* to qualified pension trusts typically equal the actuarially-determined pension *cost* that companies reflect for financial statement reporting purposes?

A. While they can be the same, often they are not. I think that it is noteworthy that actuarially-determined pension costs can actually be negative when fund return performance and other actuarial events combine in a manner so as to "beat" previous assumptions used in the pension cost estimation process. While actuarially-determined pension costs can be negative, I am not aware of any method by which pension "contributions" might become negative – or whereby a refund from the pension trust might be accomplished.

Q. What has PSE's actuarially-determined pension costs and pension contributions been for recent years?

A. First, as a matter of clarification, I would explain that pension *expense* is a subset of the Company's total pension cost. Pension benefits accrue for employees whether they are performing operations/maintenance functions or construction functions. Thus, pension *costs* are accrued on all payroll costs – including payroll costs that are capitalized. Pension costs attributable to construction payroll are capitalized to construction projects just as the payroll itself is capitalized. Pension *expense* refers to that portion of total pension costs that is attributable to payroll charged to operations and maintenance *expense*. I make this clarification inasmuch as the adjustment I pose is limited to pension *expense*, but for comparability, I will often be referring to PSE's total pension *cost* and to PSE's total pension *contributions*. With that clarification, PSE's total company pension *costs* and *contributions* for recent years has been as follows:

Table IV
PSE Total Company Pension Costs and Contributions
For the Qualified Retirement Plan

Year	Pension Costs	Pension Contributions
2004	($8,011,470)	-0-
2005	(2,569,627)	-0-
2006	1,043,496	-0-
2007	2,829,391	-0-
2008	(407,199)	$24,500,000
Total – all years	($7,115,409)	$24,000,000

Source: Public Counsel Data Request No 13 & Thomas Hunt Direct Testimony

Q. Do you know why PSE contributed such a large amount in 2008?

A. As explained by PSE's witness Mr. Thomas Hunt, the large contribution made in 2008 was responsive to the decline in the market value of the qualified trust fund which occurred in 2008.

Q. You stated that when calculating its pension expense adjustment, PSE utilized a four-year average of contributions that included anticipated contributions through September 2009. Did PSE, in fact, make the pension contributions to the qualified trust by September 30, 2009 that it was forecasting when it prepared its proforma pension adjustment?

A. PSE predicted when preparing its proforma pension adjustment that it would make $18,400,000 of pension contributions by September 30, 2009. According to PSE's Securities and Exchange Commission Form 10-Q filing for the nine months ending

September 30, 2009, PSE made pension contributions to its qualified pension plan totaling $18.0 million.

Q. If PSE did, in fact, make $18.0 million of the predicted $18.4 million contributions by September 30, 2009, why have you not included such contributions within your four-year average used to develop your proforma qualified pension cost adjustment?

A. First, according to the Company's response to Public Counsel Data Request No. 14, PSE did not use a similar post-test year period to pick up actual or projected increases in pension contributions in its last two rate cases. In the response the Company indicated that there were no projected contributions in the post-test year period – with the implication being that it made no difference whether or not a post-test year period was included within the four-year average contribution calculation. That said, the fact remains, the four-year period used by the Company in this docket to calculate average pension contributions was changed from prior case calculations.

Second, **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

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Finally, as previously noted, I have seldom observed a regulatory jurisdiction setting rates based upon pension *contributions*. I do not know the history of this treatment for PSE, but I am aware that Avista's gas and electric operations' cost of service is based upon actuarially-determined pension costs. My experience has been that actuarially-determined pension cost can also be somewhat volatile – particularly when the equities markets rise or fall rather sharply over a short period of time. However, at least the assumptions employed are expected to remain fairly constant over time and, unlike the timing and amount of pension contributions to be made, there is less subjectivity in the actuarial process. At least for the last several years it would appear that employment of a four-year average of pension contributions for setting PSE's retail rates has yielded a higher revenue requirement in the rate development process than what the Company recognized as expense on its financial statements pursuant to actuarial studies.

In response to Public Counsel Data Request No. 15 PSE provided the following projections:

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In summary, again I do not know the history of why PSE's pension cost is based upon historical contributions which for many years now, on average, have resulted in higher amounts being collected in rates than has been recorded as pension expense on the Company's financial statements. If that process is to be continued, for reasons stated, I urge adoption of an average calculated based upon contributions for the four calendar years which end in December 2008 rather than include actual/forecasted contributions through September 2009.

Q. Have you calculated the proforma level of pension expense that should be considered in the development of PSE's rates if pension expense were to be determined on the basis of actuarially determined pension cost?

A. Yes. On the table below I show the proforma level of pension expense that would result if pension expense were to be established by considering actuarially determined pension cost. I have actually shown the proforma level under two assumptions. In the first and second columns I show the proforma level of pension expense for electric and gas operations, respectively, if the proforma level of expense is developed by considering a four-year historical average of pension cost as PSE undertook for calculating proforma SERP expense. In the third and fourth columns I show the proforma level of pension expense for electric and gas operations if one considers the 2009 proforma level of actuarially determined pension cost that was calculating by annualizing the level of pension costs recorded for the nine months ending September 30, 2009.

Table VI Proforma Pension Expense Calculated by Considering Actuarially Determined Pension Cost			
Calculated with 4-Year Historical Average		Calculated with 2009 Proforma Level of Pension Cost	
Electric Operations	Gas Operations	Electric Operations	Gas Operation
$86,412	$46,653	$1,256,495	$678,361

C. Supplemental Executive Retirement Plan (SERP).

Q. Please describe your next adjustment to PSE's electric and gas operations' adjusted test year expense levels.

A. The adjustments found on Schedule C-8 of Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C) reflect the removal of all Supplemental Executive Retirement Plan (SERP) expense.

Q. What is SERP?

A. In an earlier section of testimony I briefly described how the Internal Revenue Code permitted the earnings on trust funds for "qualified" retirement plans to accrue tax free to the trust or the employer who makes the contributions to the external pension trust. The ability of a "qualified" pension plan to accept tax-deductible contributions and allow earnings of the trust to accrue tax free enables a "qualified" pension plan to be very tax efficient. In order for a plan to be "qualified" it must meet a number of tests. One of the tests includes discrimination. In order for a plan to be "qualified" and therefore tax efficient, benefits must be proportionately equal in assignment to all participants in order to prevent excessive weighting in favor of higher paid employers. Neither the Internal Revenue Code nor any other taxing authority or regulatory body that I am aware of can prohibit a company from offering discriminatory pension plans that favor highly compensated employees. However, failing the discrimination test makes the offering of such "non-qualified" SERP less tax efficient and therefore more expensive to offer.

Q. Why are you recommending disallowance of all SERP expense?

A. I am recommending that the SERP costs be eliminated given that: (1) such highly paid employees are already entitled to "normal" retirement benefits pursuant to the "qualified" retirement plan offered, (2) the plan is expensive to offer given that it is not tax efficient like the qualified retirement plan, and (3) the fact that other Washington utilities are either no longer offering the benefit or do not seek rate recovery of such costs.

In addition I believe it is reasonable to question 1) whether it is necessary to offer such plans to a select group of already highly compensated employees, and 2) whether it is reasonable to request ratepayers to pay the cost of such "supplemental" retirement plans – which provide additional retirement benefits above and beyond that which are available to the highly compensated employees through the "qualified" retirement plan. On this latter question, I again emphasize that not only does the plan provide more generous benefits than is permitted with "qualified" plans, but additionally, these plans will be more expensive to offer given that they are not tax efficient.

In the last PSE rate case, Public Counsel proposed a similar adjustment. While the case settled prior to hearings, the Company nonetheless filed rebuttal testimony on the subject of SERP stating that this employee benefit was necessary for PSE in order to be competitive in the market place. That same study has been provided within this docket as a response to Public Counsel Data Request No. 524. A similar updated study was provided in response to Public Counsel Data Request No. 525. **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXX

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On this latter point, it is notable that not all Washington regulated utilities pass the cost of SERP plans on to ratepayers, and further it appears that at least one Washington utility has chosen to discontinue the plan going forward.

Q. What is the cost of PSE's SERP relative to the cost of the qualified retirement plan?

A. The amount of qualified retirement plan expense and SERP expense that PSE seeks to recover in rates is summarized on the table below:

Table VII
PSE's Proposed Level of Rate Recovery for Retirement Plans

Utility Operation	Qualified Plan	SERP	Total
Electric Operations	$3,693,495	$2,139,086	$5,832,581
Gas Operations	1,994,055	1,154,856	3,148,911
All Utility Operations	5,687,550	3,293,942	8,981,492

Source: Exhibit No.__(JHS-10), Adjustment No. 10.24 and Exhibit No.__(MJS-9), Page 9.17

As can be calculated from amounts noted in the table above, SERP expense represents 36% of total retirement plan costs being sought for recovery in rates by

PSE in this docket ($3,293,942 total SERP expense divided by $8,981,492 of total retirement plan costs equals 36%).

Q. How many employees are covered by the qualified retirement plan?

A. According to PSE's 2009 actuarial report for the qualified retirement plan, there were **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXX**[End Confidential]**[3]

Q. How many employees are covered by the SERP?

A. According to PSE's 2009 actuarial report for the SERP, there were [**Begin Confidential]**XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.[4]

Q. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXX?

A. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

[3] Per Confidential Response to Public Counsel Data Request No. 12.
[4] Per Confidential Response to Public Counsel Data Request No. 12.

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Q. What Washington regulated utility are you aware of that does not offer SERP?

A. Pacific Power & Light, a subsidiary of PacifiCorp, closed its SERP plan to new participants in 2006 and currently has only one active member in the plan[5]. Cascade Natural Gas amended its Executive Supplemental Retirement Income Plan effective October 1, 2003 so as to prohibit new participants from being added and allowing no additional benefits to accrue for then-existing participants. While not a Washington utility, I am also aware by virtue of some work I undertook in Nevada that Sierra Pacific Resources (parent of Nevada Power Company and Sierra Pacific Power Company) ceased offering its SERP plan to new participants effective in 2008.

Q. Please explain your earlier comments that "even when offered, the cost of SERP is not always passed on to Washington ratepayers."

A. I am aware that Avista Corporation offers a SERP. However, Avista records the SERP cost below-the-line and does not seek recovery of this cost from ratepayers[6]

Q. Does PSE's proposed electric and gas rate base amounts include components related to its SERP?

A. Yes. As an element of working capital, PSE includes a significant liability on its balance sheet related to past accruals for SERP costs. The SERP liability account used in the working capital calculation is offset in part by a related accumulated deferred income tax balance. However, the net of the SERP liability account and

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[5] As reported within PacifiCorp's 2008Form 10-K report to the Securities and Exchange Commission.
[6] Transcript from Docket Nos. UE-090134 and UG-090134, p. 597, lines 10-11.

related accumulated deferred income tax balance results in an approximate $29 million total company reduction to rate base.

Q. Are you proposing to increase electric and gas operations' rate base by a proportionate share of the total company net reduction to rate base related to PSE's SERP that PSE used in the development of its pro forma electric and gas rate base?

A. No. The accrued SERP liability, net of related accumulated deferred income taxes, represents a cost free source of capital to PSE that has been funded by ratepayers and/or represents a portion of capitalized SERP that is included in PSE's plant in service which required no immediate out-of-pocket investment to PSE. As such, the SERP liability, net of accumulated deferred income taxes, should continue to be used in the development of working capital for rate base consideration. If the Commission accepts Public Counsel's adjustment for SERP expense, but PSE nonetheless continues the SERP program, in future rate cases it will become necessary to allocate the SERP liability between ratepayers and shareholders for rate base development. However, in this case, no allocation of the SERP liability is equitable or necessary

Q. Please summarize why you are proposing to eliminate the cost of the Company's SERP.

A. The plan offers benefits to only a select number of highly compensated employees – above and beyond the normal retirement benefits offered via the Company's "qualified" plan. The cost of the plan is quite expensive inasmuch as it is not tax efficient like the Company's "qualified" retirement plan. Further, a number of other regulated Washington utilities either have ceased offering the benefit or are not seeking recovery from ratepayers. Finally, I would simply point out that particularly in these difficult economic times, when approximately 10% of Washington's population is unemployed, it reasonable or fair to ask captive ratepayers to pay significant extra costs to ensure that a select, limited number of highly compensated employees can receive retirement benefits in excess of what the general population of PSE employees will receive.

D. Directors and Officers' Liability Insurance – Electric and Gas Operations Adjustment.

Q. Please discuss your next adjustment to test year operating expense that affects both electric and gas operations.

A. My next adjustment reflected on Schedule C-9 of Exhibit No. __(JRD-2C) and Exhibit No.__(JRD-3) is made to reflect an equal sharing of the cost of Directors and Officers' (D&O) liability insurance costs between ratepayers and shareholders. Inasmuch as both parties benefit from such insurance coverage, it is reasonable that its cost be shared equally by both parties.

Q. Why do companies maintain D&O insurance coverage?

A. Such coverage is acquired to pay damages to parties that may have been economically harmed as a result of some decision – or action or inaction – of a company's directors and officers. While I suppose the coverage could be payable to any "aggrieved party," I can only recall its coverage coming into play to pay claims related to shareholder lawsuits. Without its coverage, the ability to retain competent directors and officers would be diminished inasmuch a director's or officer's exposure to personal liability from making decisions on behalf of a company could far outweigh any compensation to be derived from taking on the decision making responsibility.

Q. Why are you recommending that the cost of D&O insurance be split equally between shareholders and ratepayers?

A. Because both groups benefit from the coverage. As already noted, D&O insurance facilitates the retention of directors and officers. Accordingly, ratepayers benefit from the coverage it provides in the facilitation of retaining competent management.

However, if payments were to be made by the insurance carrier, such payments would most likely be made to aggrieved shareholders for directors' and officers' actions that have caused them some kind of economic harm. Therefore, such payments provide a return to shareholders, although the payout may not necessarily be made to all shareholders. It can also be concluded that the insurance coverage reduces in some fashion the level of risk that shareholders are exposed to by virtue of poor management decisions by directors and officer.

Beyond the fact that the beneficiaries of such payoffs would most likely be shareholders, it is somewhat difficult to envision that whatever "economic harm" that was determined to be attributable to the directors and officers' lack of good judgment would, in some fashion, manifest itself as a transaction recorded above-the-line that would be eligible for recovery from ratepayers. In other words, it is likely that any payoffs made to shareholders for the unreasonable or imprudent actions or decisions of its officers would relate to the cost of an event that regulators would find *unreasonable* to charge to ratepayers. Stated more succinctly, at least to some degree it can be expected that the coverage is acquired to pay for the imprudent actions of the utility's officers that would never be charged to ratepayers.

In sum, I reiterate that both ratepayers and shareholders benefit from D&O insurance coverage, and therefore, I believe it is reasonable that the cost of the coverage be split evenly between both parties.

E. Incentive Compensation.

Q. Have you reviewed the Company's annual incentive compensation program?

A. I did a preliminary review of this issue. Based upon that review, I have concerns about whether the program is unduly weighted toward shareholder benefit. Specifically, incentive payouts are function of achieving two threshold requirements – meeting targeted earnings per share and meeting a stated number of Service Quality Index (SQI) goals. Achieving fairly mediocre SQI goals can be still result in significant incentive payouts if the earnings per share achieved results in the application of a high multiplier to the SQI weighting. That stated, I am aware of this Commission's earlier review of this program and its general acceptance for rate recovery of the program. I also note that the Company is not seeking recovery of this item for its executives in this case. Due to Commission precedent on this issue, the Company's voluntary removal of a portion of the costs in this case, as well as resource limitations, I did not develop an adjustment for this case. That stated, I believe that further review in a future proceeding may be appropriate.

F. Property Tax Expense – Electric and Gas Operations.

Q. Please discuss your next operating expense adjustment.

A. On Schedule C-10 of Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C) I reflect an adjustment to property tax expense. The adjustment for electric operations is a significant downward adjustment to the Company's proforma level of property tax expense ($5,819,657) while the adjustment for gas operations is a slight increase to the Company's proforma level of gas operations property tax expense ($64,584). The cause for the significant reduction in electric operations' proforma property tax expense is the fact that the overall value for all electric operating property at January 1, 2009 agreed to by the Department of Revenue in July of 2009 was substantially lower than the value established by the Department of Revenue for electric property owned at January 1, 2008. Specifically, notwithstanding the fact that PSE added transmission and distribution property and acquired the Sumas and Mint Farm generating units between January 1, 2008 and January 1, 2009, the value agreed to by the Department of Revenue for Washington electric properties fell from $2,627,512,000 for January 1, 2008 assessed property to $2,191,761,000 for January 1, 2009 assessed property.[7] Thus, notwithstanding an increase to electric plant in service between January 1, 2008 and January 1, 2009, PSE's electric property valuation declined by over 16.0%. I would also note that the January 1, 2009

[7] January 1, 2008 value shown in PSE electric workpapers for Adjustment No. 14; January 1, 2009 value provided in PSE's Supplemental Response to Public Counsel Data Request No. 27.

property valuation agreed to by the Department of Revenue in July 2009 was not available to PSE at the time it prepared its filing.

Q. Have you adjusted other elements of PSE's proforma property tax calculation?

A. No. That stated, I would note that the assumed levy rate which PSE utilized in its property tax calculation, which I have also accepted, are considerably higher than the actual levy rates applied to January 1, 2008 property values for purposes of calculating actual 2008 property taxes payable. Specifically, on the table below I show recent actual property tax levy rates as well as the property tax rate that PSE used – and which I accepted – for purposes of calculating proforma electric and gas property tax expense.

Table VIII
Recent Actual and Rate Case Proforma
Property Tax Levy Rates

	State Jurisdiction and Utility Operation		
Year	Washington - Electric	Montana- Electric	Washington - Gas
2006 – Actual	10.43	292.73	11.45
2007 – Actual	9.66	290.22	9.83
2008 –Actual	9.45	291.81	9.44
Rate Case Proforma	**10.085**	**291.81**	**10.156**

Source: 2006 and 2007 Actuals – Supplemental Response to Public Counsel Data Request No. 27; 2008 Actuals – Response to Public Counsel Data Request No. 471; Rate Case Proforma – PSE workpaper support for its proforma electric Adjustment No. 14 and its proforma gas Adjustment No. 10

Q. Why have you not simply used now-known 2008 actual property tax rates to calculate proforma property tax expense?

A. I understand that levy rates are to some extent a product of what the various taxing authorities require to operate. As such, and as demonstrated on the table above, the rates assessed can vary over time. Further, I understand that because of the fluctuation in levy rates from year to year, PSE uses some form of averaging technique to accrue for property tax expense in any given calendar year inasmuch as the "actual" levy rate will not be known until March of the year following any given calendar year for which property tax expense is being accrued. So, for instance, actual levy rates for property assessed on January 1, 2009 will not be known until March of 2010 – well after the time that the record will be closed in this docket.

An argument could be made that PSE's proforma property tax expense should be calculated using now-known 2008 levy rates since Washington levy rates have declined steadily over the last three year. However, I have conservatively utilized the higher levy rate proposed by PSE when calculating its proforma property tax adjustment in deference to the fact that these rates do fluctuate over time and that a significant decline in property values across the state could cause taxing authorities to increase levy rates above that assessed for 2008.

Q. PSE prepared individual property tax calculations as a component of various production facilities for which it prepared a proforma adjustment. Have you similarly prepared specific property tax adjustments for new facilities such as the Mint Farm or Sumas Generating Units?

A. The assessed value of all facilities for which PSE calculated individual production plant proforma property tax expense adjustments *except* the Wild Horse Expansion

Project would be included within the January 1, 2009 property valuation agreed to by the Department of Revenue. Accordingly, as shown on Schedule C-10 of Exhibit No.__(JRD-2C) the only incremental adjustment posted for production property after January 1, 2009 is the Wild Horse Expansion Project.

Q. Please summarize your testimony surrounding property tax expense.

A. I have utilized January 1, 2009 values for electric and gas properties that have been agreed to by the Department of Revenue, which were not available to PSE at the time of preparing its filing, to calculate proforma electric and gas property tax expense. Further, I have applied the property tax levy rates utilized by PSE in developing its proforma property tax expense when calculating my proposed amount of property tax expense as shown on Schedule C-10. The property tax levy rates that PSE and I used in developing property tax expense are considerably higher than now-known 2008 actual levy rates. As such, I believe the proforma property tax expense level I am proposing represents a reasonable, if not conservative, estimate of property tax expense to be included in rate development in this docket.

G. Income Tax Expense Adjustment – Eliminate Section 162(m) limitation – Electric and Gas Operations.

Q. Please discuss your next adjustment to PSE's electric and gas operations.

A. The adjustment reflected on Schedule C-11 of Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C) is made to reduce test year recorded income tax expense. When arriving at recorded test year current income tax expense PSE included the impact of a permanent book and tax difference that it designated as a "Section 162(m) limitation." In response to Public Counsel Data Request No. 315 PSE indicated that

Section 162(m) of the Internal Revenue Code generally imposes a limitation of $1,000,000 on the compensation deduction that a public company employer may claim for compensation paid to its chief executive officer or certain other officers whose compensation is required to be reported to stockholders under Section 12 of the Securities and Exchange Act of 1934. Thus, during the 2008 test year PSE paid its chief executive officer and possibly other officers in excess of the $1,000,000 Section 162(m) compensation deduction limitation. This resulted in current income tax expense being in excess of what it would have been absent the Section 162(m) limitation.

In response to Public Counsel Data Request No. 315 PSE also indicated that beginning in 2009 it would no longer have reporting obligations to the SEC under Section 12 of the Securities and Exchange Act of 1934, and therefore, the Section 162(m) deduction limitation would no longer be applicable. Inasmuch as this "lost tax deduction" that occurred in 2008 will no longer be forfeited in 2009, it is equitable that the increased current income tax expense that occurred during the 2008 historic test year as a result of the inability to deduct all executive compensation be eliminated from test year operating results. Accordingly, the adjustments found on the electric and gas Schedule C-11 eliminates the increased income tax expense that was incurred in 2008 as a result of PSE's inability to deduct all executive compensation – an event that should be non-recurring in the future.

H. Net Reduction in Company Travel Expense – Electric and Gas Operations.

Q. Please describe your next adjustment to PSE's electric and gas operations.

A. I have eliminated the cost of all of PSE's corporate aircraft investment from PSE's electric and gas operations retail rate base with the adjustments reflected on Schedule B-1 of Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C). On Schedule C-12 of Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C) I also remove all depreciation expense and all operations and maintenance expense recorded within the 2008 test year incurred with owning, operating and maintaining the Company's corporate aircraft. However, I also add back the cost of alternative transportation that the Company would reasonably have incurred in transporting employees and directors to various locations had it not owned a corporate aircraft. Thus, the net impact of the rate base adjustments shown on Schedule B-1 and the expense adjustments reflected on Schedule C-12 of Exhibit No.__(JRD-2C) and Exhibit No.__(JRD-3C) is to remove from the revenue requirement determination the *excess* cost of owning and operating a corporate aircraft above that which would have been incurred using reasonable estimates of the cost of alternative forms of transportation.

Q. What is the excess cost of corporate aircraft incurred in the historic test year above that of reasonable alternative forms of transportation?

A. The answer is dependent in part upon the cost of capital assumed. Using the Public Counsel's recommended overall cost of capital, the excess cost of owning and operating the Company's aircraft over reasonable alternative forms of transportation is approximately $550,000[8].

[8] Using test year above-the-line operating costs and Public Counsel's recommended return times aircraft investment minus the cost of alternative forms of transportation.

Q. How did you determine the cost of alternative transportation that would have to be incurred in the absence of PSE owning its own aircraft?

A. I tried to use a common sense approach to determining both the means as well as the cost for alternative business travel. For locations that were within approximately a three-to-four hour drive from the Company's headquarters in Bellevue I assumed that the travelers would drive a car. I priced the cost of all automobile transportation at the federal government's personal car mileage reimbursement rate of 55 cents per mile. In reality, I expect that allowance is generous inasmuch as it assumes that all travelers would have taken a personal car and charged PSE the 55 cents per mile, when in many instances, I expect a PSE fleet vehicle could have been utilized. The fixed cost of return and depreciation for fleet vehicles has already been included in the adjusted test year cost of service. Accordingly, when a fleet vehicle is used the only incremental cost would be the variable costs associated with driving the fleet vehicle – namely, gas and incremental maintenance – and not the full 55 cents per mile allowed by the federal government for personal use of ones car for business travel.

For locations that were more than approximately four hours drive away, and for which commercial air transportation was conveniently available, I priced each traveler's flight at the highest last-minute fare out of Sea-Tac that I found for that location. Further, when appropriate, I added the cost of a rental car. Finally, in recognition of other incidentals that might accompany commercial aircraft travel, such as airport parking, extra meals, and perhaps even occasionally a hotel stay that may have been avoidable with use of PSE's corporate aircraft cost, I added an extra $100 per passenger.

In a few instances where the location was over about four hours drive away, there were no reasonable commercial flight alternatives, and there were several passengers on the flight, I priced out the cost of a round trip charter flight to the location. Charter round trip fares for some of the more common destinations that met the criteria just described ranged from $4,300 to $5,000.

Q. Are you suggesting that PSE should routinely charter aircraft for its various travel destinations – at $5,000 per trip?

A. No. Attempts are often made to justify corporate aircraft ownership by pointing to the time savings of its employees and officers that must be considered when comparing the cost of aircraft ownership and operations versus the cost of alternative transportation arrangements. My personal view is that this claimed time savings is often overstated in an attempt to justify the convenience of owning or leasing a corporate aircraft. The liberal assumption that PSE might on rare occassions incur additional charter flight costs – at a significant premium over the cost of commercial air or other forms of transportation – is employed to consider the argument that employees' productive time should be considered when studying the economics of aircraft ownership. In short, there are no time or productivity savings to consider when charter flights are substituted for corporately owned aircraft costs.

Q. Have you considered the time savings that PSE's employees and representatives might realize by virtue of company aircraft flights versus the other alternative

forms of transportation when charter flights were not substituted in your adjustment calculation?

A. I undertook no specific calculations to consider this element. That stated, for destinations that are less than four hours drive away, the time savings would be minimal. Further, as noted, my cost assumption regarding mileage reimbursement at 55 cents per mile is liberal. The alternative cost calculations where the cost of commercial flights was assumed also have a good deal of conservatism included in their development. As stated previously, I used "last minute" or "highest cost" fares for pricing out the cost of alternative commercial flights. I also added $100 per passenger for incidentals which I believe is conservatively high. I recognize that in some instances last minute travel plans would result in employees incurring such "last minute" fares. That stated, undoubtedly there would be many opportunities for trips that have a longer planning horizon to achieve a much lower buy-long-in-advance airline ticket. In short, I believe I have somewhat over stated the cost of alternative forms of transportation that would also negate potential labor productivity arguments raised in support of corporate aircraft ownership.

Finally, as previously noted, in those limited instances where I assumed a charter flight would be taken there would be absolutely no "lost time" calculations to consider.

Q. Did you price out every single trip that was undertaken by PSE employees, directors or representatives that occurred in the historic test year?

A. While no extensive analysis was undertaken in an attempt to understand the nature, purpose and need of each trip, a quick review of the purpose of trips provided in the airline log revealed three trips that, on their face, appeared to have no value to ratepayers. Specifically, I did not price out the cost of alternative transportation arrangements for an officer, a senior vice president, and their spouses to attend a Montana Governor's Cup event,[9] a trip for Chief Executive Officer Steve Reynolds to attend a Whidbey Examiner's board meeting in Port Townsend, and a trip to Palm Springs, California to pick up Eric Markell related to the merger announcements. All other test year trips taken are believed to have been priced out reflecting the cost of reasonable alternative travel arrangements.

I. Interest Synchronization – Electric and Gas Operations.

Q. Please discuss your last adjustment to test year operating expense that is applicable to PSE's electric as well as gas operations.

A. The routinely prepared adjustment reflected on Schedule C-13 of Exhibit No.__(JRD-2C) and Exhibit No. __(JRD-3C) is made to synchronize the interest deduction utilized in calculating current income tax expense with Public Counsel's proposed electric and gas retail rate base and Public Counsel's recommended overall cost of capital. Ultimately the Commission should undertake a similar calculation and reflect an income tax expense adjustment that synchronizes the weighted cost of debt that it deems appropriate with the electric and gas rate base it also determines to be reasonable.

[9] This appears to be a charity golf tournament.

J. Current Income Tax Expense Related to Injuries and Damages Flowthrough Amount Recognized in the Historic 2008 Test Year – Electric Operations Adjustment.

Q. Please discuss your next adjustment to electric operations.

A. The next adjustment I shall discuss is applicable only to PSE's electric operations and can be located on Schedule C-14 of Exhibit No.__(JRD-2C). The adjustment reflected on Schedule C-14 decreases recorded test year current income tax expense to normalize for an extremely large book and tax timing difference that was recognized as an "add" to book income to arrive at test year recorded current taxable income. The book and tax timing difference that increased current income tax expense for 2008 electric operations, which is afforded "flowthrough" accounting and ratemaking treatment for PSE's electric operations, is referred to as "Reserve for Injuries and Damages.'

Q. Please describe what is meant by the term "book and tax timing difference?"

A. Accounting guidelines dictate the methods and timing for reporting revenues and expenses for public financial statement reporting purposes. The Internal Revenue Code, along with Treasury Regulations, dictate the methods and timing for recognizing revenues and expenses for purposes of calculating corporate taxable income. There is a lot of similarity between accounting guidelines for recognizing revenues and expenses for financial statement reporting purposes *and* Internal Revenue Code/Treasury Regulation rules for recognizing revenues and expense for purposes of calculating corporate taxable income – but there are nonetheless differences. When there is a difference of reporting revenues and expense for financial statement reporting purposes (accounting guideline driven) and corporate federal taxable income development (IRC/Treasury Regulation driven), and the difference is *temporary*, a book and tax *timing* difference results. Sometimes a *permanent* book/tax difference arises when a revenue or expense item is recognized for financial statement reporting purposes that is *never* considered in the development of corporate taxable income. In an earlier section of testimony I referred to a Section 162(m) limitation for executive compensation. The Section 162(m) limitation is one example of a *permanent* book and tax timing difference.

Q. Please describe what occurs when a book and tax *timing* difference is afforded "flowthrough accounting and ratemaking treatment."

A. There are two accounting and ratemaking methods employed to consider book and tax timing differences. Under the "flowthrough" method, the current income taxes actually paid, after considering book and tax timing differences that are added to, or subtracted from (as applicable), income for financial statement reporting purposes is used in the development income tax expense for the cost of service underlying rates and also used for financial statement reporting purposes. The "flowthrough" method contrasts with the "normalization" method that essentially calculates income taxes for cost of service development and financial statement reporting purposes on the basis of book income before taxes used for financial statement reporting purposes. The actual mechanics of deferral accounting used in conjunction with "normalization" tax accounting can be somewhat complex. "Current income tax" expense is calculated in the same under both "flowthrough" and "normalization" accounting. However, under "normalization" accounting a "deferred income tax expense" amount is calculated based upon the amount of the book and tax timing difference occurring in any given reporting period. In effect, under normalization accounting the "adds" and "deducts" of timing differences are essentially ignored for purposes of financial statement reporting of total income tax expense as well as for reflecting the total amount of income tax expense to be included in cost of service rate development.

It is important to remember that regardless whether flowthrough or normalization treatment is adopted for financial statement reporting and ratemaking purposes, the same amount of *total income tax expense* will be the same *over the long run*. However, the total amount of income tax expense reported for financial statement purposes and utilized for establishing rates will be different *in any given year* depending upon whether flowthrough or normalization accounting is adopted.

Q. Can distinct book and tax timing differences be afforded either flowthrough or normalization accounting for a given utility?

A. Yes. A number of regulatory bodies have adopted full normalization for all book and tax timing differences, but a number of jurisdictions afford normalization treatment for some book and tax timing differences and flowthrough treatment for other book and tax timing differences. PSE falls within this latter category – having authority to normalize a number of, but not all, book and tax timing differences. Significantly, the single largest book and tax timing difference resulting from book and tax depreciation differences is required by the Internal Revenue Code to be normalized for ratemaking purposes in order for the utility tax payer to retain the accelerated tax depreciation deduction available to it under the Internal Revenue Code.

Q. You stated previously that the book and tax timing difference referred to as "Reserve for Injuries and Damages" is afforded flowthrough treatment for electric operations. Is this book and tax timing difference afforded flowthrough treatment for gas operations?

A. According to the Company, the Injuries and Damages book/tax timing differences have historically been afforded normalization treatment for gas operations.

Q. What creates a book and tax timing difference for the item referred to as "Reserve for Injuries and Damages?"

A. For financial statement reporting purposes, when a liability for an injury or damage claim against the Company becomes probable and can reasonably be estimated it is accrued for as an expense within FERC Account No. 926. However, an injury or damage claim is only deductible for purposes of calculating federal taxable income when paid. Because a claim often becomes probable and can be estimated months, if not years, before a claim is paid, there can be a large book and tax timing difference for the "Reserve for Injuries and Damages." Further, as large claims can sometimes be paid years following the time that the event was accrued for as an expense to FERC Account No. 926, the book and tax timing difference for the "Reserve for Injuries and Damages" can swing from being a large "addition" to book income in one year to a large "deduction" to book income in a following year to arrive at current federal taxable income.

Q. What has been the electric operations' book and tax timing difference amount for the "Reserve for Injuries and Damages" in recent years?

A. For recent years, the book expense, tax deduction and book/tax timing difference for the "Reserve for Injuries and Damages" for electric operations has been as follows:

Table IX
Reserve for Injuries and Damages – Electric Operations

Year	Book Expense	Tax Deduction	Book Expense Over/(Under) Tax Deduction
2002	$1,488,049	$1,538,049	($50,000)
2003	2,154,635	1,297,635	875,000
2004	2,364,766	2,539,766	(175,000)
2005	1,967,706	2,842,706	(875,000)
2006	2,471,072	1,671,072	800,000
2006	2,494,365	3,219,365	(725,000)
2008	4,035,677	1,985,677	2,050,000

Source: PSE Response to Public Counsel Data Request No. 402

As can be easily observed from the table above, over the years the book/tax timing difference has regularly swung from "adds" to "deducts" from book income to arrive at taxable income. Again, this phenomenon is easily explained by the lag in time between when an injury or damage event is accrued on PSE's books for financial statement reporting purposes versus when a claim is ultimately paid and becomes deductible for purposes of calculating current taxable income.

The other conclusion to be drawn from the table above is that clearly the test year actual book/tax difference for the Reserve for Injuries and Damages is unusually high. Because the 2008 amount is an "add" to book income to arrive at taxable income, and because this item has been afforded "flowthrough" accounting and ratemaking treatment, its impact is to overstate any reasonable estimate of what might be considered a "normal and ongoing" level of current income tax expense. In effect, the cost of service impact of the unusually high level of recorded Injuries and Damages Expense that I addressed in an earlier section of testimony has been exacerbated in the Company's cost of service income tax calculation that left this book/tax timing difference recorded in the historic test year unadjusted. Specifically, by leaving the book/tax timing difference amount as recorded within the historic test year unadjusted, PSE's cost of service includes an abnormally high level of income tax expense created by reflection of an abnormally high amount of an "addition" to book income to arrive at taxable income in the form of the unadjusted Reserve for Injuries and Damages book/tax timing difference.

Q. Do you know why this book/tax timing difference has been afforded "normalization" treatment for PSE's gas operations and "flowthrough" treatment for PSE's electric operations?

A. According to the Company's response to Public Counsel Data Request No. 402 the differing methods resorts back to the treatment that was afforded PSE's gas operations prior to PSE's merger with Washington Natural Gas.

Q. What would be the impact to PSE's cost of service income tax expense if PSE's electric operations were to adopt "normalization" accounting as is currently done for PSE's gas operations?

A. PSE's current income tax expense would be reduced by $717,500 – calculated as follows:

Injuries and Damages Reserve book/tax "add" to book income to arrive at taxable income:	$2,050,000
Federal Income Tax Rate	35.0%
Reduction in Current Income Tax Expense if the Injuries and Damages Reserve was afforded "normalization" rate/accounting treatment	$717,500

Q. Are you advocating the adoption of "normalization" accounting and ratemaking treatment for this book/tax timing difference?

A. I certainly would not oppose it. As noted on the table above, this book/tax timing difference swings from positive to negative amounts from year to year. Over the long run, book expenses and tax deductions for this amount should exactly equal out. The "Injuries and Damages Reserve" difference is what accountants frequently characterize as a "fast turnaround" book/tax timing difference. Because it is volatile, quick to turn around, will over the longer term average to "zero," and causes income for financial statement reporting purposes to fluctuate to a larger extent from year to year than would "normalization" accounting, it would seem a good candidate for "normalization" rate and accounting treatment – as is already followed for PSE's gas operations. That stated, I have not researched the history of why this book/tax timing difference has historically been afforded "flowthrough" treatment for electric operations. Accordingly, I have not calculated an adjustment reflecting "normalization" accounting and ratemaking treatment for this book/tax timing difference.

Q. How have you calculated an adjustment for this item?

A. As shown on Schedule C-14 I have calculated an adjustment for this item by taking a three-year average amount for this book and tax timing difference – consistent with the period I used to reflect a proforma "book" expense adjustment for this item in Schedule C-5. This approach would appear to yield a conservatively high estimate of an "ongoing" addition to book income for this item – as evidenced from the data shown on the Table IX above.

K. Production Operations and Maintenance Expense – Electric Operations.

Q. Have you reviewed the Company's request for recovery of non-fuel production operations and maintenance expense in this docket?

A. Yes. Further, I have a conceptual understanding of how the Company has developed its proforma level of production operations and maintenance expense for the various generating units which owns or co-owns, as well as an understanding of its proposed prospective change in accounting for, and rate recovery of, what it refers to as "major maintenance" expense for the gas-fired generating units.

Q. Please provide an overview of your understanding of the Company's proposed recovery of non-fuel production operations and maintenance ("production O&M") expense as well as its proposed prospective accounting for production O&M expense.

A. The Company has proposed a number of different methods for reflecting production O&M expense in rates being developed in this proceeding. Those methods, by plant facility, are summarized below:

- For its ownership interest in all the Colstrip Generating Units, PSE proposes to reflect the budgeted amounts of production O&M expense for the period April 2010 through March 2011. April-2010-through-March-2011 is the first full twelve month period that new rates being established in this proceeding are expected to be in effect. It is also the period for which the Company has used forecasted sales to arrive at modeled variable power supply costs. I will frequently refer to the April-2010-through-2011-time-frame as the "rate year" as the Company also frequently refers to this period.
- For the various gas-fired generating units which it owns or co-owns, PSE has reflected an average of a five-year forecast of "minor maintenance" expense. PSE arbitrarily defines "major maintenance" as individual events or activities that exceed $2.0 million per occurrence, with "minor maintenance" consisting of all individual events or activities that are less than $2.0 million per event. For "major" maintenance events PSE has purportedly included no amount of costs within its adjusted test year cost of service. However, while PSE purportedly includes no cost for "major" maintenance events, it proposes prospectively to be allowed to defer the cost of all major maintenance events within FERC Account No. 186 (Regulatory Assets) and begin to amortize such deferral balances over five years beginning when rates being established within PSE's *next* general rate

case or Production Cost Only Rate Case (PCORC) go into effect. The gas generating units for which PSE has reflected an average of a five-year forecast of minor maintenance (i.e., less than $2.0 million per event) with no allowance for major maintenance include Ecogen, Goldendale, Mint Farm, Whitehorn, Frederickson, Fredonia Units 1 through 4, and Sumas.

- For gas-fired generating units that had been in service for more than a year, with only a couple of exceptions PSE left test year actual production *operations* expense (excluding fuel) unadjusted. Specifically, for Goldendale, Ecogen, Fredonia Units 1 – 4, Frederickson, and Whitehorn generating units, PSE only adjusted test year operating expense for company wage increases occurring from the test year through the rate year. Also, the Mint Farm and Sumas combined cycle generating units had not been in service, or had not been owned by PSE, for the entire 2008 test year. Thus, for these two new units the Company resorted to the 2010 and 2011 forecasts of non-fuel production operations expense when calculating the Company’s proforma production operations expense for these units. Finally, for reasons that I did observe explained, even though Freddy Unit 1 has been in service for a number of years, PSE nonetheless also reflected the budgeted 2010/2011 amount of production operations expense for its ownership interest in this unit when developing its proforma production operations expense.
- PSE reflected implementation costs associated with executing the requirements of relicensing the Snoqualmie Falls and Baker River Hydroelectric Projects.

- For existing wind generation at Wild Horse and Hopkins Ridge, PSE estimated increases for Vestas Contracts servicing those facilities through the rate year.
- The Wild Horse and Hopkins Ridge Wind Farms have each expanded facilities during, or following, the 2008 test year. PSE has reflected forecasted production O&M expenses for the expansion projects at each location.
- In addition to the noted proforma adjustments proposed, PSE also proposed adjustments to remove test year lease costs associated with Whitehorn and Fredonia which terminate beyond the end of the test year when the facilities were/will be purchased by PSE. Finally, PSE also removed test year environmental remediation expense at the Crystal Generating Unit that will be recovered at a later time pursuant to the Accounting Authority Order issued in Docket No. UE-070724 which provides blanket authority to defer such environmental remediation program costs.

As can be observed, PSE has used a variety methods and time periods to develop proforma production operations and maintenance expense for the various facilities which it owns or co-owns.

Q. Do you take exception to any of the Company's proforma adjustments for production O&M expense?

A. Yes. I take exception to several elements of the Company's development of proforma production O&M expense.

Q. Do you have any overriding conceptual disagreements with the Company's development of production O&M expense?

A. Yes. First, within the Company's development of proforma adjustments there is substantial movement toward wholesale reflection of projected or forecasted production O&M expense. This may be an outgrowth of the Production Cost Adjustment stipulation that specifically provides for reflection of the timely recovery of costs incurred for *new* power supply resources. Admittedly, if a facility has only been recently constructed, or is currently under construction but expected to be completed sometime during the first rate year, in the absence of any production O&M history for such new facility, it may be necessary to resort to some form of budget or forecast to meet the cost recovery expectations set forth within the PCA stipulation. The fact that a completely new facility could require use of a budget or forecast for rate development to be in compliance with the expectation to provide for timely recovery of *new* resources as set forth within the PCA stipulation should not provide the basis for widespread adoption of budgeted or forecasted production O&M for other existing and mature generating units.

Second, while I do not oppose PSE's adoption of the deferral method for accounting for overhauls in compliance with recently implemented accounting guidelines, I do take exception to PSE's specific recommendations to 1) defer only overhauls that exceed $2.0 million per occurrence, 2) amortize all overhaul costs initially deferred over a five-year period regardless the period of time until the next similar overhaul for each unit, and 3) delay the amortization of overhaul costs that may be deferred after new rates from this docket go into effect until the time that new rates from PSE's *next* general rate case or PCORC go into effect. In short, I do not take exception to PSE's adoption of the deferral method for accounting for overhaul maintenance for its gas-fired units as that accounting guidance actually provides. However, I do take exception to PSE's proposed accounting and rate making treatment for "major maintenance" for its gas-fired units which differ from the airline accounting guidelines for scheduled maintenance.

Q. Turning to your first general objection to widespread use of forecasted or projected production O&M expense, does the Washington Administrative Code provide for the reflection of budgets or forecast as a basis for reflecting "known and measurable changes?"

A. Not that I have observed. The only guidance found in the Washington Administrative Code regarding use of proforma adjustments is WAC 480-07-510(3). Again, as discussed earlier in this testimony, that guidance only states:

> (iii) "Pro forma adjustments" 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.

Nothing within the quoted regulation suggests to me that the Commission envisions, or is endorsing, widespread or even selective use of budgets and forecasts in rate setting process.

Q. Is it reasonable to use a five-year forecast of production maintenance expense for the purpose of establishing rates in this proceeding?

A. No. I submit that even a short term or one year budget does not meet the WAC requirements for a "known and measurable" adjustment. Use of a five-year forecast, as PSE proposes for maintenance activities that are expected to be less than $2.0

million per occurrence, clearly does not. Further, I emphasize that for this cost of service component PSE does not suggest any reconciliation or a true- up mechanism of any kind. Continuous use of ever increasing forecasted amounts of “minor” production maintenance expense without true- up or reconciliation would, over the long run, almost assuredly lead to over recovery of such costs. Accordingly, for existing generating units I recommend rejection of the Company’s proposed reflection of a five-year forecast of minor maintenance expense, and instead, propose to simply leave test year actual production maintenance expense unadjusted.

Q. Please expand upon your objection to the Company’s adoption of the “deferral method” of accounting for gas-fire maintenance overhauls as it would like to implement such guidelines.

A. First, one should understand what the guidelines recently implemented for airline accounting for scheduled major maintenance activities actually states, that PSE in turn utilizes as a springboard for the accounting and ratemaking treatment that it is proposing in this docket for its defined “major maintenance.” Under the deferral method of accounting established for the airline industry, the actual costs for each planned major maintenance activity will be capitalized to a balance sheet account and amortized in a systematic and rational manner over the estimated period until the next planned identical or similar major maintenance activity. Importantly, the airline accounting guideline does not define “major maintenance” activities by a dollar limit per event or occurrence as did PSE. Rather, the “major maintenance activities” that may be accounted for under the deferral method of accounting are determined by the characteristics that the inspections or replacements of major parts are required at specific maximum periodic intervals.

Also of importance, the airline accounting guideline that PSE relies on for adoption of its version of deferral accounting of major maintenance activities does not provide for a fixed amortization period for all major maintenance activities as PSE has proposed in this docket (i.e., five years). Rather, the amortization is to occur in a systematic and rational manner until the next planned major maintenance activity. If a major maintenance activity similar to that which occurred in any given year is required in two years, the amortization for that particular event would be two years. If the next similar scheduled maintenance activity is required in ten years, the amortization would be ten years.

Finally, while it is not specifically stated within PSE testimony, it appears that PSE's accounting and ratemaking proposal envisions deferral of all major maintenance (as PSE defines that term) immediately – or immediately following implementation of new rates, but does not propose to initiate any amortization of such deferred costs until rates established in PSE's next general rate case or PCORC go into effect. If this interpretation is correct, it strongly suggests that PSE is asking for specific regulatory accounting and ratemaking assurances that all costs deferred will be recovered in rates. In other words, PSE is looking for assurances sought under Financial Accounting Standards Board Opinion 71 that allows regulated industries to capitalize the cost of events that, absent assurance of future rate recovery from regulators, would be required to be expensed immediately. Again, if this interpretation of the Company's proposal is correct, it goes far beyond simply implementing a permissible method of accounting for scheduled maintenance activities as is provided under the airline guideline with which PSE initiates its request for a change in accounting in this proceeding.

Q. Do you oppose implementation of the deferral method of accounting for schedule maintenance as set forth within the airline accounting guideline?

A. No, if implemented as actually set forth in the accounting codification. Specifically, I believe the method makes sense. It is reasonable to amortize any costs over the period of expected benefit, which in this case, is the time until the next required similar maintenance activity. Further, as Company testimony indicates, these expenditures can be significant and can tend to be volatile or "lumpy" with varying intervals between occurrences. Thus, the amortization element of this accounting methodology should tend to smooth or normalize such events. This would appear to be beneficial for both financial statement reporting as well as ratemaking purposes. Finally, reflection of the amortization of "actual" costs should tend to be relatively less controversial than analyzing budgets or forecasts and would seem to be in better compliance with the intentions of WAC 480-07-510(3) that limit proforma adjustments to "known and measurable" events.

Q. If PSE adopts the proper implementation of deferral accounting, what are the ratemaking implications in this docket?

A. Very little. The Company will begin deferring major scheduled maintenance events pursuant to the deferral method of accounting as actually set forth in accounting guidelines. Those major scheduled maintenance events that are initially deferred will begin to be amortized over the scheduled interval period, and in PSE's next general rate case or PCORC the amortization of those deferrals should be recognized in the development of future rates.

L. Production O&M Adjustment for Units in Service Throughout 2008 – Electric Operations.

Q. With that background, please proceed by describing your first adjustment to the Company's proforma level of production O&M expense.

A. There are a number of generating units which were operating for the entire 2008 historic test year, and in some instances these units had been operating for many years preceding the 2008 test year. Those units include Colstrip Units 1- 4, Frederickson Combined Cycle Unit 1, Frederickson Gas Turbine, Fredonia Gas Turbine Units 1 – 4, Goldendale Combined Cycle Unit, and Whitehorn Gas Turbine Unit. For each of these existing units PSE proposed reflection of projected costs as a basis for developing at least a portion of proforma production O&M expense. Specifically, for all of the noted gas units, PSE has used a five-year forecast of minor maintenance expense – which again PSE defines as maintenance events costing less than $2.0 million per occurrence – as a basis for preparing its proforma adjustment. For all of the Colstrip Units PSE used a budget or forecast of *all* non-fuel production operations and maintenance expense.

As shown on Schedule C-15 of Exhibit No. __(JRD-2C), I am proposing to reverse the Company's proforma level of projected production O&M expenses for these existing units, and instead, reflect test year actual unadjusted amounts for each of these noted units. I note that the entire net "reversing" adjustment results in only approximately a $25,000 downward adjustment. Thus, I am not proposing such adjustment as a matter of materiality, but rather from a conceptual basis to emphasize that budgets and forecasts that underlie the Company's proforma adjustments should not be considered a "known and measurable" event pursuant to WAC 480-07-510(3).

Q. Does reflection of test year actual production O&M expense for PSE's various generating units that were in service the entire historic test year yield a reasonable level of ongoing or normalized expense?

A. Yes. I have attached as Exhibit No. __(JRD-12) production O&M expense for all of PSE's generating units for the years 2003 through 2008. For the Goldendale Unit there is limited historical data for comparison. **[Begin Confidential]** XXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXX**[End Confidential]** As shown on Exhibit JRD-12, test year production O&M for the Colstrip Units is at an all time high for the five-year period. For the remaining units (i.e., Freddie 1, Encogen, Whitehorn, Frederickson, and Fredonia Units 1-4), the historical amounts have varied over time. In some instances for these remaining units the test year production O&M amount is not the all time high for the five-year period. However, taken together, the test year amount for these remaining units is also at an all time high. Based upon historical expenditures for the mature units I believe that the test year actual amount of production O&M expense for these units represents a reasonable ongoing level of expense to include in the development of PSE's electric cost of service.

M. Sumas Combined Cycle Production O&M.

Q. Please continue with your next adjustment to production O&M expense.

A. The next production adjustment found on Schedule C-16 of Exhibit No.__(JRD-2C) is made to adjust production O&M expense for the Sumas Combined Cycle Generating Unit to the level incurred in the latest twelve month reporting period available at the time this testimony was to be prepared – namely, the twelve month period ending August 2009. The Sumas Unit went into service on July 25, 2008. As such, the unit had not been in service for a full twelve month period during the 2008 historic test year. Accordingly, it is necessary, appropriate and equitable to reflect twelve full months of ongoing production O&M expense for this relatively new unit.

Q. How did PSE develop a proforma level of production O&M expense for the new Sumas unit?

A. PSE proposes a proforma adjustment to capture the annual cost impact of the new Sumas Generating Unit by reflecting production *operations* expense forecasted for the rate year (i.e., projected operations expense for the twelve months ending March 2011) and a five-year average of projected *maintenance* activities that individually are expected to cost less than $2.0 million per occurrence (i.e., events which PSE defines as "minor maintenance"). Once again, PSE has proposed wholesale adoption of projected amounts to develop its proforma production O&M adjustment for the Sumas Generating Unit.

Q. Please explain why your adjustment for Sumas production O&M expense should be adopted.

A. Inasmuch the Sumas Unit was not operational the entire historic test year it is necessary and equitable to develop a proforma adjustment to reflect the cost of twelve full months of operations. If there were no historic results available for the unit, perhaps an exception to the strict adherence to the WAC 480-07-510(3) "known and measurable" standard may have to be made to be in compliance of the PCA stipulation that requires timely recovery of new power supply resources. However, inasmuch as there now exists twelve full months of operating results following commercial operation of the Sumas Unit, I believe it appropriate, equitable and entirely consistent with WAC 480-07-510(3) to simply reflect the latest twelve month ending period of actual production O&M expenses available for the Sumas Unit as a basis to develop a proforma expense level for this new unit. As previously described, the adjustment reflected on Schedule C-16 replaces the Company's forecast for Sumas production O&M with actual Sumas production O&M for the twelve months ending August 31, 2009.

N. Mint Farm Combined Cycle Production O&M – Electric Operations.

Q. Please continue with your next proposed adjustment to production O&M expense.

A. As shown on Schedule C-17 of Exhibit No. __(JRD-2C), I am proposing an adjustment to reflect ongoing production O&M expenses for the recently acquired Mint Farm Combined Cycle Generating Unit. Like the Sumas Unit, the Mint Farm Unit was not in commercial operation – or in commercial operation providing service to PSE retail ratepayers – for the entire historic test year. In fact, having been acquired in November 2008, the Mint Farm unit was only operated on behalf of PSE for a very small portion of the 2008 historic test year.

Q. How do you propose that a proforma level of production O&M expense be developed for the Mint Farm unit?

A. As shown on Schedule C-17, I am proposing to divide the actual amount of Mint Farm production O&M expense incurred for the eight month period ending August 2009 to arrive at a monthly average of ongoing expense. I then multiply this calculated monthly average times twelve months to arrive at an annualized level or proforma amount of Mint Farm production O&M expense.

Q. How does the method you propose to reflect proforma production O&M expenses for Mint Farm compare to that employed by the Company?

A. As with the new Sumas Unit, PSE developed a proforma adjustment for the new Mint Farm Generating Unit by reflecting production *operations* expense forecasted for the rate year and a five-year average of projected *maintenance* activities that individually are expected to cost less than $2.0 million per occurrence. As previously noted, use of projections and forecasts do not meet the known and measurable limitations of WAC 480-07-510(3), and should therefore be rejected.

O. Hopkins and Wild Horse Wind Farms – Vestas Service Contract Agreement.

Q. Please describe your next production O&M adjustment.

A. PSE has a five-year service agreement with Vestas-Americas to maintain turbines owned by PSE at the Hopkins and Wild Horse Wind Farms. **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXX. **[End Confidential]**

P. Reverse PSE's Proposed Amortization of Over Recovered Production Maintenance Expense and Colstrip Settlement Costs.

Q. Please discuss your next adjustment to production O&M expense.

A. I will address my next two production O&M adjustments together as I believe they are somewhat related. First, PSE has proposed to amortize prospectively over three years the amount of production maintenance expense, that by its own calculations, have been over collected since 2002. This PSE amortization proposal is but one element of several regulatory asset and liability events which PSE adjusts within Exhibit No.__(JHS-10), Adjustment 10.31, page 37. This PSE adjustment is linked to its proposed adoption of the deferral method of accounting for scheduled production maintenance. The upshot of this Company proposal is that PSE is recommending the establishment of a *regulatory liability* – or effectively an IOU to ratepayers for over collections of production maintenance expense occurring since 2002. The amount included within the Regulatory Liability account would be returned to ratepayers via a credit amortization over a three-year period to be reflected in the development of base rates. At this point in time this regulatory liability has not been established on PSE's financial statements inasmuch as to date this Company proposal has not been acted upon by this Commission.

PSE has also proposed to defer and amortize over a five-year period the cost which it incurred in settling a litigation claim at the Colstrip Generating Station that occurred during the 2008 test year. PSE originally filed a request for an accounting authority order with this Commission on May 21, 2008 wherein it requested to defer the noted Colstrip settlement payments. This Commission has not acted on PSE's accounting petition and the Company has not yet reflected the Colstrip settlement payments on its balance sheet as a *regulatory asset* – or an IOU from ratepayers.

I am recommending that this Commission deny PSE's proposals to defer and amortize as an expense/credit in the development of rates in this docket both the over recovered production maintenance expense and the Colstrip litigation settlement payment. The Colstrip settlement payment can be viewed as a relatively abnormal or non-recurring event – or at least infrequently-occurring event. As such, it is not appropriate to leave this significant test year charge unadjusted. While the litigation settlement is somewhat significant, in my opinion it does not warrant the unique deferral-with-amortization treatment being proposed by PSE.

Viewed in isolation, it could be argued that the Colstrip settlement payment was never recovered from ratepayers. But as the Company's own calculations demonstrate, production maintenance expense has been *over collected* – at least since 2002. Viewed together, one might conclude that on balance – considering the *over recovered* production maintenance expense and the *under recovered* Colstrip settlement payment – that PSE has been unable to recover all production expense. However, while base rates are typically established in a manner so as to provide a utility the *opportunity* to recover all prudently incurred costs and earn a reasonable return on investment, it is typically does not *guarantee* the ability to do so. In summary, I am recommending that PSE be denied its request to defer and amortize in the development of base rates in this proceeding the over recovered maintenance expense occurring since 2002 and the unusual Colstrip litigation settlement payment expensed during the historic test year. The reversal of the Company's request to include deferred Colstrip litigation costs in rate base is reflected on Schedule B-2 of Exhibit No.__(JRD-2C) while the reversal of the Company's request to amortize the Colstrip litigation costs is reflected on Schedule C-19 of Exhibit No.__(JRD-2C).

Similarly, the Company's request to reflect deferred over recovered maintenance expense as a rate base offset is reversed on Schedule B-3 of Exhibit No.__(JRD-2C) while the Company's request to amortize the over recovered production maintenance expense is reflected on Schedule C-20 of Exhibit No.__(JRD-2C).

Q. Other Production O&M Expense Adjustments.

Q. Are you recommending any other adjustments to PSE's proposed proforma level of production O&M expense?

A. No. However, I would point out that there were two other elements of PSE's proforma production O&M adjustment that I did not get to fully explore because of time and resource limitations. Specifically, PSE has proposed proforma adjustments to reflect added costs for relicensing the Baker and Snoqualmie Falls hydro facilities and for expanding the Hopkins Ridge and Wild Horse wind facilities that I did not fully explore. The fact that I may not have objected to PSE's proforma level of production O&M expense for these facilities should not be construed as endorsement of any methodology or calculation employed by PSE in their development.

R. Advertising Expense – Electric Operations Adjustment.

Q. Please discuss your final adjustment to electric operating expense.

A. The adjustment shown on Schedule C-21 of Exhibit No.__(JRD-2C) removes from test year electric operating expense the advertising cost that PSE incurred during the historic test year promoting its voluntary Green Power Program as well as a small amount incurred to provide gifts of framed artwork given to seventeen employees in recognition of their contributions to PSE's community advertising efforts during the merger that was consummated in 2009.

Q. Why have you eliminated the cost of promoting PSE's Green Power Program?

A. Pursuant to Washington statute, the cost of a voluntary renewable energy program such as PSE's Green Power Program cannot be recovered in the utility's general rates. Specifically, RCW 19.29A.090 provides that "[all] costs and benefits with any option offered by an electric utility under this section must be allocated to the customers who voluntarily choose that option and *may not be shifted to any customers who have not chosen such options."* (*emphasis added*)

Q. If the Green Power Program is a state-mandated program, isn't it reasonable that PSE should be able to recover the costs of promoting the program within base rates?

A. This Commission has already determined that even when programs such as Green Power are deemed reasonable, laudable or even state-mandated, it nonetheless cannot legally pass on the cost of such program to customers who do not elect to voluntarily participate in the program. Specifically, citing RCW 19.29A.090 this Commission rejected Northwest Natural Gas Company's request to defer for later recovery from the general body of ratepayers the start up cost of a "Smart Energy Program"." In short and in sum, this Commission has already determined that it simply cannot legally pass on the cost of programs such as Green Power in rates to be paid by non-participating members of the program.

Q. How did you quantify the costs the Company incurred in promoting the Green Power Program?

A. In response to Public Counsel Data Request No. 59, attached as Exhibit No. __(JRD-13) to this testimony, PSE provide both the cost of, as well as ad copies prepared to promote, PSE's Green Power Program. In addition to removing the test year cost of promoting Green Power, I have also eliminated the cost of artwork given to employees for efforts in promoting the merger that PSE acknowledged in response to Public Counsel Data Request NO. 473 should be removed.

S. Power Supply Adjustments Sponsored by Mr. Scott Norwood.

Q. Please discuss your next adjustment to test year electric operations.

A. The next four adjustments found on Schedules C-22 through C-25 of Exhibit No.__(JRD-2C) are sponsored by Public Counsel's witness Mr. Scott Norwood. Schedule C-22 reflects an adjustment eliminating the amortization of deferred Mint Farm Generating Unit fixed cost. It is a corollary adjustment to the rate base adjustment reflected on Schedule B-5 of Exhibit No.__(JRD-2C). Schedule C-23 reflects a power supply adjustment to normalize the availability of hydro generating facilities. The adjustment shown on Schedule C-24 reflects the impact of normalizing off-system sales margins. Schedule C-25 reflects the impact of Mr. Norwood's recommendation to credit anticipated sales of Renewable Energy Credits within the development of PSE's retail cost of service in this docket.

T. Production Adjustment.

Q. Please discuss your final electric operations adjustment.

A. The adjustment shown on Schedule C-26 of Exhibit No.__(JRD-2C factors Public Counsel's fixed production function non-fuel expense adjustment for the difference between rate year and test year electric energy sales. It represents a "matching" adjustment comparable to what the Company undertook with its Adjustment 10.37 of Exhibit No.__(JHS-10).

Q. Does this conclude your direct testimony?

A. Yes, it does.