EXHIBIT NO. ___(MJS-1T)
DOCKET NO. UE-072300/UG-072301
2007 PSE GENERAL RATE CASE
WITNESS: MICHAEL J. STRANIK

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-072300** **Docket No. UG-072301**

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
MICHAEL J. STRANIK
ON BEHALF OF PUGET SOUND ENERGY, INC.

JULY 3, 2008

PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Michael J. Stranik, and my business address is 10885 NE 4th Street, Bellevue, Washington.

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

A. I am employed by Puget Sound Energy, Inc. ("PSE" or "the Company") as its Assistant Controller.

Q. Have you filed an exhibit discussing your education and work experience?

A. Yes, I have. It is Exhibit No.___(MJS-2).

Q. Please summarize the purpose of your rebuttal testimony.

A. My testimony describes how PSE implemented Financial Accounting Standard No. 143 ("FAS 143") "Accounting for Asset Retirement Obligations" and Financial Accounting Standards Board Interpretation No. 47 ("FIN 47") for reporting its financial statements in accordance with Generally Accepted Accounting Principles ("GAAP"). I will also discuss the accounting treatment of cost of removal other than legal obligations in accordance with Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USoA") and identify why adjustments proposed by Public Counsel are not in accordance with FERC accounting regulations and should be rejected by this Commission.

II. IMPLEMENTATION OF FAS 143 AND FIN 47 FOR FINANCIAL REPORTING ON A GAAP BASIS

Q. When and why was statement of FAS 143 implemented for GAAP basis reporting at PSE?

A. PSE implemented FAS 143 in January 2003 for financial reporting of legal obligations related to costs of removal and to recognize, in PSE's financial reporting, its legal asset retirement obligations. FAS 143 was also implemented in accordance with Federal Energy Regulatory Commission ("FERC") Order No. 631 (issued April 2003), which states,

> The accounting for asset retirement obligations in this rule is consistent with the accounting and reporting requirements that jurisdictional entities will use in their general purpose financial statements provided to shareholders and the Securities and Exchange Commission (e.g. companies will separately account and report the liability for the asset retirement obligations, capitalize the asset retirement costs, charge earnings for depreciation of the asset, and charge operating expense for the accretion of the liability).[1]

As discussed by Mr. William Stout in Exhibit No. ___(WMS-1T), FERC Order No. 631 modified the Uniform System of Accounts to allow utilities to record the

[1] FERC Docket No. RM02-7-000; ¶5.

entries required for financial reporting by FAS 143 on the books maintained for regulatory accounting.

Asset retirement obligations ("AROs") are legal obligations associated with the retirement of a tangible long-lived asset that an entity is required to settle as a result of an existing enacted law, statute, ordinance, or contract. The full definition of an ARO is stated in the Code of Federal Regulation Chapter 18, Uniform System of Accounts ("USoA") general instruction 25, "Accounting for asset retirement obligations." FERC has also defined AROs in Order No. 631, "An asset retirement obligation is a liability resulting from a legal obligation to retire or decommission a plant asset…."

Company witness Jan A. Umbaugh will discuss the scope of FAS 143 and FERC Order No. 631.

Q. Would you please provide examples of legal obligations as they relate to PSE?

A. PSE has a limited number of legal obligations in relation to utility assets and leased equipment or property. PSE's legal obligations include dismantling of the leased Whitehorn 2 & 3 generation turbines, removal of structures at the Shuffleton Steam Plant harbor, replacement or lining of all cast iron pipes, restoration and capping of Colstrip ash holding ponds, asbestos removal from PSE buildings, disposal of treated wood poles; disposal of oil containing polychlorinated biphenyls ("PCB") and the related equipment that held the oil, and disconnection of abandoned pipelines, purge of the gas, and cutting and capping supplies of gas. I will describe later in my testimony why and when PSE recorded these legal obligations.

Q. Has FERC provided accounting procedures that utilities must follow related to AROs?

A. Yes. In General Instruction 25, FERC set forth the ARO accounting framework that utilities must follow to recognize a liability for the fair value of an ARO at the time an asset is constructed or acquired or when a change in the law creates a legal obligation to perform retirement activities. At initial recognition of the ARO, the entity increases the cost of the related asset that gives rise to the ARO. This is accomplished by increasing the asset value by the present value of the estimated retirement cost and creating a liability in the same amount. The liability is increased over time until the actual retirement activity begins, at which time the ARO should be equal to the estimate of the legal obligation costs to remove the plant. The asset retirement cost ("ARC"), which is the increase in asset value discussed above, is depreciated over the same life as the underlying asset that gave rise to the obligation. The entity is required to re-measure and adjust the liability due to the passage of time and when there are events that may change the estimate of the liability.

A. FAS 143

Q. What steps did PSE follow to implement FAS 143?

A. PSE created an implementation team comprised of Property Accounting personnel and PSE's in-house counsel ("the Team"). The Director of Budgets and Performance Management and I provided oversight and assistance to the Team regarding scope of the project, compliance with FERC requirements, as well as the direction and progress of implementation.

The team reviewed authoritative literature for guidance and attended Edison Electric Institute and American Gas Association-sponsored seminars. The team also reviewed relevant written materials and had discussions with colleagues from other utilities.

The team identified the leaders in PSE's major business areas and invited them and other interested parties to attend a presentation of FAS 143 requirements and the related impact on PSE. The key contact individuals in each business area investigated their respective business areas to identify potential retirement obligations. The team then met with the key individuals to further identify other potential retirement obligations. The final list of potential obligations was then reviewed for completeness with the responsible director.

The Team identified criteria to determine (1) what obligations were within the scope of FAS 143 and (2) methodology to determine if an obligation is measurable, the probability of final retirement, and materiality to the financial statements. FAS 143, paragraph A20, requires that measurable obligations include costs that a third party would incur to fulfill the retirement obligations. The literature states that to the extent a third party estimate is not available, a prescribed expected present value method is to be used based on a utility's internal cost estimate and adjusted for estimated third party cost assumptions such as a profit margin, overhead and equipment costs and a market risk premium. This is the approach PSE used. After cost estimates were finalized, the team determined whether each obligation was material or immaterial. If the obligation was determined to be immaterial, no entry was made to the financial statements. FIN 47 subsequently clarified that provisions need not be applied to immaterial items.

PSE developed an MS Excel spreadsheet template to perform the complex calculations required to calculate the present value and the required journal entries for the material measurable obligations. Credit adjusted risk-free interest rates were used as the discount rate.

Q. Why did PSE use the risk-free interest rate as the discount factor instead of PSE's rate of return?

A. FAS 143, paragraph 14, states that an entity should measure changes in its asset retirement obligation at the credit adjusted risk-free interest rate that existed when the liability was initially measured. Therefore, using PSE's rate of return is not appropriate, according to FAS 143 guidance.

Q. What AROs did PSE record when it implemented FAS 143?

A. At the initial implementation, PSE recorded asset retirement obligations pursuant to FAS 143 for the followings items:

1) dismantling of the leased Whitehorn 2 & 3 generation turbines, which required PSE to deliver the turbines to the nearest railhead at the end of the lease,

2) removal of certain structures associated with an expired lease with the Department of Natural Resources for an area related to the Shuffleton Steam Plant harbor,

3) replacement or lining of all cast iron pipes in PSE's service territory (pursuant to Washington Utilities and Transportation Commission ("Commission") order in Docket No. UG-920487), and

4) restoration and capping of two Colstrip ash holding ponds.

Q. What was the impact to PSE's financial statements as a result of implementing FAS 143?

A. The impact to the financial statements depended on whether or not the approved depreciation rates of the underlying assets contained a provision for cost of removal that was sufficient to cover the ARO ("Recovered ARO"). All AROs listed above except Whitehorn 2 & 3 fell under this category. For Recovered AROs, implementing FAS 143 resulted in a gross-up of the balance sheet, reflecting an increase in assets for the ARC and an increase in liabilities for the ARO. The amount of both increases was equal to the value of the AROs at the time of implementation. Because expenses sufficient to cover the depreciation of the ARC and accretion of the ARO was previously recognized in the income statement from inception of the liability through the implementation date, there was no impact to PSE's income statement at implementation for Recovered AROs. For AROs associated with the Whitehorn 2 & 3 lease, costs of removal sufficient to cover the ARO were not included in the depreciation rate. These types of AROs can be referred to as "Not Recovered". Exhibit No.___(MJS-3) provides a detail of the amounts and accounts that were affected as a result of implementing FAS 143.

Q. What was the impact on the books maintained for regulatory accounting as a result of implementing FAS 143?

A. For regulatory purposes, PSE has not requested from the WUTC any accounting treatment related to FAS 143. In addition, PSE had no requirement to file with FERC because the impact was not relevant to regulatory accounting. Therefore, for regulatory purposes (which would include this proceeding) the effects of FAS 143 have been eliminated. The regulatory treatment of AROs depends on whether or not the ARO was Recovered or Not Recovered. Because the initial and ongoing accounting for Recovered AROs merely represents reclassifications of existing expense and accumulated depreciation, the effects of FAS 143 are eliminated by treating the accounts to which these reclassifications are made the same as the underlying asset. This translates into the ARC depreciation expense (FERC Account 403.1) and the ARO accretion expense (FERC Account 411.1) being included in net operating income and including the ARO (FERC 230) in Utility Plant in Service (FERC Account 101). Likewise, because the initial and ongoing accounting for Not Recovered AROs recognizes assets, liabilities and expenses that would not have been incurred except for FAS 143, these accounts are not included in the regulatory accounting financial statements. This is achieved by excluding 1) ARC depreciation expenses and ARO accretion expenses from net operating income[2] and 2) the ARCs and AROs from Utility Plant in Service. The impact of this regulatory treatment is to eliminate the effects of FAS 143 from the books maintained for regulatory accounting.

B. FIN 47

Q. When and why was FIN 47 implemented at PSE?

A. As discussed by Mr Umbaugh, FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143* ("FIN 47"), required companies to record additional AROs as a result of conditional obligations to remove or dispose of assets but does not change any of the fundamental accounting requirements of FAS 143 or FERC Order No. 631. In December 2005 PSE implemented FIN 47. FIN 47 clarifies the term "conditional asset retirement obligation" as a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity.[3] The obligation to perform the asset retirement activity is unconditional even though

[2] *See* Adjustment No. 15.33 and Adjustment No. 13.06, provided as Exhibit No. ___(JHS-15) and Exhibit No. ___ (KRK-13), respectively.

uncertainty exists about the timing or method of settlement. Uncertainty about the timing or method of settlement of a conditional ARO should be factored into the measurement of the liability when sufficient information exists. FIN 47 clarifies when an entity has information sufficient to reasonably estimate the fair value of an ARO.

Where indefinite life exists, material obligations should be recognized or disclosed if a legal retirement obligation applies to the interim retirement of a system and the timing and method of settlement can be reasonably estimated. If a liability's fair value cannot be reasonably estimated, that fact and the reasons shall be disclosed.[4]

Q. What steps did PSE follow to ensure proper implementation of FIN 47?

A. PSE reviewed its legal obligations as of September 30, 2005 to verify that obligations within the scope of FAS 143 were properly measured and recorded upon initial implementation in 2003. For the obligations that were not previously recorded, PSE verified that those that did not meet the requirements at the time of implementation of FAS 143 were still valid under FIN 47. For those that were not originally measured due to an indeterminable settlement date, PSE determined if the facts and circumstances would require an asset retirement obligation. PSE reviewed the items with the responsible field personnel to determine if

[3] FIN 47, ¶3.
[4] *See* id., ¶6.

information was available to reasonably estimate the settlement date or a range of potential settlement dates. PSE also reviewed leases, agreements, and other contracts. Material obligations that could be measured were accounted for with the implementation of FIN 47. Material items that still could not be measured were disclosed in the financial statements.

AROs that were considered immaterial and that did not have indeterminable settlement dates were aggregated in logical groupings for further consideration of whether a liability should be booked. These consisted primarily of miscellaneous facility leases and communication site agreements.

Q. What additional AROs were recorded at the implementation of FIN 47?

A. PSE recorded an asset retirement obligation for the following items:

1) disposal costs related to asbestos in facilities that are scheduled for remodeling or demolition under federal hazardous waste and Washington dangerous waste regulations,

2) costs related to disposal of treated wood poles,

3) costs related to disposal of oil containing polychlorinated biphenyls (“PCB”) and the related equipment that held the oil, and

4) costs to disconnect abandoned pipelines, purge gas, and cut and cap supplies of gas.

Q. What was the impact of implementation of FIN 47 to PSE’s financial statements?

A. Exhibit ___(MJS-4) provides the accounts affected by the implementation of FIN

47 along with the impacts to PSE's financial statements.

Q. What AROs are recovered in depreciation rates versus not recovered in depreciation rates?

A. The table below identifies the AROs and whether or not costs of removal were sufficient to cover the ARO currently being recovered in the Company's approved depreciation rates.

Asset Retirement Obligation	FERC Account	Underlying Asset Account	In Depreciation Rates?
Whitehorn 2 & 3	347	N/A	no
Hopkins Ridge Wind Project	347	N/A	no
Asbestos - Electric	399	N/A	no
Asbestos - Common	399	N/A	no
Frederickson - steam 57%	317	N/A	no
Frederickson - other 43%	347	N/A	no
Wild Horse Wind	347	N/A	no
Shuffleton Harbor Lease	317	N/A	yes
Cast Iron Gas Pipe	388	376.4	yes
Colstrip 1 & 2 Ash Pond Capping	317	311	yes
Colstrip 3 & 4 Ash Pond Capping	317	311	yes
Bare Steel Gas Pipe	388	376.3	yes
Distribution Wood Poles	374	364	yes
Transmission Wood Poles	359	355	yes
Contaminated Oil & Related Equip	374	368	yes
Gas Mains	388	376.1	yes
Steel Wrapped Gas Services	388	380.3	yes

Q. Why are some of PSE's newer plant additions listed as not recovered in rates?

A. When the plants were added to in-service the depreciation rate was not based on a depreciation study, and the depreciation rates did not include costs of removal in the calculation of the depreciation rate. With the implementation of the depreciation study proposed by Mr. Clarke, the calculation of the depreciation rates for these plants will include cost of removal.

Q. How does rate recovery affect the recording of ARC depreciation and accretion on PSE's financial statements?

A. For financial reporting for AROs in which cost of removal is embedded in PSE's depreciation rates (and are thus being recovered in rates), the embedded ARC depreciation and ARO accretion expense is reclassified from Account 403 depreciation expense and from Account 108 accumulated deprecation because cost of removal is part of the original depreciation expense. The ARC depreciation is expensed to Account 403.1 and the credit is to Account 108, while the ARO accretion expense is expensed to Account 411.10 and the credit is to ARO Account 230. Because both the ARC depreciation expense and the ARO accretion expense are included in the original depreciation expense of the underlying asset; there is no impact to net operating income because the entries merely represent a reclassification. Also, because all of these accounts are above the line, they are included in the regulatory income statement. While these entries represent a gross-up of the balance sheet on PSE's financial statements, the effect of this gross-up is reversed on PSE's books maintained for regulatory accounting and for ratemaking process by including both the ARC accumulated depreciation and the ARO liability in Utility Plant in Service.

For financial reporting for AROs in which cost of removal is not embedded in PSE's depreciation rates and not recovered through rates, the gross-up of the balance sheet for the ARC and ARO liability as well as the recognition of the ARC depreciation expense and the ARO accretion expense are incremental to the accounting for FAS 143. Similarly, these balance sheet and income statement accounts are excluded from ratebase on PSE's books maintained for regulatory accounting and from net operating income in the regulatory financial statements filed in a rate case proceeding such as this.

Q. Do you agree with Public Counsel's statement that FAS 143 can be applied to cost of removal other than legal obligations?

A. No. FAS 143, paragraph 2, states that the scope of FAS 143 applies only to legal obligations and excludes obligations that arise solely from a plan to dispose of a long-lived asset and excludes obligations that result from the improper operation of an asset. Additionally, FERC Order No. 631, paragraphs 38 and 39, state that costs of removal that do not qualify as legal retirement obligations fall outside the scope of Order 631 and do not require costs of removal to be transferred to a regulatory liability. FERC Order No. 631 does require the company's books to be maintained to separate records for costs of removal for non-legal retirement obligations to be maintained in accumulated depreciation. Additionally, paragraphs 38 and 39 of Federal Energy Regulatory Commission ("FERC") Order No. 631 does not require cost of removal to be transferred to a regulatory liability, but rather it requires that a company's records of accumulated depreciation be kept in enough detail to show the cost of removal included in the company's reserve.

Q. What is the definition of non-legal retirement obligation (cost of removal other than legal obligations)?

A. It is retirement obligations that do not meet the definition of FAS 143 legal obligations. It does not mean that the retirement obligation does not exist, as Mr. King and Mr. Majoros define it.

III. COST OF REMOVAL

Q. How is cost of removal for obligations other than legal obligations calculated and recorded?

A. The calculation of costs of removal for obligations other than legal obligations is based on a confusing formula which is the net salvage accrual, less incurred cost of removal, plus salvage, less return to stores, and less retirement work in progress, where net salvage accrual equals depreciation expense multiplied by a net salvage ratio.

Under FERC guidelines, costs of removal are required to be included as a component of the depreciation expense and recorded in accumulated depreciation. With FERC Order No. 631, FERC did not fundamentally change existing accounting concepts but added a requirement for entities to maintain separate subsidiary records for the cost of removal of other than legal obligations that are included as specific identifiable allowances recorded in accumulated depreciation in order to facilitate external reporting and regulatory analysis, and for rate setting purposes.

Q. Do you agree with Public Counsel's statement that all cost of removal collected are AROs?

A. No. Cost of removal that has been collected for non-legal obligations are not AROs and should not be accounted for pursuant to FAS 143 or FIN 47. Following Public Counsel's recommendation in this regard would violate FERC instructions. USoA General Instruction 25 defines AROs, and Account 108 provides how cost of removal other than legal obligations should be recorded in Account 108. The FERC instructions for Account 108 state that entities should not transfer any portion of Account 108 to retained earnings or make any other use without the authorization of FERC.[5]

Q. Do you agree with Public Counsel that $137.9 million represents overcollection of future costs?

A. No. The $137.9 million represents cost of removal other than legal obligations that have been collected from customers to pay for future costs of removal. Examples of non-ARO types of costs are costs of removing electric generation equipment, transmission and distribution poles and transformers overhead

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[5] Title 18: Conservation of Power and Water Resources: Part 101 — Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act,

conductor and devices, substation equipment, underground conductor and devices, meters, gas regulating station equipment and gas mains. Any collection of cost of removal included as a component of the depreciation expense from customers will result in a credit balance in accumulated depreciation and is an offset to plant costs prior to final settlement of cost of removal on retired assets. As the removal work is completed at the end of the asset life, the cost of removal is charged to the accumulated depreciation reserve. Periodic depreciation studies are intended to adjust the accumulated depreciation reserve if it is over-stated and under-stated, as explained by Mr. Clarke in his prefiled direct testimony, Exhibit No.___ (CRC-1T). Public Counsel witness Michael Majoros has not provided any evidence to support his statement that the amount of cost of removal is overstated as compared to future costs.

Q. Do you agree with Public Counsel's statement that Both FAS 143 and FERC Order No. 631 identify and highlight utilities' prior excess collection for future cost of removal?

A. No. I do not agree that either FAS 143 or FERC Order No. 631 deals with excess future cost of removal. These documents deal with the financial reporting of legal obligations related to cost of removal so that users of the financial statements have information regarding future obligations that is comparable across entities. Neither FAS 143 nor FERC Order No. 631 has anything to do with excess cost of removal.

Account 108.

Q. Do you agree with Public Counsel's statement that when a utility has collected depreciation related to future cost of removal, the utility must report such collections as a separate regulatory liability?

A. No. PSE has collected through depreciation expense for future cost of removal other than legal obligations related to its assets in order to allocate these costs to customers over the lives of those assets. Because the costs of removal will not be incurred until after the asset ceases operations, these collections must occur prior to the costs being paid. The Securities and Exchange Commission ("SEC") requires utilities to report these collected costs as a regulatory liability for financial reporting. However, this is an SEC requirement for financial reporting purposes only. The Company does not make this adjustment to its regulatory financial statements and follows FERC guidance by keeping accumulated cost of removal other than legal obligations in accumulated depreciation.

Q. Does FERC Order No. 631 apply to cost of removal that do not qualify as legal obligations?

A. No. FERC has stated that costs of removal that do not qualify as legal obligations, as defined by FAS 143, fall outside of Order No. 631.[6] Therefore, PSE must follow USoA Plant Instructions 10, which states that the cost of removal and the salvage shall be charged or credited to accumulated provision for depreciation. In addition, Account 108 provides that cost of removal other than

[6] FERC Order No. 631, ¶37.

legal obligations should be recorded in Account 108.

Q. Is it true, as Public Counsel states, that PSE does not have an opinion as to the treatment of legal obligations or costs of removal other than legal obligations being treated as a regulatory liability?

A. No. PSE's Response to Public Counsel Data Request No. 243 is taken out of context in Mr. Majoros's testimony. Public Counsel concludes that PSE does not have an opinion with regard to accounting treatment of costs related to removal of assets, which in not true. PSE stated in its Response to Public Counsel Data Request No. 243 that FAS 143 was not part of the rate proceeding because such accounting is based on GAAP rather than USoA. See Exhibit No. ___(MJS-5) for a copy of this data request and response. USoA and FERC do not allow for AROs or cost of removal to be treated as a regulatory liability.

In addition, Mr. Majoros also ignores PSE's Response to Public Counsel Data Request No. 242, in which PSE states,

> PSE does not propose to separate retirement cost accounting from depreciation accounting, with separate rates and reserves. PSE believes that its current methodology of accounting in its GAAP basis consolidated financial statements for legal costs of removal and estimating non-legal costs of removal for compliance with SEC regulations and FERC Order No. 631 is sufficient. Regardless, PSE did not include the impacts of the above mentioned accounting in any proposals made in this proceeding.

Q. Would PSE be able to transfer the costs of removal from Account 108 and record accumulated depreciation as a regulatory liability if it wanted to?

A. No. As stated previously in my rebuttal testimony, USoA Account 108 makes it very clear that items in accumulated deprecation are prohibited from being transferred without the authority of FERC. Account 108, item E, states,

> The utility is restricted in its use of the accumulated provision for depreciation to the purposes set forth above. It shall not transfer any portion of this account to retained earnings or make any other use thereof without authorization by the Commission.

In addition, FERC has issued several letters to utilities as well as a FERC Order prohibiting them from reallocating accumulated depreciation.[7] FERC has also stated that adjustments are not permitted without the authorization of the Chief Accountant of FERC.[8] Moreover, transferring costs of removal from Account 108 to Account 254 as advocated by Public Counsel would be an unwarranted departure from the accounting treatment directed by FERC because FERC requires the Chief Accountant to approve all departures from USoA.[9]

Q. Can this Commission order PSE to transfer accumulated cost of removal to a regulatory liability?

A. Yes. However, FERC's Chief Accountant still must approve any departure from USoA. If PSE cannot obtain such approval, PSE would be obligated to create a

[7] These letters and an example of such an order are attached as Exhibit No. ___(MJS- 6).

[8] Title 18: Conservation of Power and Water Resources: Part 101 — Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act, 375.303

separate set of regulatory books for state regulatory accounting and rate proceedings.

Q. Does FERC or USoA provide any guidance regarding accounting treatment of excess costs of removal?

A. Yes. In a letter issued to Bruder, Gentile and Marcoux on behalf of Florida Power Corporation on November 22, 1991, the Chief Accountant of FERC stated that when applying straight-line remaining life method for depreciation, the over and under accruals of depreciation recorded in past periods are corrected over the remaining life of the related property by adjusting the book depreciation rates prospectively.[10]

Q. What are the accounting implications for treating cost of removal other than legal obligations in the method that Public Counsel recommends?

A. Public Counsel witness Mr. King suggests the Company should be required by the Commission to use the same procedures as FAS 143 to account for cost of removal other than legal obligations. As previously discussed, this would require PSE to use a combination of straight line depreciation and a present value technique to ultimately accrue the full amount of removal costs over the life of the associated plant thereby resulting in retirement obligations being accounted for pursuant to FAS 143 and accreted up to the appropriate liability without recovery

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9 *See* FERC Docket No. FA84-2-200, at 4.
10 *See* Exhibit No.___(MJS-7).

in rates of the accretion expense. As I previously stated, FAS 143 does not allow cost of removal other than legal obligations to be accounted for under this accounting pronouncement. If PSE were to implement Mr. King's suggestion that PSE use the same procedures for cost of removal other than legal obligations as for FAS 143 legal obligations, PSE would need to create asset retirement costs for these assets along with accumulated depreciation for the asset retirement costs so that PSE could record depreciation expense for these items. PSE would also need to create asset retirement obligation liabilities, as well. Public Counsel has not taken into account this methodology to recover new assets, liabilities or expenses in Mr. King's adjustments for depreciation expense. The procedures that are used for FAS 143 require PSE to accrete the ARO liability to its fair value each month. As indicated above, the future increases in interest costs to accrete up the liability are not included in any of Public Counsel's adjustments.

Q. What would happen if cost of removal were not adjusted for period-to-period changes?

A. The present value of the estimated costs of removal must be accreted monthly until the settlement date to accumulate the future value of the cost of removal. This accretion amount increases every month over the cost recovery period. If the rate recovery for cost of removal is not accreted or adjusted for these changes, there will be a shortfall when it is time to settle the liability. The effect would be that future customers would bear the burden of costs for which current customers received the benefit.

Q. What are some of the additional costs that would be incurred by PSE if it were required to implement FAS 143 for costs of removal other than legal obligations, as Public Counsel has proposed?

A. If PSE were required to implement FAS 143 for all cost of removal, additional accounting staff would be required to manage the process of obtaining and monitoring changes in cash flows used in estimates of fair value, which would vary by asset type. FAS 143 requires an entity to recognize period to period changes in the liability for an ARO that result from the passage of time and changes to the timing or amount of the original estimate of undiscounted cash flows. These types of costs are unnecessary for PSE customers because cost of removal other than legal obligations do not fall in the scope of FAS 143 or FIN 47. Public Counsel did not consider any such additional costs to implement FAS 143 procedures for all assets.

Q. Public Counsel recommends using a five-year average and a present value method for costs of removal. What would happen if the Company's infrastructure replacement program over the next several years assumed an annual cost of removal higher than the Company's experience over the previous five years or at the present value of the cost of removal?

A. Legal costs of removal (ARO depreciation and accretion) could no longer be reclassified from the underlying asset depreciation expense. Currently, there is no impact on PSE's financial statements under FAS 143 methodology; however, under Public Counsel's methodology, the Company would be required to expense more costs under FAS 143 than what are recovered in rates for legal obligations.

Another problem with Public Counsel's recommendations is that they lack consistency. Mr. King proposes using the discounted rates for cost of removal, but his recommendation also includes an adjustment to take the higher of the actual average for the last five years or the discounted rate for cost of removal. This is not in accordance with FAS 143 methodology for calculating AROs.

IV. STORM ADJUSTMENT RELATED TO COST OF REMOVAL

Q. Is Public Counsel's proposed adjustment to PSE's storm costs relating to the amortization of cost of removal from a regulatory liability appropriate?

A. No. As previously described, Account 108 of USoA accounting instructions for accumulated depreciation does not allow amounts to be transferred from Account 108 to any other classification without the authorization of FERC's Chief Accountant. As noted previously, in FERC's Chief Accountant letters, a transfer to a regulatory liability and amortization of such liability to operations and maintenance expense is against USoA guidance and highly unlikely to be accepted by FERC.

V. CONCLUSION

Q. Does that conclude your prefiled rebuttal testimony?

A. Yes.