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October 18, 2006

VIA FEDERAL EXPRESS
& VIA EMAIL

Ms. Carole J. Washburn, Secretary
Washington Utilities and Transportation
Commission
1300 S. Evergreen Park Drive SW
Olympia, WA 98504

Deborah L. Cook
Continental Reporting, Inc.
500 Union Street, Suite 926
Seattle, WA 98101

Re: WUTC Docket Nos. UE-060366 et al. (consolidated)

Dear Ms. Washburn and Ms. Cook:

Enclosed please find Puget Sound Energy, Inc.'s corrections to the transcript for the hearing in the above matter, held September 18 – 25, 2006. We are enclosing both a table listing the corrections, and for your convenience, copies of each page marked with the correction. Please contact me if you have any questions concerning these corrections.

Very truly yours,

Sheree Strom Carson

Sheree Strom Carson

SSC:db
Enclosures
cc: Judge Moss
Service List

07771-0887/LEGAL11927878.1

Puget Sound Energy, Inc's Hearing Transcript Corrections (UE-060266 & UG-060267)

PAGE	LINE	CORRECTION
98	15	Insert "gas" after "natural"
149	20	Delete "f" in "for"
151	6	Replace "an" with "into"
236	18	Change: "lease" to "least"
242	14	Change: "firm" to "from"
245	6	Change: "ANOS" to "analyst"
245	19	Insert: "$" before "20"
245	19	Change: "50" to "$22.50 per share"
251	1	Insert: "what" between "of" & "our"
252	4	Delete: "and" between "risks" & "of"
252	8	Change: "yesterday" to "earlier"
258	6	Change" assign" to "assigned"; add: "that" after "assigned"
258	12	Insert: "recommendations" after "sell"
258	13	Delete: "these"
258	14	Delete: "have"
258	15	Insert "have" between "obviously" & "a"
259	4	Change" "circumstance" to "consideration"
259	14	Change: "seem to" to "must"
260	6	Change: "a" to "at"
260	20	Change: "if the" to "for"

PAGE	LINE	CORRECTION
261	21	Delete: "sorts of"
263	16	Delete: "in thoughtful"
263	17	Delete: "returns"
265	24	Change: "over" to "of"
270	10	Change: "factor" to "tracker"
271	7	Change: "factor" to "tracker"
271	25	Insert: "Sue McLain" between "colleague" and "talked"
272	14	Change: "factor" to "tracker"
274	16	Should read: "...ways outside of trackers....."
277	11	Change: "disproportionate" to "approximations"
277	23	Insert: "when" between "ago" and "I"
277	23	Delete: "much"
280	4	Change: "operation" to "operations"
280	5	Change: "operation" to "operations"
280	5	Change: "is" to "as"
281	21	Delete: "had"
281	22	Insert: "excess power costs" between "of" and "50/50"
282	6	Change: "140" to "$1.40"
282	7	Change: "150" to "$1.55"
282	13	Insert: "Puget Sound Energy, Inc." between "covered" and "closely"
282	17	Change: "Valesse's" to "Bellessa's"
283	11	Change: "marketing" to "market"

PAGE	LINE	CORRECTION
285	21	Change: "CEO" to "CFO"
286	20	Change: "and" to "in an"
287	21	Change: "morph" to "move"
288	1	Change: "Valesse" to "Bellessa"
288	7	Change: "Valesse" to "Bellessa"
288	18	Change: "Valesse" to "Bellessa"
289	19	Change: "lines" to "wines"
290	7	Delete: "power of"
290	11	Change: "earning" to "earnings"
291	Page	Change: "Lehmann" to "Lehman" throughout
291	1	Insert: "research" between "Lehmann" and "when"
291	20	Insert: "on" between "view" and "is"
291	20	Delete: "A"
291	22	Change: "10.68" to "10.8"
292	10	Should read: "…the Lehman conference"
292	11	Change: "Lehmann" to "Lehman"
303	3	Insert: "of" between "recovery" and "depreciation"
401	24	Insert "s" after earning; replace "editions" with "additions"
402	15	Replace the comma following "now" with a period; capitalize "t" in "the" to read "The"
402	17	Delete "s" from the word "plants"
409	18	Delete "s" from the word "nest" to read "net"
424	7	Replace "in the" with "and"

PAGE	LINE	CORRECTION
424	9	Insert a comma after "economy"
425	17	Delete "t" from "this" to read "his"
435	5	Insert "D" before "AVID"
457	9	Insert "a" before "director" and capitalize "director" to read "Director"
464	12	Delete "No."
467	14	Replace "and then" with "in"
471	22	Replace "or that there was no" with "nor was there"
472	4	Insert "just" between "have" & "explained"
474	24	Replace "demand" with "demands"
475	6	Replace "in" with "and"
485	14	Replace "Electran" with "Vectren"
487	8	Delete "I"
491	24	Insert "2004" after "September 21,"
495	4	Replace "marginal" with "margin"
504	10	Replace "setting" with "situation"
507	14	Delete "it"
509	11	Insert "a" between "pay" & "procurement"
511	7	Delete "been"
517	22	Insert an apostrophe after classes to read "classes'"
520	1	Replace "1.40" with "1.401"
520	11	Replace ".85" with ".852"
523	20	Insert "the" after "being"
533	1	Insert "with" between "combined" and "the"

PAGE	LINE	CORRECTION
538	25	Replace "disparit" with "disparate"
546	10	Replace "sight" with "side"
551	13	Replace "security" with "securities"
553	17	Replace "opposed" with "posed"
579	14	Replace "terrifying" with "clarifying"
605	8	Replace "SEETED" with "CTED"
630	2	Replace "expense" with "suspension"
796	5	Insert "of" between "average" and "monthly"
796	6	Insert "s" following "average" to read "averages"; replace "in the" with "end of"
796	14	Replace comma following "My number," with a question mark to read, "My number?"; replace "w" with capital "W"; replace comma following "which number," with a question mark to read, "which number?". Capitalize "there's"
796	19	Insert "of" between "average" and "monthly"
797	11	Insert "of" between "average" and "monthly"
869	1	Delete "southwest"; replace "gases" with "gas is"; replace "only" with "on the"
870	2	Insert "2" before "280"
887	7	Replace "two" with "into"
890	18	Replace "private" with "prior"
893	17	Replace "Titlement" with "Entitlement"
899	2	Replace "fund" with "run"
899	3	Replace "proviso" with "provision"
909	24	Replace "THE WITNESS" with "MS. DODGE"

PAGE	LINE	CORRECTION
920	4	Replace "Monday-Tuesday" with "Sunday-Monday"
920	5	Replace "Saturday-Sunday" with "Friday-Saturday"
928	20	Insert "log" between "the" & "difference", remove "two"
928	21	Delete "of the"; replace "a" with "this"; insert "log differences of the" between "series of" & "prices"
932	3	Delete "the cap it would be $40 Million, without"

insertion after the words changes to the, the insertion should be, electric and the overall in between the words the and caps. So that the sentence would read:

> The Company will be filing proposed changes to the electric and overall caps in Schedule 129 to implement this aspect of the partial settlement agreement no later than September 1st.

To give some context for that change or clarification for that change, the low income assistance program actually is funded through two separate pieces of this case, the electric rate design and the natural gas rate design. The parties, all parties have entered into the electric rate design settlement so that the increase to the natural gas or the electric portion of the low income assistance program flows through the electric rate design settlement. On the natural gas rate design settlement the company has not agreed to the rate design settlement, and so the company opposes many aspects of the natural gas rate design settlement that's proposed by the other parties.

However, the company does not oppose the additional increase to the low income assistance program that is part of that natural gas settlement. The company had opted to file such increase in a September 1

A. I'm sorry, where are you?

Q. This is page 11 of your rebuttal at line 4.

A. Yes.

Q. I won't read every word here, but if you could follow, the Company's proposed depreciation tracker addresses only the recovery of and not recovery on transmission and distribution system investments made since the end of the most current test year. Can you explain what you mean by recovery of here?

A. Yes, I think I alluded to there are several mechanisms contained in other jurisdictions. Some have been proposed by parties, some have been developed by commissions, some have been statutorily developed by legislatures, and those types of mechanisms are what I would call incentive mechanisms, and I believe that we have listed several states that have incentive mechanisms. And what they are trying to achieve there is to actually incent the utility to invest, whether it be in infrastructure, or on the natural gas side maybe it's to eliminate or address bare steel or cast iron types of programs.

In each one of those instances, it's an incentive mechanism so that the Company will do the right thing, they will invest in infrastructure, so they provide not only recovery of the costs but also a return distribution tracker that you want to obtain recovery of T&D investment related to customer growth; is that correct?

A. I believe actually that Mr. Story has an exhibit to his testimony that makes that calculation. We are actually -- the depreciation tracker takes ~~an~~ into account revenue growth for new customers, and I believe that that is a question for Mr. Story on his exhibit.

Q. Okay.

A. We have addressed that concern within the mechanism.

JUDGE MOSS: Mr. Furuta, just to be clear, when you say T&D, you mean transmission and distribution?

MR. FURUTA: Yes, Your Honor, thank you.

JUDGE MOSS: The one being electric, the other being gas?

MR. FURUTA: No, I didn't intend to distinguish between electric and gas, just T&D for say electric.

JUDGE MOSS: Okay.

MR. FURUTA: Thank you though for pointing that out.

BY MR. FURUTA:

Q. Now it's correct that Puget can file a rate

Q And on this page you discuss the topic in your rebuttal testimony concerning the current capital spending needs?

A Yes.

Q And he shows planned expenditures total $850 million?

A Yes. Between delivery and the Wildhorse project, as well as the Chelan contract payment.

Q Is it correct that the Company's construction expenditures will decline in 2007 and 2008 relative to 2006 levels?

A We don't know the answer to that. And let me address it specifically in two components. We have a delivery component, and those go to 500 million, based on our current estimates.

And in terms of new generation, we're in the process of executing the RFP related to our least ~~lease~~ cost plan. We have identified six resources, and depending on which resources we're ultimately able to acquire, that will drive the capital expenditures. So it may well be that the capital expenditures are more in 2006. We simply don't know.

And the key factor is resources. But what we do know is delivery and other will be higher in

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clarification between Staff and the Company on the corrected page 1 of 465, I would offer 465 with the opportunity to just address that later if we can't understand the source of the corrections.

THE WITNESS: And, Mr. Cedarbaum, it's a very minor correction, so it doesn't change at all the substance of what is on this page. And we will be happy to review that with Staff.

Q BY MR. CEDARBAUM: Why don't you go ahead then?

A In the calculations of PSE equity, the $60 million preferred stock was included incorrectly. So what we adjusted was we backed out the 60 million ~~firm~~ from equity. So just to flow it through, where you see average the 2.6 percent net earning in the original exhibit, it's now 2.5. It's a 10 basis point difference.

MR. CEDARBAUM: Again, I don't want to belabor this. I just want to consult with Staff.

(EXHIBIT OFFERED.)

JUDGE MOSS: 464 and 465 have been offered. Any objection?

MS. DODGE: No.

JUDGE MOSS: Hearing none, they will be admitted.

date of the report. It was 22.40 and some change.

Q Up?

A So the prognosis that we would expect PSE shares to trade lower was not correct. And I think if you read further in the exhibits you would find that the ~~** ANOS~~ analyst community appropriately stated that it's not Staff that determines revenue, but the Commission, that it's only the beginning of the process. So that trading behavior would be therefore consistent with the substance of most of these research reports here.

Q And do you know what the closing price on PSE stock was on last Friday, September 15?

A No.

Q Would you --

A But I can tell you that I tracked the share price very closely, and it's not a hard question given that over the last three years Puget has basically traded in the $20 to ~~50~~ $22.50 per share range, which incidentally is -- trails the Philadelphia Utility Index by about 60 percent.

Q Would you accept, subject to check, that the price at closing on Friday, September 15 was $22.46?

MS. DODGE: I object that this is an

what

their perception of our risk is.

Q Is it true that the average of all utilities include utilities that have different business risk from Puget's?

A Absolutely. And that's why it's very dangerous to look at averages, and why you have to explore the specific circumstances of the particular utility. And ours are really unique if you consider the commodity price risk, the capital expenditure program, our capitalization of 2.6 billion versus future capital requirements of 2 billion.

If you consider the imputed debt related to the hydroelectric contracts, the seasonality of our business, which we are a winter-peaking utility only. So there are a number of other factors. And you are absolutely right. It's important to consider those.

Q Your third point was that the recommended ROE was below the average of Mr. Gorman's comparable group; is that right?

A Yes.

Q And is it your understanding that ROE is generally determined by taking a simple average of the comparable group?

A Again, it's one measure. I think you earlier correctly identified the appropriate way, and that is really to very carefully consider the business risks ~~and~~ of a particular utility, and factor those in in the calculations of an ROE. And most importantly is a utility's ability to actually earn that ROE. Which is, as you might -- as we discussed earlier ~~yesterday~~, the substance of our case here.

Q You also criticize ICNU for opposing the Company's proposed revisions to the power cost adjustment mechanism; is that right?

A Yes.

Q Are you aware that Mr. Gorman considered the current state of the power cost adjustment mechanism in determining his recommended ROE?

MS. DODGE: Objection; they are asking the witness to speculate as to what is in Mr. Gorman's mind.

JUDGE MOSS: Well, I would assume if it's not in Mr. Gorman's testimony, the witness couldn't answer it. But since the witness is responding to Mr. Gorman's presentation, I think he can answer so I will overrule the objection.

THE WITNESS: Could you ask the question

Q Would you also agree that a PSE's current business profile score of 4 reflects the current PCA without a cap?

A No.

Q Why is that?

A Because they assign ed that before, when PCA had a cap, very simply. I think that S&P, like Moody's, like many of the other equity research firms are waiting for final ruling in this case. And based on that final ruling, they will go back and reassess their 4 business ratings.

These business ratings, buy and sell, recommendations ~~these~~ are constantly reviewed based on new circumstances. And I would argue that we ~~have~~ obviously have a new body of information for the financial markets to consider after this case.

Q Wasn't it a new circumstance when the $40 million cap went away in July?

A No, because it was part of this proceeding. Again, rating agencies consider forward looking metrics. The evidence that Mr. Cedarbaum introduced based on our rating agency presentation, what we do with the rating agencies is meet with them annually. We take our most recent 5 and 10 year plan and that is forward

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looking and review it with them. So rating agencies think of forward looking metrics, and they won't adjust until circumstances have been clarified. This is an important ~~circumstance~~ consideration.

Q Are you aware that the average business profile score for Mr. Gorman's comparable group was 5?

A I was not aware of it, but doesn't surprise me.

Q Does a score of 5 reflect a higher business risk than a score of 4?

A Yes. But, again, as you pointed out, Mr. Van Cleve, the business risk of individual companies ~~seem to~~ must be carefully considered. So you could well have a business position 5, and have a different power recovery mechanism than someone who has a business position 4, and no ability to recover power costs or vice versa.

Q If you could refer to page 7 of your rebuttal testimony.

A (Complies.)

Q At line 6 you state, "We're fortunate that borrowing costs are near all-time lows"; is that right?

A Yes.

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Q And you also state that the Company's cost to borrow is currently less than 150 basis points over the Federal funds rate?

A Yes.

Q And is the spread between the cost of utility debt ~~a~~ at different credit ratings also at a near all-time low?

A It is. And it's an interesting thing to take a look at, because essentially what you are asking and what this is telling us is that right now the market isn't really pricing for risk in the utility sector. That as a BBB minus company you could borrow at spreads of under 150 basis points. If you look at the historic trend, that wasn't always so.

What is very interesting to do, and this is publicly available on Bloomberg, is take a look at the spread between a single A company and a BBB company over time. What you find is that there's tremendous volatility ~~if the~~ for companies that are BBB and below in terms of their ability to access low-cost capital in credit spreads. Credit spreads widen and narrow significantly, whereas if you're a stronger credit, credit spreads are more stable. And that is the basis on which we have made our commitment to strengthen our credit rating. That's precisely so we can continue to enjoy low credit spreads when we raise capital for our multi-billion dollar infrastructure program.

Q And do you know what the current spread is between debt cost for a BBB minus utility compared to a BBB?

A I don't know that, but that would be a great question for Mr. Gaines. We were recently in the market, and I am certain he has spread levels for BBB versus a BBB minus. But it continues to be quite attractive compared to historic levels.

And, again, I can tell you this: as a former banker, the financial markets are quite cyclical and you have periods of very tight credit. And during periods of very tight credit, when you are a BBB minus company, it's awful hard to borrow at a low cost. And that's where you want to be, in that BBB plus range where you can assure low cost access through good times and bad, through all ~~sorts of~~ business cycles.

Q Could you refer to page 10 of your rebuttal testimony?

A (Complies.)

Q Now, at lines 6 to 8 you criticize both

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essentially, to fund infrastructure needs that support SQI metrics and reliability, that you are -- you have to incur high prices for equity capital, and high prices for your debt capital.

So that's why you want to target a credit rating that is something that is a little bit better than the last rating before noninvestment grade. And on the equity side, you want to make sure that you trade with your peers and that you offer equity investors an attractive profile for future earnings.

And, again, I always like to say you can either pay for it now in the form of modest rate increases, or you pay for it later as a customer in the form of a very high cost of capital. And it's probably cheaper to pay for it now ~~in thoughtful returns~~, whether its an ROE, whether it's some of the mechanisms we have proposed.

Q If you can now refer to page 14 of your rebuttal testimony, there's a table at the top of the page.

A (Complies.)

Q Didn't Mr. Gorman recommend an ROE range of 9.6 to 10.45 with a mid point of 9.9?

A I am sorry. You are referring to which

ROE estimates, and this is my Exhibit BAV-8. So again, it's subject to check. We could always check this.

JUDGE MOSS: That's Exhibit 458 that the witness just referred to.

Q BY MR. VAN CLEVE: Do you have Mr. Gorman's testimony, Exhibit 471?

A I am happy -- if someone could hand it to me. I have his testimony.

Q If you could refer to page 22 of Exhibit 471 C, table 3 on page 22.

A (Reading document.) Okay.

Q Doesn't that show the recommended ROE range for Mr. Gorman is 9.6 to 10.4?

A This is something that I would prefer Dr. Morin address, because I'm looking at the table and it says constant growth discounted cash flow. Well, discounted cash flow is a very different measure than return on equity.

So based on this table, I'm not in a position to opine on your question. Again, if we're talking about ROEs, that's one measure, that's essentially a return measure, net income over some form of average of ~~over~~ book equity.

If we're talking about discounted cash

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general rate cases of this company?

A Could you restate the question?

Q Is it your understanding that the Commission determined in the orders in those cases that the rates set for Puget for both its gas and electric service provided the Company with an opportunity to earn its authorized rate of return?

A I believe that's the intention.

Q And at the time of the cases Puget did not, and does not now, have a depreciation ~~factor~~ tracker; is that correct?

A That's correct. And we have consistently not earned that rate of return that the Commission granted in the past rate cases.

Q In your rebuttal testimony, Exhibit 457, if we could turn to page 28 --

A (Complies.)

Q I believe at line 19 of that page.

A I am sorry. 457, exhibit --

Q Yes, the rebuttal?

A Let me just -- is it 457 C?

JUDGE MOSS: Yes.

THE WITNESS: What page?

Q BY MR. FURUTA: Page 28, and at line 19 I believe you testified that "If the Company is to

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have a fair opportunity to earn its authorized return on equity, it needs to recover its capital investments in a timely manner"; is that correct?

A That's correct.

Q I assume that this would apply in the past three general rate cases where the Company did not propose a depreciation tracker ~~factor,~~ is that correct?

A Two points there, Mr. Furuta. One is that we were not able to earn our authorized rate of return after the last rate case. And two, the circumstances are somewhat different. We are looking at significant delivery infrastructure capital requirements. And there's no mechanism to recover the depreciation related to that.

So what we're bringing forward in this case is the fact that we have in rates, currently, $246 million depreciation. Our actual depreciation is 264 or so. Those are estimates for calendar year 2006. We're underrecovering by 18 to 20 million. Those are changed circumstances from the past rate cases. And this will continue, and will -- the underearning will get worse the more we bring in new delivery.

The Novelty Hill substation that my colleague Sue McLain talked about, that substation is currently in service. It was a $23 million capital cost. We're not earning our return, and we're not collecting depreciation in rates on that asset. That translates to roughly $2 million of lost revenue. This is the reason why we're here today in part.

Q If you turn to page 30 of the same exhibit, at lines 8 and 9, I believe you state that "Depreciation expense, when reflected in rates, provides a substantial source of cash flow." Do you see that?

A Yes. Depreciation is added back in the calculations of cash flow, correct.

Q Now, putting aside the depreciation tracker ~~factor~~ for the moment, do you know how much depreciation expense for Puget's electric and gas utility service is being proposed to be reflected in rates in this proceeding by the Company?

A You know, I don't have that number. But what I cited earlier is in calendar year 2006 we're recovering depreciation rates of approximately 245 to 246 million, versus our actual depreciation of 264, so there is a gap.

And in calendar year 2005, we had $233 million of depreciation rates, and our actual

Q And I presume from your testimony that you have read the testimony of our witness, Mr. Smith, about the alternative that he proposes regarding the known and measurable adjustment that he proposes?

A I may have skimmed it. I didn't read it thoroughly. Again, my focus was primarily on the more financial aspects of this case.

Q But I refer to, again, to page 32 of your testimony.

A Correct.

Q Where you refer to his testimony?

A Right. Right.

Q And you are saying that the Company is agreeable to that type of alternative proposal?

A We're open to ways of outside trackers to recover our depreciation. For us, really, it's a question of coming to the right balance between an appropriate ROE that reflects our risk and the ability to actually earn that ROE.

MR. FURUTA: Thank you, Mr. Valdman. I have no further question.

JUDGE MOSS: Thank you, Mr. Furuta. I have one quick question. When you said we're still just asking for the depreciation, were you between our 2004 general rate case and today, and we have an initial response for you. And we will provide the more complete data, but in terms of delivery operations, it is 22 percent higher this rate case versus our 2004 rate case, around say 20 percent.

And in the terms of non-new resource energy supplies, so this is maintenance related to our generation resource plant, it's roughly 90 percent higher. So when you add those two together, and, again, they are approximations ~~disproportionate~~. There is much more in delivery capital expenditures versus total supply -- it's a total increase of 3 percent versus our last rate case.

Q BY COMMISSIONER JONES: Mr. Cedarbaum asked you some questions on an exhibit that I guess you provided to the analysts in 2005. When was the last time you presented to the analysts on this specific -- well, on the topic I am most interested in is the capital expenditure budget from 2006 to 2008 or 2009?

A The most recent would be roughly two weeks ago when I was in New York presenting ~~much~~ to investors in the Lehmann Energy Conference. And I explained in detail our capital expenditure plans, and the financial metrics in terms of what you have to deal with Wall Street analysts on in terms of free FFO versus -- what is the proper acronym for FFO?

A Funds from operations.

Q Funds from operations, ~~is~~ as a percentage of interest. Have you provided that to us yet on what the rebuttal case -- what your rebuttal case would be with the settlement entered into with the Staff? I think Mr. Gaines has some analysis of the metrics in his.

A I believe it's Mr. Gaines' testimony that addresses this.

Q So that is the most recent financial metrics analysis that we have?

A And, Commissioner Jones, to clarify your question on cash flow, when I meet with investors I frequently use a cash flow number that excludes -- in other words, it's before we pay dividends. So the number -- you just asked the question, when did you last meet with analysts. And in a number of those meetings we have identified our cash flow for calendar year 2006 as roughly $450 million, is the number we have been using. That's an important number because they use that in the total sources and total uses of funds for the Company. And gives some insight in terms of what our funding needs will be.

Q How many analysts cover Puget Energy right now?

A Approximately 10 or so. But what I would say is that a handful cover us very actively. And those are Lehmann Brothers, DA Davidson, J.P. Morgan, Key Bank. So we're very well covered by the financial community.

Q I think in early August you announced the second quarter earnings, did you not?

A Yes.

Q Is it safe to say you exceeded the expectations and estimates of most analysts on Wall Street? It was a good quarter for you, wasn't it?

A It was a very good quarter. And the reason it was a very good quarter is we over recovered power costs.

And I think that's part of the reason we're excited about the proposal we submitted on the PCA. And that is, ~~had~~ we had the proposal to share the first 25 million of excess power costs 50/50 with customers, customers would have been able to benefit from a favorable hydroenvironment during the second quarter of this year.

Q Is the Company in that earnings conference call that you and the CEO participated in, are you still affirming your earnings guidance, EPS, your earnings per share estimates for calendar year 2006?

A And the guidance we provided was $1.40 ~~140~~ to $1.55 ~~150~~ per share.

Q What does that assume in terms of this Commission's rate case?

A It doesn't assume a thing, because it's for year 2005. We have not provided year guidance for calendar year 2006, although a number of those analysts that covered Puget Energy, Inc. closely have put their projection out there. But that's not based on anything we have told them.

Q You had a conversation with counsel on DA Davidson's, on Mr. Bellessa's ~~Valesse's (ph)~~ opinion, especially the last paragraph, which covers the EPS estimate, and the valuation of the Company, did you not?

A Yes.

Q Would you agree that his is the majority opinion or the minority opinion in terms of the valuation of the Company in his earnings estimates?

A Well, he is one of the few that has a buy recommendation. Most other people have a more somber outlook.

Q What does somber mean?

A That means it's a hold.

Q In an exchange with, I think, Mr. Van Cleve on market conditions, you stated that market conditions are attractive, and will continue to be attractive based on things like interest rates, relative spread. Is that your statement for the record?

A No. I think market~~ing~~s conditions have been attractive. We don't know what they will be. I'm certainly -- I wish I did. I would be in a much better position. But anyone in my position can hope they will continue to be as good as they have been, but we don't know.

Q You used to work for J.P. Morgan, did you not?

A Yes, I did.

Q Is there a shortage of investment bankers that are seeking your business, either on the equity side or debt side?

A No, there's not. The question is at what price. And I would prefer it to be a more attractive price to both customers and

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that we're thinking very carefully about. And it would -- obviously we would get some equity credit at the cost of the debt, and that's always very attractive.

Q Mr. Gorman, in his testimony, also talks about off-balance debt risk. Is there any off-balance debt risk associated with the Company?

A Yes. There's imputed debt, and that's related to the hydro contracts. And that's something that is relatively unique for Puget, not that we have imputed debt. Many companies have power purchase agreements. But the level of our imputed debt, which, again, Mr. Gaines can take you through the exact numbers. But it's roughly $400 million.

And that weighs on our credit rating. And that is something, again, by acquiring resources slowly but surely we can address that and reduce our dependence on the PPAs and ultimately eliminate imputed debt.

Q You have been employed as ~~CEO~~ CFO of the Company for how long now?

A Three years.

Q Is it a frustration to you that in spite of the improvements in common equity, reduced leverage and more favorable earnings, that you haven't been able to move the credit rating up from a BBB minus? And why, if you could opine on that, why have the credit agencies, the rating agencies not adjusted your credit rating, in your view?

A It has been frustrating, but I think the rating agencies -- and you see this in the write-ups, the Company has been quite thoughtful. And what they have addressed is some of the key financial ratios in a particular -- the ratios related to cash flow that are on the weaker side.

But more importantly they stepped back and a lot of weight is given to the regulatory recovery mechanisms available to us. And what they acknowledge is, yes, on one hand we have the ability to very efficiently recover on new generation, but on the other hand, we have the specter of increased commodity risk related to power costs. And we don't have the ability to recover on depreciation in an ~~and~~ environment where we're investing significantly.

So when you take a look at the balance, I think what they are saying is this company has a lot of risk. And therefore, we're not comfortable until we can better understand how the Company will actually recover, and bring some of the risk to the bottom line and will enhance these ratios, we're not comfortable upgrading.

And the other thing I would say is size-wise we're a relatively small company. And size is important to the rating agencies as a metric. You don't see that as a ratio, it's somewhat qualitative. But our firm value, which is our market capitalization plus our debt, is 4.6 -- it's under $5 billion. Which, in this sector, which is consolidating. We're tiny in the scheme of things. And we're a small company with big infrastructure needs, and a growing service territory which I, again, I think the rating agencies consider.

So that's my opinion on why we're where we are. It makes intuitive sense and we're working very hard to address the rating agency concerns. We issued as I mentioned before, we issued 25 million shares to strengthen our capital, our equity capital. So we're able to move ~~morph~~ from 31 percent in 2002 to where we are today, which is around 43 percent. But we need to work on some of those other ratios, and some of the mechanisms that we have proposed will address that.

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Q But wouldn't you agree that Mr. Bellessa ~~Valesse~~ with DA Davidson is one of the most informed analysts, at least has been covering the Company for a long time, hasn't he?

A He has been covering the Company, and I have a tremendous amount of respect for Mr. Bellessa ~~Valesse~~.

Q And I would like to quote the final paragraph, and he believes the final decision in the rate case will be a compromise between what the Company, what you are asking and what the Staff's proposal -- he's maintaining his EPS estimate. He's valuing your shares at $25. And he's maintaining a buy rating on the Company. So shouldn't that opinion be given some weight?

A Like all opinions, it should be given some weight. And here we are sitting at $22.50, and it warms my heart that Mr. Bellessa ~~Valesse~~ believes we will get to 25. And if it's through a thoughtful compromise, that's terrific.

COMMISSIONER JONES: Thank you.

JUDGE MOSS: Mr. Oshie, do you have anything?

COMMISSIONER OSHIE: I have no questions.

JUDGE MOSS: Chairman Sidran.

CHAIRMAN SIDRAN: Good morning.

EXAMINATION

BY CHAIRMAN SIDRAN:

Q I noticed in the Exhibit 459 in the first page related to J.P. Morgan -- which did I hear you say you used to work for J.P. Morgan?

A Yes. I started in 1987, and I worked all the way until I left to become a CFO of Puget.

Q We will simply note in the record you don't look old enough to have started with J.P. Morgan in 1987.

A I am very youthful, but thank you for the compliment. I get carded at stores all the time, and that makes me very happy.

Q I take it that refers to purchasing alcohol?

A Yes. Washington State wines ~~lines~~. I am supporting the diversified economy of our State.

Q On behalf of the State, we applaud you.

A Thank you.

Q In this J.P. Morgan document it says in the second bullet point, we modeled a 10.5 ROE based on a 44 percent equity component. And given your familiarity with Wall Street and rating agencies, and how they go about things, when they say we modeled a 10.50 ROE based on a 44 percent equity component, what does that mean? When they model something, what are they doing?

A What they are doing is saying you, Puget, we have assumed a rate base of ~~power of~~ of 4.2 billion. They are multiplying that 4.2 billion by 10.50 percent, and by the allowed equity of 44 percent. They divide by shares outstanding, and they come up with an earnings per share number.

So what they are saying is, we are taking the view that you have asked for "X". Staff recommended Y, and other intervenors, and we're picking 10.5. And there's no surprise where they got the 10.5. They got it the same place I did in my testimony. They took a look, and took an average of what commissions have done across the country, and they came up with that number.

The 44 percent, no accident there. They are basically taking a view on where they think we will be, and came up with that based on where we are today, and what they think our capitalization plans are.

What is interesting here, and this is

highlighted as well in the Lehma~~n~~ research, when Lehma~~n~~ takes a position on what 2006 earnings are -- and they go through similar calculations -- they assumed a 10.80 ROE. They assumed we earn perfectly on the 10.5. If you go through -- and I didn't do the math for J.P. Morgan, but I did for Lehma~~n~~, their 2006 of \$1.63 assumes we will earn that 10.8, makes some additional assumptions for additional equity issuance, but that's the philosophy of how they come up with their earnings per share guidance numbers.

Q So do you think they make any assumptions with respect to the shares of the various mechanisms that the Company is proposing here, the depreciation tracker, decoupling, and so on?

A They are assuming that we will be able to earn the ROE, whether it's through mechanisms or whether it's a higher ROE with lag that we have incurred, historic lag. They go at it both ways.

I think what they are taking a view on is ~~A,~~ what they believe a fair actual ROE is. And that in this report is 10.5 and Lehma~~n~~ it's 10.~~0~~8. But you have it bounded by the ranges of what other commissions have done.

Q And when Wall Street looks at the

companies, do they assume that you are earning your return, or do they actually look at the numbers such as you have presented to the Commission in order to discover that you purportedly are not earning your authorized rate of return?

A Part of our job is to explain why we don't earn our return. Obviously what we want to do is make sure that we're giving an accurate representation of our earnings power, and whether it's through the Lehmann conferences or conferences like Lehmann, or whether it's through one-on-one meetings, we meet and we take analysts through why we get to our actual ROE.

And if you take a look at some of my materials that I have used in investor meetings, we break it down, and break it down component by component. So, yes, they understand what all of this is about. And what you are seeing is they are taking a view on what the actual is.

Q You mentioned your range of reasonableness calculations which reflects thoughtful reading of the Commission's prior orders. In that range, which is 10.2 to 10.9, roughly, do you think that where one ends up in that range would depend in part on whether and to what degree the Commission

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A The one time known and measurable adjustment. But that's one point in time. It's not on an ongoing recovery of depreciation like the depreciation tracker. And, again, it's not an ongoing recovery for return on. It's just one point in time known and measurable.

The investor community often asks me about an ongoing ability to do both, and that we're not asking. I hope that clarifies the question.

JUDGE MOSS: That does. Thank you very much. If there's nothing further --

MR. CEDARBAUM: Your Honor, I am sorry. It's out of order, but could I ask one clarifying question?

JUDGE MOSS: Sure.

RECROSS EXAMINATION

BY MR. CEDARBAUM:

Q Mr. Valdman, I want to make sure I am not confused about your use of the term cash flow. And it's Exhibit 466, which I think was a cross exhibit from Public Counsel. And that's your most recently filed 10Q; is that right?

A Let me get to it -- yes. I remember

Q Is that essentially retained earnings?
A Yes -- I don't know, though, if that is for -- if that's a cumulative number, or if that is the number for the year.
Q Well, I am trying to get an idea of the trend.
A Okay.
Q And if we look in the 2001 column, there's an amount of $55.3 million which goes up in the 2002 column to 66, just under $67 million; is that right?
A That's correct.
Q And then turning to page 5, the numbers from 2002 to 2003 show an additional increase; is that correct?
A About 34 million, yes.
Q And without belaboring the point, is it correct that throughout the time period shown in this exhibit, earnings reinvested in the business increased over from one year to the next?
A I would think so, Mr. Cedarbaum, because I believe in every one of these years at the utility level, the utility's earnings exceeded its dividends. So a retained earnings ~~editions~~ additions would be positive.

Q If I could have you look at Exhibit 151, and the page numbers in the bottom right-hand corner.

A Okay.

Q Do you recognize this as other pages from the Company's December 31st, 2005, 10K?

A Yes.

Q And if you look at page 3 of the exhibit, under the section, Restrictive Covenants?

A Yes.

Q Does that describe various aspects of the Company's borrowing capacity under the most restrictive tests?

A It does, but as of that date, which is several months ago now. The Company, of course, frequently adds to the amount of its borrowing capacity as it adds more plant~~s~~. So these numbers grow, and would be higher today.

Q And in the exhibit on page 3, there's a reference to in the first bullet, and in the second bullet, electric -- excuse me, electric bondable property and gas bondable property.

Does that refer to the Company's investment in T&D and generation property on the electric side and delivery property on the gas

Commission set rates using an equity ratio of 43 percent?

A Yes, it did. And in my testimony in that proceeding I showed that we would sell stock -- at that time it was confidential. Since it was completed, it no longer is -- in February of '07. And we moved that up to -- I am sorry, February of '06, and we moved that up to November of '05, and we increased the size.

Q Earlier in the prior exhibit --

JUDGE MOSS: Give us a number.

MR. CEDARBAUM: Okay, Your Honor. Exhibit 151, page 4, shows the -- describes that equity issuance in November 2005.

Q BY MR. CEDARBAUM: Is it correct that for that issuance the Company earned just under $21 per share?

A I see now the ~~nest~~ price that we got. It was $20.80.

Q I say "earned." I should say received.

A It was a discount of the previous close of I want to say 2 or 3 percent.

Q So that would compare to the stock price around the time of the 2004 rate order in February of around $24 per share?

spreads are volatile, of course, that the range would be 3 to 7 basis points -- sorry, 3 to 10 basis points. The other one was 5 to 10 basis points. And since the overlap is in the 5 to 10 range of the two, I would say 5 to 10.

This gets to -- people use this in the estimation of safety ~~in the~~ and economy. And when they do that, they forget to look at the value of the safety part. This gets to the economy, debt is always cheaper than equity.

The safety part is the value of having this cushion. Our stock price -- our credit rating can change in a day. And likely will be looked at in a day shortly after we get a rate order from this Commission on this proceeding.

The agencies have made it clear on pages 34 and 35 of their views of the importance of this. And it's important, as David Mills said, to have a higher credit rating to support counterparties. The vast majority of our counterparties have higher credit ratings than us.

Mr. Valdman showed nearly three-quarters of the regulated industry has higher credit ratings than us. None of this gets factored into this safety in economy. It's sort of a theoretical discussion.

So when we talk about those spreads, and someone will be tempted to say, well, look, it's only 10 basis points, we have to make sure we look at the value of the cushion of the safety part and not just the economy part.

Q Thank you. And a follow-up question would be, and I don't know if you can do this in your head or not, but can you give us ballpark estimate of the savings given the projected capital expenditures that, let's say, 5 to 10 basis points would mean?

A There's a bunch of pieces to that savings. On -- and by increasing the credit rating, obviously, we're talking about. One is the direct reduction in the amount of financing that we would put forth. And as Dr. Morin said, based on this 2 billion look at capital, a portion of that would be debt and a portion would be equity. The debt piece would be applicable to that spread, the savings would be there.

The company has a credit rating -- I'm sorry, credit facility that has a pricing grid in it. And that pricing grid, the cost that we pay for the availability of the credit changes as the

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INDEX OF EXAMINATION

WITNESS:

DAVID HOFF

CALVIN SHIRLEY

Your counsel is bringing you some water there.

DIRECT EXAMINATION

BY MS. DODGE:

Q Mr. Amen, please state your name and title, and spell your name for the court reporter.
A My name is Ronald Amen, A-m-e-n. I am a Director at Navgant Consulting, Inc.
Q Do you have before you what have been marked for identification as Exhibit Nos. 21 through 30?
A Yes, I do.
Q And do these constitute your prefiled direct testimony and related exhibits in this proceeding?
A Yes, they do.
Q Do you also have before you Exhibit Nos. 38 through 48?
A Yes.
Q Do these exhibits constitute the prefiled direct testimony of Ms. Janet Phelps and related exhibits, each of which you have adopted for purposes of this proceeding?
A Yes.

I think falls into the series for Mr. Hoff, although it is a data request that, looking at it, he answered jointly with Mr. Hoff.

JUDGE MOSS: What is the data request number?

MR. CEDARBAUM: Exhibit 78.

JUDGE MOSS: That is identified as Exhibit 49 for this witness.

Q BY MR. CEDARBAUM: First of all, before we pass by Exhibit 69, do you recognize this as your response to Staff Data Request No. 411?

A ~~No.~~

THE WITNESS: Yes.

MR. CEDARBAUM: I would offer Exhibit 69.

JUDGE MOSS: Do you mean 49?

MR. CEDARBAUM: I was referring to 69 since we had just talked about 68, and people's books might have been open to that.

(EXHIBIT OFFERED.)

JUDGE MOSS: I lost track of what is going on there.

MS. DODGE: The Company has no objection.

JUDGE MOSS: Can we stipulate in all of the PSE responses to data requests that have been offered as cross exhibits, instead of spending time

A Yes. What we're trying to do, and have been trying to do for some time now, this issue really dates back to the rate restructuring proceeding that was conducted by the Commission in the mid '90s. I believe it was UG 940814, where we were seeking to realign both cost of service and the rate schedules of the various customer classes accordingly.

And one of the factors that had become problematic over the years was the deterioration of the load factor in general on rate 41, which was designed for generally larger, firm, higher load factor customers. And this deterioration of the load factor manifested itself, ~~and then~~ in the cost of service results that we obtained for rate 41.

So the idea was that the smaller load factor customers that had migrated to rate 41 from the small commercial schedule rate 31, because the price signal was aligned such that it was less expensive for them to migrate to rate 41, did so.

And as we were trying to stop the bleeding, if you will, the way to do that absent some artificial constraint in a tariff where you put a limitation, and say customers of this size or this load factor cannot take service. We would exception to the rate spread agreement reached between the Joint Parties specifically to allocate $576,000 of the overall increase, the transportation special contract customers, the balance to the remaining classes?

A Well, I think the fact that the Company proposed its own rate spread proposal that was based on its Cost of Service Study, and was fully supported by that Cost of Service Study, and the fact that the Joint Parties in their testimony, as I recall, said that they could not reach consensus between them as to whether the PSE Cost of Service Study or the Joint Parties' reliance, perhaps, at least some of them, on the Commission basis Cost of Service Study -- they couldn't come to a consensus between themselves as to which was a better indicator of cost causation on the Company's system.

But because they couldn't reach consensus and because they offered no evidentiary basis upon which to suggest that the Company's Cost of Service Study was inappropriate, ~~or that there was no~~ nor was there specific criticism of any change that the Company made to the allocation methods under the Commission basis study, there was really nothing to rebut.

Q So that's a way of saying no, your testimony does not take exception to that rate spread agreement, and explain why?

A I have just explained why.

Q Would you turn to Exhibit 60, please. That's one of our cross-examination exhibits. It's a response to Public Counsel 18. And there you were asked if the Company prepared an analysis of the typical use of new apartment/condo natural gas customers, correct?

A Yes, I see that.

Q And you indicated that the Company has not prepared such analysis, right?

A I understand that based on the wording of the data request that the Company has not prepared analysis of the typical use of new apartment or condo natural gas customers, yes, that's true. However, I think one can look no further than the tariff of the Company and its line extension policy where standard usage levels are presented for not only single-family homes, but duplex, triplex, four-unit residential dwellings, as well as apartment complexes.

Now, these standard consumption levels are updated periodically by the Company --

verify those load factor numbers. Because at first blush a couple of them looked a bit odd to me. And then in so doing, I discovered that one of them, in fact, needed to be corrected.

Q So it's just a change to one number, and could you just tell us what that is?

A Well, in the table presented in Exhibit 61, the load factor under docket No. UG 040640 has been changed from 20.39 percent to 31.01 percent. This table actually is illustrative of the situation of --

MR. FFITCH: Your Honor, there's no question pending. I simply asked for the correction to be identified, and the witness is beginning to make a statement. I'm not sure about what.

JUDGE MOSS: Let's wait for a question.

THE WITNESS: Certainly.

Q BY MR. FFITCH: This exhibit indicates that the residential natural gas load factor is decreasing, doesn't it?

A It does in this table, because the load factors in this table represent different peak day demands. The point I was about to make relates to this. And that is in the line labeled UG 060267, the load factor of 23.9 percent is based on the Company's design day peak, whereas in the other cases it is not, with the exception, I believe -- I may correct myself here, but with the exception that in UG 950278 the number 22.6 percent was also initially presented in testimony ~~in~~ and exhibits by the Company as the load factor based on its design day peak.

This goes to the variability that one gets when in cost of service you base your peak day on historical peaks that can vary depending on the particular period. Whereas if you use a more stable peak based on the Company's design day, which is the basis upon which they design their system, and which is also the basis in their integrated resource plan that they have spent time acquiring resources, then have you a more stable representation of peak day.

Q Apart from that issue do you disagree that the residential load factor generally is decreasing for the Company?

A It's hard for me to tell from these numbers, because they are based on different peak days. If they were all based on the Company's design day, I could perhaps draw a conclusion. But that the decoupling has only been approved by regulatory Commissions in four states, correct?

A Yes. That was the question.

Q And if we go over to the next page of the exhibit, page 2, and look at response B, towards the bottom of the page you confirm -- you state, "Yes. Although proposals are pending in several states, been granted by final Commission order only in the following four states" -- or "in the following four states." And that's California, Maryland, North Carolina, and Oregon, right?

A Yes. I must update that number, however, because I just learned a few days ago, on September 13, in the state of Ohio, ~~Electran~~ Vectren Energy Delivery Company received approval under a settlement for decoupling mechanism. Which I believe now brings the talley to 14 states where decoupling has either been approved, or is currently under consideration. Including Washington Gas Light, which also last week just filed in the state of Virginia. They already have a decoupling mechanism approved in Maryland, but they just filed in Virginia.

Q So the total number of approvals you are stating is now five, correct?

A Yes.

total of four states where you supported adoption of decoupling?

A That's correct.

Q Has your consulting firm ever opposed adoption of a decoupling mechanism?

A Opposed?

Q Yes.

A No, ~~I~~ --

Q I was checking, because the wording is very specific. So I wanted to make sure there weren't other kinds of activities you were involved in.

A No. That would not be the case.

Q And in general, the bulk of the other answers, or questions and answers in this data request go to explain the status of the decoupling cases in a variety of other jurisdictions, right?

A Yes.

Q Would you please turn to Exhibit 24 of your direct testimony. This is RJA 4, Charts Regarding Use of Customer.

A (Complies.)

Q And these -- are you there?

A Yes, I am.

Q And these charts indicate that declining

Your Honor.

MS. DODGE: The exhibit speaks for itself. There's been no question that goes beyond it.

JUDGE MOSS: Ask your final question, Mr. ffitch. But I don't know that it's particularly an evidentiary objection. But there really is no reason to go through and confirm what the documents say, because you can point to them on brief and we can look at them then, which we will certainly do. But go ahead with the last question and tie this stuff up.

Q BY MR. FFITCH: Tying back to the beginning of the line of questioning on the declining rate of usage, this study beginning on page 20 shows, does it not, the rate of decline has actually decreased dramatically over the rate for the past two decades; isn't that right? And that's in the first paragraph on page 20, about the third line down -- fourth line down, excuse me.

A (Reading document.) Yeah. And I think part of that is based on a forecast as well. There's a forecast period that goes all the way out to 2020. And at the time this document was prepared in advance of September 21, 2004 I suppose that was the forecast. I think changes in the

THE WITNESS: I'm not saying they are too high. I am saying they are improper. When you have 98.4 percent, roughly, of the Company's fixed costs in the Company's margin~~al~~ revenue, I think it's inappropriate to recover a large amount of these fixed costs through volumetric rates.

What is appropriate to be recovered through volumetric rates is the obvious, which is the cost of the commodity, which varies.

Q So you are saying the appropriate price signal should be the marginal cost of gas?

A And the marginal cost of gas in this case, because of the operation of the PGA mechanism, is the average cost of gas.

Q So imagine, if you will, a customer who is considering installing some more insulation in their home, or perhaps an energy efficient appliance. Shouldn't the price signal that person would respond to include the long-term marginal cost of gas perhaps over a 20- to 40-year period as opposed to something just in that one year?

A If the customer had information on the long-term cost of gas as it might affect that customer, that might be some information that they would consider.

A That's correct. And that would be approximately 100 percent of the customer-related costs, fixed costs.

Q And isn't that fairly atypical of the industry practice in the study you just referenced?

A Well, it is higher than the current average, I will allow that. And there has been, of course, as the study states, movement to raise customer charges. And I think this would be a Situation ~~setting~~, taking a leadership position, if you will, with regard to the recovery of customer related costs.

Q All right. Now I would like to change topics in terms of the decoupling mechanism you have proposed. There are some differences in how your proposal would treat new customers within the mechanism and the proposal that the Northwest Energy Coalition and, in fact, WUTC Staff have put forward. And I would like to ask you a question regarding the proper design of a decoupling mechanism, as it applies to new customers.

A Okay.

Q Do you agree that one goal, if we were to properly structure a decoupling mechanism, would be to treat new customers in such a way that it would since they were last updated.

Q But you do continue to agree that one goal of a properly structured decoupling mechanism is the Company would collect the same amount of revenues with decoupling as it did without decoupling as it relates to new customers?

A Yes, I think that's correct. The idea is that decoupling will collect the revenue from all customers, both existing and new customers, that would be the same as if the Company experienced normal weather, and didn't experience some of the other factors that are causing consumption to decline. Which in highly volumetric rate scenarios, ~~it~~ causes the margin to erode.

So the idea then is to collect the same amount of fixed costs, the Company's marginal revenues, as one would under conventional perfect conditions, if you will.

MS. GLASER: Thank you. I have no further questions.

JUDGE MOSS: Mr. Finklea, Northwest Industrial Gas Users.

purchases their own commodity, so they are only seeing a margin?
A Yes.
Q And so sometimes we, in focusing on designing transportation rates, compare the transportation rate that a customer would pay to the sales rate, the margin that they would pay inside the sales rate?
A Yes, with the exception that, of course, there's -- if you are a sales customer under rate 87, you would pay a procurement charge which you wouldn't pay under rate 57. You are paying a balancing charge instead. So those are a couple of unique differences, cost-based differences between the two schedules.
Q From a customer's perspective, when they are making a choice between being a transporter or being a sales customer, and say their choices are 57 or 87, they take all of those other than the commodity into account in making their decision as to which rate to be on?
A Yes.
Q And presently the rate for Schedule 57, which has no commodity, is slightly higher than the margin for Schedule 87; is that correct?

correct that from a rate design perspective, that narrowing the disparity between Schedules 57 and 87 is a legitimate concern, and a legitimate objective of any rate design that we choose for those two schedules?

A Yes. I think it's a legitimate objective. That has been the case, ~~been~~ the objective of the Company for some time now, as I understand it, because the customers that take service under these two schedules are typically the same. They migrate back and forth from time to time, depending on some of those factors that you discussed in terms of gas prices versus the Company's cost of gas, and so forth. But I think that's been an objective of the Company over the years.

Q So if the Joint Parties' proposal for the rate design narrows that disparity, you don't find that to be a problematic objective?

A I don't find that to be problematic. I fail to understand how their rate design proposal does that. The Company's rate design proposal for rate 57 and 87 recovers the incremental revenues, or the incremental marginal revenues that we were proposing to recover from Schedules 57 and 87 in the cost-based charges that we identified, that proposal that may be different from what else has been proposed. So I will sustain the objection.

Q BY MS. SPENCER: Would you describe the concept of parity to the Commission?

A Yes. Actually, I believe I have a definition of parity in my testimony.

MR. CEDARBAUM: Your Honor, before the witness answers, I will renew the same objection. I don't see how any additional questions could be anything other than friendly cross.

JUDGE MOSS: That's an abstract proposition that I am not willing to accept. We have to have the questions before we have an objection to them.

THE WITNESS: On page 22 of Exhibit 21 of my direct testimony I talk about parity at the bottom of the page. Parity being the cost of service and the comparison of the total cost of service to the indicated cost of service for each class. And if you assume that the cost of service for the system is 1.0, then the closer that those classes' parity ratio, which is a revenue to cost ratio, the closer those approach 1.0, the closer they are to parity.

Q BY MS. SPENCER: Would you turn to Exhibit

87, it is 1.401. And for rate 57, it is 1.724.

Q BY MS. SPENCER: Thank you. And perhaps so that we have them all together, can you give us the parity ratio for the residential, commercial, and industrial large volume transport ends?

A Certainly. For residential rate 23, it is .862. For rate Schedule 31, 36, et cetera, the small commercial industrial, it is 85.2. For rate Schedule 41 --

Q 85.2 or --

A .852 I am sorry. For rate Schedule 41 it's 1.135. And those are the primary schedules. There's, you know, rentals and CNG service, and so forth, but if you are interested I can give you those.

Q Sure. If you have them right there.

A For the transportation contracts, it's 1.008. For CNG service, it's .018. And for the rentals schedule, it's .559.

Q Under the Company's proposed rate increase, would that be line 39 on page 1 of Exhibit 41?

A Line 39 would be the revenue to cost ratios that result from the Company's proposed revenue allocation.

JUDGE MOSS: I will overrule the objection, and why don't you answer that, the last question, if you can.

THE WITNESS: The parity ratios or the revenue to cost ratios under the Company's proposal for those classes would increase somewhat. And the reason for that is really outlined in my testimony where I have stated that the Company, first of all, felt that every class should participate to some degree in the revenue increase.

So naturally those interruptible schedules would, under that objective, have to get some revenue increase. And any revenue increase to those schedules are going to cause their revenue to cost ratios to increase to some extent.

However, the Company was focused in that effort to identify, as I mentioned under cross-examination by Mr. Finklea, that we targeted those increases to specific cost elements that we think are important to be addressed. That being the procurement charge for the sales customers under rate 87, and the balancing charge for the customers served under rate 57.

So we think there's a good reason for it, albeit it does result in additional revenues from think in particular where it's combined with the Company's proposal on the customer charge, that they work complimentary to one another, and help reduce bill volatility, in particular volatility in winter bills when low income customers need that relief the most. And so I believe that the two in combination provide benefits to low income customers.

Q And if the proposed $17 customer charge would not be adopted by the Commission, then your answer would be --

A That there would be greater volatility in the customers' bills, and therefore, there would be less of a benefit to low income customers.

Q Would you also agree that as certain customers become more efficient in their use of -- or frankly conserve, let's use that term, conserve in their use of natural gas, and if there were decoupling mechanisms in place that the fixed costs would be spread -- or the shortfall on fixed costs would be spread among all customers within that class? That's my understanding.

A Yes, that's correct.

Q So those customers, over time that either can't afford to make either their homes or their proposal that the Company has made on those -- and do it in bands, 10 percent, 20, 30, incrementally up to the 90 to 100 percent range of those customers, so the full range, if you will, of the customers from the highest to the lowest usage?

A Certainly. I think that we can do that. Until you came to your last criteria, I was going to say that we have done it. But we haven't done it over a stratified group of residential customers.

We have compared, through data responses, the impact of the decoupling adjustment that we have modeled, but started out with what I presented in my exhibits in terms of modeling the impact. And we have done it for current rates, proposed rates, the $17 customer charge, but we haven't done, as you suggest, something that crosses the spectrum of residential customers.

Q Would it be difficult to do the same for the other customer classes that are being -- that are also included within the decoupling mechanisms purview, if you will?

A It may be a little more difficult task in that, for example, the rate 31 class is a very ~~disparit~~ disparate, less homogenous class.

Q Could you answer the same questions for the North Carolina order with Piedmont? Are you familiar with that --

A I am familiar enough, Commissioner, to know that there were targets, of sorts. The Company -- this was part of a settlement, by the way, that was reached in North Carolina. And the Commission approved that settlement based on, the Company did make a commitment to fund a certain amount of demand side ~~sight~~ management programs or energy conservation measures that they had not done before.

And beyond that, they have a provision in their mechanism whereby if the total adjustment -- and you will forgive me if I am a little vague on this, but I believe the total adjustment under the decoupling mechanism is greater than the weather component of that adjustment by a certain amount, that that will be contributed in addition to additional energy conservation programs up to a cap. I believe it's $750,000.

Q I'm going around the country. Let's go to California, and end with Oregon. California's order was Southwestern Gas. For those criteria, again weather, rate of return limitation, or ROE

Company, but in the context of the Company's return on equity or rate of return, that a decoupling mechanism, as you suggested the credit rating agencies viewed Northwestern's decoupling mechanism, has the effect of reducing risk from the market's perspective?

A I think that's fair to say, Commissioner. I think, in fact, one of the credit agency reports that I think I even cited in my testimony supports that. That companies that have these mechanisms in place generally have a better view in the marketplace when it comes to the risk of its securit~~y~~ies.

Q Presumably that risk has to go somewhere. So wouldn't it be fair to say that this does in some way shift that risk now borne by the Company under recovery of its margin, and puts some risk on the customers that they will, in effect, be paying more of that margin, which isn't that part of the purpose of the mechanism?

A Well, again, I think that the benefits remain somewhat symmetrical in that the customers will also benefit in the long term from a lower overall cost of capital, perhaps as a result. And presumably then pay rates that would be lower than rebuttal testimony, Exhibit 31, page 8.

A I am there.

Q There was quite a bit of discussion on line 19, that third point that you make in your testimony.

A Yes. The point I think you are referring to is with regard to promoting inefficient use of the gas utility system.

Q Yes. Would you then look at Exhibit 67, please, one of your cross exam exhibits?

A (Complies.) Yes, I am there.

Q Is this a data request response -- is Exhibit 67 a data request response that you prepared to further explain what you meant by your third point?

A Yes, that's correct. In fact, if you look at the question, that was ~~o~~posed in the data request by Commission Staff. They are referencing that page and line of my testimony, and then the response is provided to illustrate the concept there that I was talking about in terms of efficient use of the gas system.

MS. DODGE: Thank you. That's all.

JUDGE MOSS: Thank you.

Mr. Amen, I believe that completes our

turn to Exhibit 394, that's the November 18 Puget Sound Energy letter. That's one of your cross exhibits.

A (Complies.)

Q Do you have that?

A It's a letter to --

Q It's an advice letter dated November 18, 2005, Exhibit 394.

A Yes.

Q Do you have that?

A To Ms. Washburn?

Q Correct.

A Yes, I have that.

Q And that is in general a clarifying ~~terrifying~~ letter for your natural gas conservation programs?

A Yes, it is.

Q And at the time of that filing, this letter represents, does it not, the Company's best efforts to reach the conservation targets that were referred to in the stipulation we just looked at, or the settlement that we just looked at?

A I believe it is.

Q Thank you. Now, can I ask you to turn to page 2 of that exhibit?

A (Complies.)

weatherization funding levels based on more thorough analysis of each agency's specific needs."

A Yes.

Q Would you describe how and when PSE will commence a process to adjust its low income energy efficiency funding level?

A I would suggest to you that that process is already in place. We work closely with ~~SEETED~~ CTED (ph). They are the entity that we actually write the check to, and then they distribute to the agencies.

So we work directly with them, and we do have some work that we do directly with local agencies. The big question has to do with the spending capability of each of the agencies. Some spend their money much quicker than others.

What we have not been able to get to is how we help those agencies that don't spend down their money as much. And so we're basically trying to help them even now, come up with tools, whether they be electronic tools, tracking tools, other devices that can help them with their spend down. And also have the ability to move money around to agencies that do have more need than others.

Q So there is no incremental activity Puget forward on the merits of those filings without the technical barrier of the ~~expense~~ suspension order on this proceeding, and we're making that motion now in this docket.

JUDGE MOSS: Anyone else need to be heard on this? Motion is granted.

Anything else?

MR. FFITCH: Your Honor, I have two matters.

JUDGE MOSS: Go ahead.

MR. FFITCH: The first is that, as you may recall, we have offered a demonstrative -- excuse me, an illustrative exhibit in connection with Ms. Steward's appearance which consists of a two-page chart. We have had input from the Company today indicating that they had spotted a correction that they thought needed to be made.

So what we would propose to do is revise that. And I apologize. Those will be a second revision, but we're prepared to review that chart so when Ms. Steward gets on the stand tomorrow everybody will be comfortable with the factual basis for the chart, so we can have that ready to distribute in the morning.

JUDGE MOSS: And I will say in general I

$127,453,655; do you see that?

A. Yes.

Q. Okay. Now that's a figure different from what you show in your Exhibit 445; is that not correct?

A. Yes, 445 is done on an average of monthly averages~~,~~ this is ~~in the~~ end of period. This is the total additions during the time period.

Q. Okay.

A. And what we did is take these same numbers and calculate an average investment going into plant.

Q. Okay. Perhaps for the benefit of the record could we determine what your number is based on your Exhibit 445?

A. My number~~,~~? W~~which~~ number~~,~~? T~~there~~'s a lot of them?

Q. Yes, I'm looking for total T&D additions for the period October 2005 through June 2006. Now I took a stab at it, and I added lines 4, 8, 24, and 29.

A. Again, those are average of monthly averages, you would have to go back into the pages behind the first page, and you can see each month's activity, and adding those up would come to $145 Million. Like if you go back to page 8.

Q. Okay, and that was $145 Million?

A. That's what she has here.

Q. Oh, I see.

A. So you have on page 8, you have $78 Million, 7 of electric distribution and $7 Million of transmission if you look under the June column, and I'm doing this -- I haven't added these up to make sure, well, if you have added these up to make sure, they total 145, I'm not sure I'm picking the right pages.

Q. Okay.

A. But these are where you will find the additions laid out in a monthly format, and then we took the average of monthly averages of these, and that should tie into the $145 Million.

Q. Okay. Now bearing in mind that $145 Million figure, is it true that over half of that amount, over half of the amount which is -- let me start over.

The $145 Million is the total increase in T&D plant for that period, the net amount is the $127 Million figure; is that correct?

A. The $145 Million is not the total T&D for that time period, it's the total T&D associated with the non-revenue producing transmission and distribution, and the $127 Million is the $145 Million minus the retirements shown in the second column.

Q. Okay. But of the $127.4 Million, almost two thirds of that amount -- strike that.

~~southwest~~ natural gas~~es~~ is the fuel on~~ly~~ the margin for electric generation, that cooling or air conditioning demand during heat waves drive up power for gas consumption. We have also skated through, as compared to last year, we have been very lucky in avoiding hurricanes in the Gulf of Mexico in the producing regions. I think the combination of those two plus a natural gas storage what we will call an overhang, I believe we're at about nationally 300 billion cubic feet of storage above where we are on a five year average. I think all of these events have combined to drop this. The other thing I might add though, and it's rather newsworthy over the last few weeks, is this kind of decline has taken a few of the hedge funds out. It makes you, as a trader, it makes you wonder, you know, what additional kind of volatility that activity is bringing into the marketplace.

Q. Thank you.

I would like to focus now on the adjustments that the joint parties proposed to the Aurora results, and I think there's four adjustments that the joint parties proposed. The first had to do with adding a couple of new plants to the database and updating some capacity ratings. Is that an adjustment that the Company is in agreement with?

A. I believe that we did adjust the Aurora database upward of 2,280 megawatts for that additional generating capacity.

Q. So the answer is yes?

A. Yes.

Q. The other adjustments that were proposed to the Aurora results were to the minimum up and down times for gas fired plants; is that correct?

A. That's correct.

Q. And there was also a proposed adjustment for the hydro shaping factors, which is the amount of hydro energy that is in the on peak hours as compared to the off peak hours; is that correct?

A. That is correct.

Q. Focusing first on the issue of minimum, well, let me ask you first about the Aurora model itself. In your rebuttal testimony at page 10, line 21, you talk about the fact that Aurora is a standardized model that's widely used in the Northwest; is that correct?

A. That's correct.

Q. And do the utilities all use the same version of the Aurora model?

A. I can't speak to the different versions that might be in use between the different companies, nor can I speak to the date of the most recent input data set including fish, flood control, navigation, recreation, when you get to the power component of the purpose for the system, that's true.

Q. Could you refer to Exhibit 274.

MS. DODGE: PSE objects to this exhibit. It appears to be two different BPA documents from two different proceedings that were never made into ~~two~~ exhibits by ICNU in this proceeding.

JUDGE CLARK: Mr. Van Cleve.

MR. VAN CLEVE: Your Honor, we did provide the first portion of this document previously, which is the load resource study and an excerpt from that study, it's quite long. As far as the estimates that Bonneville makes of the heavy load hour production hydro system, it's referred to at page 15, line 6, and we neglected when we first produced this exhibit to include the portion of that study that talks about the hydro shaping factors, but it's a companion document that bears the same date as the load resource study, and we did send this out to all the parties last Friday.

JUDGE CLARK: Well, I understand that, and the record should reflect that on Friday you sent an electronic copy to Judge Moss and all other parties with the understanding that you would provide the hard copies this morning, but my understanding is that is not right?

A. That's true.

Q. I would like you to look at Exhibit 279, page 13.

A. 279?

Q. I'm sorry, 274, it's the BPA new resource study.

A. Any specific page?

Q. Page 3 of the cross exhibit, which is page 13 of the load resource study.

A. I'm there.

Q. Let me ask you first whether you have had occasion to review the load resource study that's part of Bonneville's 2007 power rate case?

A. Only in a cursory manner. Puget does not purchase long-term contract power from BPA, our relationship is on a wholesale basis. But given that, I am from my prior ~~private~~ employment, 18 years at Bonneville, I'm very familiar with these models that Bonneville uses to project generation from the system.

Q. Now it says at page 13, line 18, that Bonneville uses the HYDSIM model to project energy from the federal system and that it's based on 50 water years and that it's based on meeting the power and non-power requirements of the system; were you aware of that?

system, do you consider how Bonneville plans to operate the system when you're determining how much energy is going to be on-peak hours?

A. The only -- on a forward looking basis, the inputs that we consider are the reservoir, known reservoir elevations at the time that we conduct a study or run the risk model. But with respect to how Bonneville might choose to shape their system, keep in mind there's a, you know, we're limiting non-power constraint discussions to fish, but there is a number of other adjustments that are made generally exogenous to this study that impact the flow of the system, and these could be things -- and I really don't want to dive into the detail, but I would be glad to, but the after the fact adjustments or the real time adjustments that Bonneville has to make for the return of the Canadian EnTitlement Treaty and for the relationship between BPA and BP Hydro with respect to the non-treaty storage.

Q. Could you take a look at the chart on page 4 of your direct testimony, rebuttal testimony.

A. Oh, rebuttal?

Q. Sorry, 269C.

A. I'm there.

Q. Now with the chart on page 4, you're attempting to validate the Aurora shaping of on peak

California ISO, the contractual provisions can often be overridden for must ~~fund~~ run reliability needs. But without that ~~proviso~~ provision, I guess the answer is yes, that would -- 16 hours would be the minimum run time per the contract excluding any reliability or must run provisions.

Q. So referring back to page 20, line 19, that confidential number there, is that what the minimum run time for Frederickson I is?

A. No, that's the minimum down time.

Q. Is it also the same as the minimum up time?

A. No, it is not, and that would be an equally confidential number.

MR. VAN CLEVE: Your Honor, I think we would like to make a records requisition request for the minimum up and down times for the PSE owned gas resources that have been put into the Aurora model. If the Company can't provide that, then maybe we should go into confidential session and ask about it.

MS. DODGE: Your Honor, the Company objects. Again, the EPIS database has been put into issue in this case as of last February, we have responded to over 1,000 data requests, this could easily have been one of them. This appears to be an issue that's being inserted at the last minute in this proceeding, and it denies the Company as well as the Commission an adequate out what the results were, and the second scenario add $2 to the Aurora $2, making it a $4 O&M cost, running that and then verifying the results.

Q. Did you go back and look at any of the contracts like for example the Mountain View contract and see how the maintenance costs were charged in that contract?

A. We looked at -- it was -- only two contracts were submitted in their entirety, it would be the Sunrise and the Mountain View, but we also took a look at I believe there was ten California Department of Water Resources contracts, only excerpts were provided. We struggled to try to find all of those contracts of the current vintage that was provided by the Industrial Customers and it -- I think without diving into each one of those in detail, but since the Sunrise contract listed showed up both as being provided in its entirety and was also referenced in the DWR contracts, I will try to answer your question looking at that contract.

In the Sunrise contract it wasn't clear, and it maybe just escapes me at this moment, but it wasn't clear what the O&M component of the cost calculation was, and I will point out that I believe --

Ms. Dodge ~~THE WITNESS~~: Can I have a minute, Your Honor?

week, so there's a couple of days, like on Thursdays and Fridays most notably, we have to trade for two days. So on Friday we trade in the schedule for the Sunday-Monday ~~Monday-Tuesday~~ package, on Thursday we trade in the schedule for the Friday-Saturday ~~Saturday-Sunday~~ package. And that becomes even more complicated when you lay in a Monday holiday, so now your preschedule definition, which is still under the guise or the definition of spot, could be transactions that are executed but the delivery wouldn't occur maybe for three or four days out.

Q. And then finally Mr. Van Cleve asked some questions about whether the Company would be willing to update gas costs in November, would such an update be sufficient in terms of trying to get a better projection of power costs for 2007?

A. I think as I said in my testimony, we're not intending nor do we choose to make use of stale market information. I think it's imperative that we would look to update or at least check where the prices are before the rates for this proceeding go into effect. I guess as a trader, my preference, my recommendation would be that we do that as close to the start of these rates going into effect, by that I mean January 1, so that would have a middle, third week of December.

And the reason for that is we're in what we behavior. And so it's perhaps a component, but like Mr. Mills was saying, it's the way the market behaves is very complex, so when he was talking about -- Mr. Mills was talking about the heat rates, well, you know, if the correlation between and the behavior between gas and power breaks down, which it does quite a few times, you know, the heat rates blow out. So it depends, sometimes there's a tight relationship, sometimes there is none, and that's the nature of the market, so it just depends.

Q. And would you agree that the natural gas prices have been fairly volatile over the past four years?

A. You would have -- could you define volatile, I mean can you give me a definition of volatile, because I mean --

Q. How about if you give a definition in your opinion what the term volatile means.

A. Sure. First I will just give a more of a little bit more technical definition. Typically in the markets you define volatility as the log difference of ~~two of the~~ prices, and you take ~~a~~ this series of log differences of the prices and take the standard deviation. Then you take the -- and then you annualize it. So when you hear the -- when you hear volatility in the market, if you talk about -- if the market talks about volatility, it talks about a have $438 Million, with the proposed mechanism it would be $392 Million, and with the current mechanism without ~~the cap it would be $40 Million, without~~ the $40 Million cap it would be $328 Million. So the proposed mechanism follows for the customers would fall in between, and I don't know if it's exactly in between, but it's in between the existing mechanism with the $40 Million cap and the current mechanism without the $40 Million cap. And this was just to show the different, the three different mechanisms so to speak.

Q. Okay.

A. And later on I talk more about the analysis we did to give a more accurate picture of these outcomes, and it's directionally the same as what's shown here.

Q. But do you know what the actual power cost excesses that have occurred in each of the past four years?

A. I have a general idea.

Q. Go ahead.

A. And I have it, if you turn to page 10 of my rebuttal, this chart basically shows the last four years under and overrecovery of power costs.

Q. So if we were to sum the four data, that four amounts shown on your chart, that would give us an idea