

Exhibit No. \_\_ T (RTA-1T)  
Dockets UE-111048/UG-111049  
Witness: Rick T. Applegate

BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION  
COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

DOCKET UE-111048  
DOCKET UG-111049  
(Consolidated)

TESTIMONY OF

RICK T. APPLGATE

ON BEHALF OF THE STAFF OF  
WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION

*Revenue Requirement Adjustments:  
Lower Snake River, Storm Damage, Property Taxes, and Rate Case Expenses*

December 7, 2011

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## LIST OF EXHIBITS

Exhibit No. ____ (RTA-2)	Lead Sheet of Attachment D, Company Response to Staff Data Request No. 195
Exhibit No. ____ (RTA-3)	Lower Snake River Adjustment Summary
Exhibit No. ____ (RTA-4)	Storm Damage Adjustment Calculation
Exhibit No. ____ (RTA-5)	Storm Damage Adjustment Summary
Exhibit No. ____ (RTA-6)	Property Taxes Adjustment Summary

1 I. INTRODUCTION

2

3 Q. Please state your name and business address.

4 A. My name is Rick T. Applegate. My business address is the Richard Hemstad  
5 Building, 1300 S. Evergreen Park Drive SW, P.O. Box 47250, Olympia, WA 98504.  
6 My e-mail address is rapplega@utc.wa.gov.

7

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

9 A. I am employed by the Washington Utilities and Transportation Commission  
10 (“Commission”) as a Regulatory Analyst in the Energy Section of the Regulatory  
11 Services Division.

12

13 Q. How long have you been employed by the Commission?

14 A. I have been employed with the Commission since August 2008.

15

16 Q. Please state your educational and professional background.

17 A. I graduated from the University of Montana in 2001 receiving a degree in Business  
18 Administration with an emphasis in Finance. In 2005, I received a J.D. degree from  
19 the Willamette University College of Law and an M.B.A. degree from the Atkinson  
20 Graduate School of Management.

21

22 My current responsibilities include the analysis of general rate cases  
23 (“GRC”), conservation, and other filings by energy companies subject to regulation  
by the Commission. I filed responsive testimony in the CenturyTel/Qwest Merger

1 Docket UT-100820, the Verizon/Frontier Merger Docket UT-090842, and the  
2 Embarq Access Charge Compliant Docket UT-081393.

3 Prior to joining the Commission, I worked for various employers in the legal,  
4 real estate, and financial services industries.

5  
6 **II. SCOPE AND SUMMARY OF TESTIMONY**

7  
8 **Q. What is the purpose of your testimony in this proceeding?**

9 A. My testimony presents Staff's recommendation regarding the following ten  
10 ratemaking adjustments proposed by Puget Sound Energy, Inc. ("PSE" or "the  
11 Company") for its electricity and natural gas results of operations:

- 12 • Adjustment 5.01G, Water Heater Depreciation
- 13 • Adjustment 13.02, Lower Snake River
- 14 • Adjustment 13.04, Montana Electric Energy Tax
- 15 • Adjustment 13.07, Storm Damage
- 16 • Adjustments 14.07 and 6.07G, General Plant Depreciation
- 17 • Adjustments 14.08 and 6.08G, Injuries & Damages
- 18 • Adjustments 14.11 and 6.11G, Property Taxes
- 19 • Adjustments 14.15 and 6.15G, Rate Case Expenses
- 20 • Adjustments 14.16 and 6.16G, Deferred G/L on Property Sales
- 21 • Adjustments 14.17 and 6.17G, Property and Liability Insurance

22 The results of my analysis of these adjustments are incorporated into the summary  
23 revenue requirement exhibits of Staff witness Roland C. Martin for PSE's electric

1 operations (Exhibit No. \_\_ (RCM-2) and Christopher T. Mickelson for PSE's natural  
2 gas operations (Exhibit No. \_\_ (CTM-2)).  
3

4 **Q. Which Company adjustments that you have reviewed are uncontested by Staff?**

5 A. The following adjustments are uncontested by Staff:

- 6 • Adjustment 5.01G, Water Heater Depreciation
- 7 • Adjustment 13.04, Montana Electric Energy Tax
- 8 • Adjustments 14.07 and 6.07G, General Plant Depreciation
- 9 • Adjustments 14.8 and 6.08G, Normalize Injuries & Damages
- 10 • Adjustments 14.16 and 6.16G, Deferred G/L on Property Sales
- 11 • Adjustments 14.17 and 6.17G, Property and Liability Insurance

12  
13 **Q. Does Staff contest all of the remaining Company adjustments within your area  
14 of responsibility?**

15 A. Yes. These contested adjustments are:

- 16 • Adjustment 13.02, Lower Snake River
- 17 • Adjustment 13.07, Storm Damage
- 18 • Adjustments 14.11 and 6.11G, Property Taxes
- 19 • Adjustments 14.15 and 6.15G, Rate Case Expenses

20  
21 **Q. Are you sponsoring any exhibits in support of your testimony?**

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

- 23 • Exhibit No. \_\_ (RTA-2), Lead Sheet of Attachment D, Company Response to  
24 Staff Data Request No. 195

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- Exhibit No. \_\_\_\_ (RTA-3), Lower Snake River Adjustment Summary
- Exhibit No. \_\_\_\_ (RTA-4), Storm Damage Adjustment Calculation
- Exhibit No. \_\_\_\_ (RTA-5), Storm Damage Adjustment Summary
- Exhibit No. \_\_\_\_ (RTA-6), Property Tax Adjustment Summary

### III. DISCUSSION

#### A. Adjustment 13.02, Lower Snake River

#### Q. Please describe the Lower Snake River adjustment.

A. The adjustment recovers the pro forma costs of operating the new Lower Snake River (“LSR”) Phase 1 generating facility. Staff’s adjustment presumes the prudence of LSR, as discussed by Staff witness David Nightingale, but contests certain aspects of the Company’s calculation of the adjustment.

#### Q. Please describe the aspects of this adjustment that you contest.

A. I recommend that the Commission update this adjustment to reflect an in-service date of February 11, 2012. I also recommend that the Commission reject PSE’s pro forma property tax expense for LSR and limit recovery of capital expenditures to construction work in progress (“CWIP”) and remaining contractual obligation balances.

1 **Q. Why does the in-service date affect the amounts appearing in this adjustment?**

2 A. Allowance for funds used during construction (“AFUDC”) ceases to accrue and  
3 depreciation commences when plant enters commercial operation. Accordingly,  
4 amounts contemplated in PSE’s pro forma adjustment will change depending on  
5 when LSR becomes operational. At present, PSE anticipates that LSR will enter  
6 service on February 11, 2012 and not in April 2012 as contemplated by PSE at the  
7 start of this proceeding.<sup>1</sup> Therefore, it is appropriate to calculate the adjustment  
8 using the updated in-service date. Staff witness Roland C. Martin also discusses in  
9 his testimony the revenue requirements implications of recognizing an early in-  
10 service date for LSR.

11  
12 **Q. Does your recommendation for LSR property taxes follow your reasoning with**  
13 **respect to Adjustments 14.11 and 6.11G, Property Taxes Adjustments,**  
14 **discussed later in your testimony?**

15 A. Yes. PSE proposes to recover pro forma property taxes of \$2,967,101 for LSR.  
16 While PSE’s calculation of that amount varies slightly from the calculation of pro  
17 forma property taxes for other electric and natural gas plant, it still represents the  
18 product of multiple estimated values, including an adjusted total project cost,  
19 personal property tax electric discount rate, system ratio, and levy rate. Accordingly,  
20 the Commission should reject the Company’s proposal to recover pro forma property  
21 taxes of \$2,967,101 for LSR, as that amount is not known and measurable.

22  

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<sup>1</sup> Exhibit No. \_\_ (RG-1HCT) at 83:9.

1 **Q. Please identify the basis on which the Commission may calculate rates based on**  
2 **CWIP and remaining contractual obligation balances?**

3 A. Exhibit No. \_\_ (RTA-2) presents the lead sheet from Part D of PSE's response to  
4 Staff Data Request 195 that compares two versions of the LSR adjustment. The first  
5 version presents PSE's proposed adjustment, which is based on forecasted  
6 expenditures. The second version represents a recast adjustment showing the most  
7 recent actual charges to CWIP as of October 31, 2011 and remaining contractual  
8 obligations. I recommend that the Commission reject recovery of the first version  
9 and allow recovery based on the second version.

10  
11 **Q. Why should the Commission limit recovery to CWIP and remaining contractual**  
12 **obligations?**

13 A. Forecasted costs should not determine rates because they are not known and  
14 measurable. CWIP and remaining contractual obligations provide a more credible  
15 basis on which to base rates.

16  
17 **Q. Please identify the effect of your LSR adjustment on electric revenue**  
18 **requirement.**

19 A. My proposed adjustment decreases net operating income ("NOI") by \$35,151,089  
20 and increases rate base by \$644,066,095. A comparison of this adjustment with the  
21 adjustment proposed by PSE appears in Exhibit No. \_\_ (RTA-3).



1 **B. Adjustment 13.07, Storm Damage Adjustment**

2

3 **Q. Please summarize the purpose of the Company's Adjustment 13.07 for Storm**  
4 **Damage.**

5 A. This restating and pro forma adjustment provides for recovery of expenses caused by  
6 major storms. It operates through three mechanisms. The first mechanism recovers  
7 PSE's storm-related damages for annual expenses of less than \$8 million dollars  
8 through a six year average. The second mechanism defers storm costs that exceed  
9 the annual \$8 million threshold. This deferral amortizes over a four year period and  
10 can earn a return through the working capital allowance. The third mechanism  
11 recovers the unamortized portion of damages resulting from the extraordinary events  
12 of the December 13, 2006 Hanukkah Eve storm over ten years, again with a return  
13 on the deferred expense.

14

15 **Q. Please describe the aspects of this adjustment that you contest.**

16 A. PSE seeks to recover deferred damage amounts of \$86,185 from 2008 and  
17 \$13,909,769 from 2010 through the four year amortization mechanism. I  
18 recommend that the Commission reject this request and require the Company to  
19 instead recover these amounts through the same six year average mechanism that  
20 applies when average annual storm costs are less than \$8 million. My  
21 recommendation stems from a broader policy to transition away from use of the four  
22 year deferral mechanism. Exhibit No. \_\_ (RTA-4) shows the calculation of my  
23 adjustment.

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**Q. How did the current storm damage recovery mechanisms come about?**

A. The Company's 2007 GRC in Docket UE-072300 gave rise to the three recovery mechanisms appearing in this adjustment. During that rate case, the Commission approved recovery of \$83.6 million of deferred Hanukkah Eve storm costs over 10 years.<sup>2</sup> It also set the \$8 million threshold to defer storm costs starting in 2009.<sup>3</sup> The case reaffirmed the use of a six year average mechanism, which has been a long standing feature of a storm damage adjustment.<sup>4</sup>

**Q. Please explain generally the difference between a methodology based on average costs that your adjustment uses and a methodology based on deferred costs that PSE's adjustment uses.**

A. For ratemaking purposes, an average treats expenditures as an expense and it sets expense recovery in rates at a level that is representational of expenditures over a period of time longer than one year. In the instance of storm damages, this period has historically been six years because storm damage expenditures fluctuate significantly from year to year.

A deferral treats expenditures as an intangible asset that amortizes over a set life. By delaying the start of amortization until the point in time when rates can reflect the deferral, a company eventually receives dollar-for-dollar recovery of the deferred expenditures. Also, because a deferral balance is an asset, it creates an

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<sup>2</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-072300 and UG-072300, Order 12, ¶¶ 58 and 89 (October 8, 2008).

<sup>3</sup> *Id.*

<sup>4</sup> See *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-920433, UE-920499, and UE-921262, Eleventh Supplemental Order, page 52 (September 21, 1993).

1 opportunity for the company to earn an additional return on the deferral balance  
2 through an allowance for working capital.

3  
4 **Q. Should a company recover its normal expenses through a deferral?**

5 A. No. Deferred recovery of normal operating expenses forces future rate payers to pay  
6 the day-to-day costs of serving present rate payers. It also forces future rate payers  
7 to compensate the company for waiting to recover those expenses.

8  
9 **Q. How should rates provide for recovery of normal operating expenses?**

10 A. Present rates should reflect present normal operating costs. For significantly  
11 fluctuating expenditures such as storm damage costs, this can be accomplished  
12 reasonably by calculating costs on annual average over a multiyear period, as I  
13 recommend.

14  
15 **Q. Does PSE's proposed storm damage adjustment inappropriately recover  
16 normal operating costs through the four year deferral?**

17 A. Yes. PSE's proposed storm damage adjustment recovers normal operating costs  
18 through the four year deferral. Recent experience demonstrates that PSE routinely  
19 incurs storm damage costs in excess of the annual \$8 million deferral threshold.  
20 Between 2005 and 2010, PSE storm-related costs exceeded \$8 million in 2006, 2007,  
21 2008 and 2010. During 2006, 2007, and 2010, storm-related damages were more  
22 than double this threshold.

1 **Q. Does your proposed adjustment recover normal operating costs through a**  
2 **deferral?**

3 A. No. In moving certain 2008 and 2010 storm damage costs from the four year  
4 deferral to the six year average, my proposed adjustment reduces the recovery of  
5 normal expenses through a deferral.

6

7 **Q. Are there other benefits to transitioning away from the use of the four year**  
8 **deferral mechanism?**

9 A. Yes. The four year deferral mechanism is undesirable because it creates rate shock  
10 and adds to the complexity of a GRC filing. The six year average moderates rate  
11 changes by recognizing 1/6 the cost of major storms in annual rates whereas the four  
12 year deferral recognizes 1/4 the cost.

13 The six year average also simplifies a company's GRC filing because it can  
14 be supported with a simple set of queries from a company's accounting system  
15 whereas a deferral requires custom amortization schedules that must account for the  
16 timing of a storm and the recognition of storm costs in rates.

17

18 **Q. Do you recommend transitioning away from all deferred recovery of storm**  
19 **related damages?**

20 A. No. In limited catastrophic circumstances, I support the use of deferrals that recover  
21 storm-related damages over seven or more years. When calculated over periods of  
22 more than seven years, a deferral can effectively reduce the rate impact of a truly  
23 catastrophic year, such as 2006.

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**Q. Does your recommendation shift benefits and risks between the Company and ratepayer?**

A. In theory, my proposal shifts risk from ratepayers to the Company. However, in an era of frequently occurring rate cases, such as we have with PSE and expect to see continue, it is unlikely that my recommendation will have much of an effect on risk allocation.

**Q. In contesting PSE's proposed storm damage adjustment, are you changing the handling of specific expenses approved for recovery in any prior rate case?**

A. No. My proposed adjustment allows PSE to amortize all storm related expenses approved for recovery in Docket UE-090704. The 2008 and 2010 storm damage amounts of \$86,185 and \$13,909,769, which are the subject of my proposed adjustment, were not included in the Company's GRC filing. Accordingly, these damage amounts were not contemplated by the final rate order of that GRC.

**Q. In contesting PSE's proposed storm damage adjustment, are you disallowing any storm-related damages?**

A. No. My adjustment allows PSE to collect all storm-related costs reported in this rate case.

1 **Q. Please identify the effect of your adjustment on electric net operating income.**

2 A. My proposed adjustment increases NOI by \$2,107,628. A comparison of this  
3 adjustment with the adjustment proposed by PSE appears in Exhibit No. \_\_ (RTA-5).

4  
5 **C. Adjustments 14.11 and 6.11G, Property Taxes Adjustments**

6  
7 **Q. Please describe your Property Taxes Adjustments.**

8 A. This pro forma and restating adjustment determines the amount of property tax  
9 expense to recover in rates. In his direct testimony, PSE witness Matt Marcellia  
10 describes the process PSE must undergo to pay its annual property taxes.<sup>5</sup> I  
11 summarize his testimony and the PSE process as creating a 16 month difference  
12 between the time when property tax liability arises and when property tax bills are  
13 determined. It is this substantial timing differential that gives rise to this adjustment.

14  
15 **Q. Please describe the aspects of this adjustment that you contest.**

16 A. PSE seeks to recover property tax expenses by estimating the amount it expects to  
17 pay for property owned *at the end* of the test year. I recommend that the  
18 Commission reject this request and instead allow the Company to recover the actual  
19 amount of property tax payable for property owned by PSE *at the start* of the test  
20 year.

21

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<sup>5</sup> Exhibit No. \_\_ (MRM-1T) at 35:10-40:6.

1 **Q. Please describe the standard for this adjustment.**

2 A. In Order 11 in Docket UE-090704, the Commission found it appropriate to use test  
3 year actual tax rates and Department of Revenue (“DOR”) centrally assessed values  
4 to determine the amount of property taxes recoverable in rates.<sup>6</sup> The Commission  
5 further found it was inappropriate to set rates based on estimated levy rates that will  
6 not be known until a later time.<sup>7</sup> Underlying that decision is WAC 480-07-  
7 510(3)(e)(iii), which specifies that pro forma adjustments should “... give effect for  
8 the test period to all *known and measurable* changes that are not offset by other  
9 factors.” (Emphasis added). This adjustment must also comply with the matching  
10 principal or the requirement that revenues, expenses, and investments synchronize  
11 during the test year.

12  
13 **Q. Please describe the method that you recommend for calculating the property  
14 tax adjustment.**

15 A. I recommend that the Commission use the property tax values assessed in April of  
16 2011 for property owned by PSE on January 1, 2010, the beginning of the test year,  
17 as the basis for calculating this adjustment. Mr. Marcelia provides these values for  
18 electric and natural gas property in Exhibit No. \_\_ (MRM-13). I incorporated them  
19 into my Exhibit No. \_\_ (RTA-4) to restate PSE’s accrued property taxes for the test  
20 year. This treatment is consistent with the treatment described by the Commission’s  
21 Order 11 in Docket UE-090704.

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<sup>6</sup> *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-090704 and UG-090705, Order 11, ¶ 59 (April 2, 2010).

<sup>7</sup> *Id.*

1 **Q. Is your adjustment consistent with the “known and measurable” standard for**  
2 **ratemaking?**

3 A. Yes. Because my adjustment relies on values issued by DOR and various counties,  
4 my proposed adjustment is known and measurable for rate making purposes.

5

6 **Q. Is your proposed adjustment consistent with the matching principal of**  
7 **ratemaking?**

8 A. Yes. My proposed adjustment matches revenue requirement with the actual cash  
9 outlays PSE must make as the result of owning and operating its property during the  
10 test year. Any property acquired by PSE during the test period is not subject to  
11 property tax liability until January 1 of the following year, which is outside of the  
12 test year. Accordingly, no additional revenue than what is provided in my  
13 adjustment is necessary to support the Company’s property tax obligations during the  
14 test year.

15

16 **Q. Does the adjustment proposed by PSE violate the “known and measurable”**  
17 **standard?**

18 A. Yes. To produce its property tax adjustment, PSE applies three estimated  
19 coefficients to the known values issued by DOR and county taxing authorities. Each  
20 coefficient introduces error, which could compound as the values are multiplied  
21 against each other.

22 PSE begins its proposed adjustment with the taxable property amount  
23 identified by DOR. The Company then applies the three estimated coefficients.



1 First, PSE multiplies the DOR assessed property value by the growth in PSE's  
2 taxable plant accounts during the test year. The product represents PSE's estimated  
3 property value for tax purposes at the end of the test year. Second, PSE multiplies  
4 the estimated property value by PSE's overall system ratio from the most recent tax  
5 year. This product provides an estimate of PSE's adjusted property value that the  
6 Company will use to calculate a billed amount. Third, PSE multiplies this adjusted  
7 property value by a levy rate averaged across the counties in PSE's service territory.  
8 The final product represents PSE's estimated tax amount for property owned at the  
9 end of the test year.

10  
11 **Q. Please identify the effect of your adjustment on electric and natural gas net**  
12 **operating income.**

13 A. My proposed adjustment decreases electric NOI by \$474,214 and natural gas NOI by  
14 \$545,997. A comparison of this adjustment with the adjustment proposed by PSE  
15 appears in Exhibit No. \_\_ (RTA-6).

16  
17 **D. Adjustments 14.15 and 6.15G, Rate Case Expenses Adjustments**

18  
19 **Q. Please describe the Rate Case Expenses adjustments.**

20 A. These adjustments restate test year rate case expenses to normalized levels. PSE's  
21 proposed adjustment determines the normalized level by considering the costs of the  
22 Company's two most recent GRCs and two most recent power cost only rate cases  
23 ("PCORCs"). To calculate the normalized natural gas rate case expense, PSE

1 averages the cost of the GRCs, allocates 50 percent of this cost to natural gas  
2 operations, and then adjusts the number by the frequency of GRC filings. PSE  
3 follows the same process to calculate the normalized electric rate case expense,  
4 except that it adds the average PCORC cost adjusted for the frequency of those  
5 filings.

6  
7 **Q. Please describe the aspects of this adjustment that you contest.**

8 A. I recommend that the Commission reject PSE's proposed rate case adjustments in  
9 their entirety and allow the Company to recover 2010 test year rate case expenses.

10  
11 **Q. Does your proposed adjustment provide fair and sufficient compensation to the  
12 Company for its rate case expenses?**

13 A. Yes. Even though PSE did not file a combined gas and electric GRC in 2010, the  
14 Company incurred substantial GRC costs during 2010 that are reflected in test year  
15 values. For electric operations after allocation of common costs, in 2010 PSE  
16 expended \$410,189 to complete the 2009 GRC and \$231,386 in preparation for this  
17 2011 GRC. Likewise, for natural gas operations after allocation of common costs, in  
18 2010 PSE expended \$173,298 and \$98,127 on the 2009 and 2011 GRC, respectively.  
19 PSE's per books results also include 2010 costs for Docket UG-101644, a natural gas  
20 tariff filing that increased natural gas revenues on margin (*i.e.*, relative to the non-gas  
21 costs) by 4.76 percent.<sup>8</sup>

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<sup>8</sup> *WUTC v. Puget Sound Energy, Inc.*, Docket UG-101644, Order 4, ¶ 9 (March 15, 2011).

1 **Q. Please explain why the Commission should reject the Company's proposed**  
2 **adjustment.**

3 A. First, PSE's proposal to recover GRC costs in annual rates normalized by the  
4 frequency of GRC filings violates the matching principal because GRC filings  
5 contain costs from multiple years. A good example is PSE's last GRC which saw  
6 combined electric and natural gas charges of \$109,191.81 in 2008, \$1,330,396.18 in  
7 2009, and \$583,486.91 in 2010. In order to match a year's revenue with a year's  
8 expense, this adjustment would have to be normalized by the number of years  
9 reflecting expense, not the frequency of GRC filings as PSE has done.

10 Second, PSE's proposal to allocate 50 percent of the average cost of GRCs to  
11 natural gas customers is unfair to those customers. Almost any allocation factor or  
12 service metric such as the Company's customer count, rate base, or revenue  
13 requirement from this proceeding demonstrates that electric costs represent a  
14 disproportionately larger share of PSE's overall costs.

15 Third, PSE's proposal to include 2007 and 2005 PCORC costs in this case is  
16 unreasonable double counting because these costs have already been recovered in  
17 rates. These costs were included in the Company's 2007 GRC filing, normalized on  
18 a two year filing frequency. Rates for that GRC became effective on November 1,  
19 2008. The Company's 2009 GRC also included these costs, normalized again on a  
20 two year filing frequency. Rates for that GRC went into effect on April 8, 2010. In  
21 both cases, therefore, rate case costs will be recovered fully before new rates from  
22 this case go into effect.

1                    Finally, the normalizing of rate case expenses from prior periods adds to the  
2 complexity of the GRC filing.

3

4 **Q.    Please identify the effect of your adjustment on electric and natural gas net**  
5 **operating income.**

6 A.    My recommendation removes the Company's increase to electric NOI of \$44,411  
7 and removes the decrease to natural gas NOI of \$142,724.

8

9 **Q.    Does this conclude your testimony?**

10 A.    Yes.