BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. WASHINGTON NATURAL GAS COMPANY, Respondent.	Hearing No. UG-920840 Volume 17 Pages 3279 - 3527

A hearing in the above matter was held on July 8, 1993 at 8:30 a.m., at 1300 South Evergreen Park Drive Southwest, Olympia, Washington, before Chairman SHARON NELSON, Commissioners RICHARD CASAD and RICHARD HEMSTAD, and Administrative Law Judge LISA ANDERL.

The parties were present as follows:

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, JEFFREY GOLTZ and ROBERT D. CEDERBAUM, Attorneys General, 1400 South Evergreen Park Drive Southwest, Olympia, Washington 98502.

WASHINGTON NATURAL GAS, D. SCOTT JOHNSON, Attorney at Law, 815 Mercer Street, Seattle, Washington 98109, and HARRY E. GRANT, Attorney at Law, Suite 4400, 1001 Fourth Avenue Plaza, Seattle, Washington 98154.

NORTHWEST INDUSTRIAL GAS, PAULA PYRON, Attorney at Law, 1300 S.W. Fifth Avenue, Suite 3400, Portland, Oregon 97201.

PARTNERSHIP FOR EQUITABLE RATES FOR COMMERCIAL CUSTOMERS, CAROL S. ARNOLD, Attorney at Law, 5000 Columbia Center, Seattle, Washington 98104.

Donna Davis, Court Reporter

FOR THE PUBLIC, CHARLES F. ADAMS, Attorney at Law, 900 Fourth Avenue, Suite 2000, Seattle, Washington 98164.

FOR SEATTLE STEAM COMPANY, FREDERICK O. FREDERICKSON, Attorney at Law, 33rd Floor, 1420 Fifth Avenue, Seattle, Washington 98101.

I N D E X

P R O C E E D I N G S

JUDGE ANDERL: Good morning, everyone. Let's be on the record, please. We are reconvened in docket UG-920840 to continue the company's rebuttal case.

Let's see, Mr. Grant, you indicated that you had a statement that you wanted to make before we went any further?

MR. GRANT: Right. Thank you, Judge Anderl. I wanted to indicate for your benefit and particularly for the benefit of the Commissioners and opposing counsel that there have been yesterday a number of questions concerning the impact to the regulated utility's employee count, if you will, of having the merchandising subsidiary created as a separate entity. And there were concerns about confidentiality. And in order to ensure that that information is available to the parties and particularly to the Commissioners, it will be available through the testimony of Company witness Karzmar, and it will be in the form of a document that can be a confidential exhibit subject to the confidentiality order, thereby record responding to those concerns that were articulated yesterday about the need to maintain the confidentiality of that

information. But it will be available in the proceeding.

JUDGE ANDERL: Thank you, Mr. Grant.

Is there anything further before the company calls its next witness?

Go ahead then.

MR. GRANT: The company calls James Torgerson.

JUDGE ANDERL: Let me ask you, Mr. Grant, before we swear him in. Does he just have the one exhibit in addition to the testimony JPT-1A?

MR. GRANT: It has 33 schedules but it's one exhibit.

JUDGE ANDERL: We'll identify Mr. Torgerson's rebuttal testimony as Exhibit 345 and JPT-1A will be Exhibit 346.

(Marked Exhibits T-345 and 346.)

MR. GRANT: Thank you, Judge.

JUDGE ANDERL: All right, Mr. Torgerson, if you would raise your right hand, please.

Whereupon,

JAMES P. TORGERSON,

having been first duly sworn, was called as a witness herein and was examined and testified as follows:

JUDGE ANDERL: Go ahead, Mr. Grant.

DIRECT EXAMINATION

BY MR. GRANT:

Q. Will you state your full name for the record, please?

A. James P. Torgerson.

Q. What is your occupation, Mr. Torgerson?

A. I'm the senior vice-president of finance planning and development and chief financial officer for Washington Natural Gas.

Q. Mr. Torgerson, have you testified previously before this Commission?

A. In this current hearing, yes.

Q. And have you filed on a prefiled basis rebuttal testimony in this proceeding?

A. Yes, I have.

Q. And is a copy of that rebuttal testimony before you previously marked as Exhibit T-345?

A. Yes, it is.

Q. And in reviewing Exhibit T-345, are there any corrections that you wish to make?

A. Yes. I have a couple minor changes.

Q. Can you go through those, please?

A. Certainly. The first one is on page 5, line 3, where it says "based upon total capital,"

delete "total" and replace it with "permanent" capital.

Then on page 12, line 14, where it says "criteria for an A rating," A is in lower case. It should be upper case.

On page 14, line 14, the same changes as the first one where it says "based on total capital," the "total" should be deleted and change the word to "permanent capital."

And finally on page 53, line 10, the answer is, "yes, using" then insert the word "substantially."

COMMISSIONER CASAD: That last one was what?

THE WITNESS: Page 53, line 10, the sentence starts "yes." And then "using" and insert the word "substantially."

That's it.

BY MR. GRANT:

Q. With those corrections that you have just made to your prefiled rebuttal testimony, is it now true and accurate to the best of your knowledge and belief?

A. Yes, it is.

Q. In addition, Mr. Torgerson, have you

prepared an exhibit that goes with your rebuttal

testimony?

A. Yes, I have.

Q. And is a copy of that exhibit before you previously marked as Exhibit 346?

A. Yes, it is.

Q. Is that exhibit one that was prepared by you or under your direction and supervision?

A. Yes, it is.

Q. Have you reviewed Exhibit 346?

A. Yes.

Q. Is it true and accurate to the best of your understanding?

A. Yes, it is.

MR. GRANT: Your Honor, the company would move for admission into evidence of Exhibits T-345 and 346.

JUDGE ANDERL: Mr. Goltz, any objection?

MR. GOLTZ: I have an objection to page 12.

JUDGE ANDERL: Of the testimony?

MR. GOLTZ: Of the testimony. The sentence which begins on line 8 and ends on line 11. I have objection on hearsay grounds. This is statements, reports of a conversation with unnamed rating agency personnel about the substance of their

conversation. And that's -- it's the classic definition of hearsay. It is not available here for cross-examination. And I know that the rules of evidence in administrative hearing are more lenient than those in a superior court. Still, I think there is a line to be drawn somewhere, and I think this is far enough over the line where that merits an objection.

JUDGE ANDERL: Mr. Adams, do you have any comments or any objection to the testimony or the exhibit?

MR. ADAMS: I have an inquiry concerning Exhibit 346, Schedule 25. It's the AG Edwards and sons attachment. I have no objection to it provided the witness has available and can provide the whole document. He has provided just a few pages out of it. As long as he has available the whole document, I have no objection to it.

JUDGE ANDERL: Okay. Does the company have that available?

MR. GRANT: Just a moment, Judge Anderl, please.

JUDGE ANDERL: Sure.

MR. ADAMS: While the witness is looking I think I would concur with Mr. Goltz's objection on the

particular lines.

JUDGE ANDERL: Schedule 25 I have what appears to be the front page, and then I have pages which are numbered at the bottom 4 and 5. I think it would be helpful to know how long the document was and if the whole of it is present in the hearing room today.

THE WITNESS: That was the subject of a data request, which perhaps it hasn't arrived yet.

MR. ADAMS: I think there are a bunch of them that haven't been provided yet.

MR. GRANT: I appreciate your acknowledgement of that, Mr. Adams. I think, your Honor, the short answer is that that document is available. It's either being provided as a response to a data request or, alternatively, we will do whatever we can to get it down for Mr. Adams today if it's not in the hearing room.

JUDGE ANDERL: All right.

MR. ADAMS: Assuming that I can have it before I have to cross the witness, I have no objection to the document.

JUDGE ANDERL: You may be able to get it by lunch. You probably won't be crossing the witness before lunch. Given the time estimates that I have,

maybe you will. We'll work with that if it becomes a problem.

Mr. Grant, would you like to respond to the staff and public counsel's hearsay objection?

MR. GRANT: Well, yes, your Honor. First of all, as Mr. Goltz indicated, the rules of evidence have not been rigidly applied in this proceeding. I think Mr. Goltz has alluded to that on previous occasions.

I think that this is a situation where the witness has testified on page 12 about what he has heard from individuals at the rating agencies, and I believe the witness is entitled even under a strict interpretation of the hearsay rules to testify as to what he heard.

I think that the real issue here is one of the weight that the Commissioners would want to give to it. And I think that this is something that should be admitted into evidence. The Commissioners are quite able to then decide on the basis of what Mr. Torgerson testifies to having heard what weight they would choose to give it.

So, I think that Mr. Goltz' motion to exclude this one sentence from Mr. Torgerson's testimony should be denied in this particular

proceeding.

JUDGE ANDERL: Brief response, Mr. Goltz?

MR. GOLTZ: Yes. Even under a strict reading of the hearsay rules, he is not entitled to make a hearsay statement if it's offered to the truth of the matter asserted. I think Mr. Torgerson is saying if you adopt staff's recommendation there will be a downgrading of the debt rating. And we disagree with that conclusion strenuously.

And here is evidence offered to prove what we are attempting to disprove, and it is made not by the witness we have before us, but by unknown rating agency personnel, unnamed rating agency personnel, I should say, who we do not have an opportunity to examine about their assumptions, about what they know, about their expertise, about any of that, nor about, well, if it's not -- what part of staff's recommendation? How much of staff's recommendation? What if staff's recommendation wasn't quite that much? All those things one normally does with a witness in cross-examination, we don't have that opportunity.

I also point out that they have another witness here today that testifies in general about the same general subject matter, and Mr. Torgerson can talk about personal knowledge. But he is not entitled

under strict or lenient rules in the application of the hearsay rule to simply report things he has heard if offered to prove the truth of the matters concerned.

MR. GRANT: Judge Anderl --

JUDGE ANDERL: One minute. Excuse me. I'm sorry.

Go ahead.

MR. GRANT: With all due respect, I think that Mr. Goltz's comment proves exactly the point I'm making. First of all, he is speculating about why Mr. Torgerson may want to testify as to what he has heard.

Mr. Goltz' speculation about why the witness may want to testify to this is not a basis for excluding the testimony. But, in fact, it illustrates exactly why the testimony should be allowed so that the Commissioners have the opportunity to evaluate it and give it the weight that they choose to give to it.

JUDGE ANDERL: Okay, thank you.

I have looked at this and I have been thinking about this while you have been making your arguments. I don't think that this is a valid objection raised to this statement in the testimony, and I'm therefore going to overrule it.

I believe that the objection does go to

the weight that it should be given, and to the extent that it would be offered to prove that the debt rating would be downgraded I think that it would be subject to the administrative act with regard to whether or not a finding could be based on it. But I don't think that it should be excluded.

Objection is therefore overruled.

Mr. Goltz, you may proceed with your cross.

MR. GRANT: Excuse me, your Honor. I guess then two points. I have just given Mr. Adams the document that he requested in its entirety. So, I would like to renew my request now for admission into evidence of Exhibits T-345 and 346.

JUDGE ANDERL: Okay. And --

MR. CEDARBAUM: I agree I have received it, and I have no objection.

JUDGE ANDERL: Thank you. The only objection to the exhibits being disposed of then, those exhibits would be admitted as identified.

(Admitted Exhibits T-345 and 346.)

MR. GRANT: Thank you, Judge Anderl. Mr. Torgerson is available for cross-examination.

JUDGE ANDERL: Go ahead, Mr. Goltz.

CROSS-EXAMINATION

BY MR. GOLTZ:

Q. Mr. Torgerson, good morning.

A. Good morning, Mr. Goltz.

Q. First of all, just perhaps to point out something in your case and ask for a slight clarification in your testimony, you testified on page 19, line 19 and 20, you have an anticipated follow-up rate case. Is that correct?

A. Yes, that's what it says.

Q. And so, can I gather from that that the company is planning to file shortly after the order in this case another rate case of some sort?

A. I would anticipate that we will file a rate case at some point in time within, my guess would be the next twelve months or so. I believe Mr. Thorpe in testimony said we would definitely file within 36 months.

It all depends on the outcome of this case. But there are a lot of issues specifically related to like storage gas, the safety program, environmental programs which may require us to file pretty quickly afterwards.

Q. So, that is envisioned by the company at this point as being anticipated?

A. It's a possibility.

Q. And that could include a number of issues that arise out of this case because this case has a 1991 test period, and then a new case could use a more recent test period, for example?

A. Yes, that would be what would happen, yes.

Q. And it could be, in effect, what is commonly termed a "make whole" case?

A. That is a distinct possibility, yes.

Q. On page 45 of your testimony -- this is another thing in the nature of a correction, I gather -- I gather that the -- on line 17 that date should be 7/27/92?

A. Oh, yes, you're correct.

Q. Now, Mr. Torgerson, in your prefiled testimony you recommended that Washington Natural's rates be based on a 13 percent return on equity; is that correct?

A. In my prefiled direct testimony.

Q. If your first round of testimony.

A. Yes, sir.

Q. And what you're presenting today in your rebuttal testimony reduces this recommendation by 75 to 100 basis points to 12 to 12.25 percent; is that correct?

A. Yes, that's correct.

Q. Would it be fair to say that, from the time you prepared your prefiled direct testimony in this case in July 1992 to the present time, you believe that Washington Natural's cost of common equity capital has fallen by about 75 to 100 basis points?

A. Yes, that's what my testimony says.

Q. Could you turn to Schedule 16 of your exhibit, please.

A. Yes, I have it.

Q. And there you show that returns on equity allowed by various state regulatory Commissions for major gas distributors during -- you show the returns allowed by various state Commissions for major gas distributors for 1992?

A. Yes, sir.

Q. And would you accept that the average allowed return on equity for the first half of 1992 was 12.25 percent subject to check?

A. I would accept that subject to check, knowing full well that one of those has an extremely low return on equity of 11, and there is only 8 companies in there.

Q. You also have a 13 in there, too, as I

see.

A. And 12.84 and 12.75.

Q. Would you accept that the average allowed return on equity for the third quarter of 1992, the same quarter in which you filed your direct testimony in this case, was 11.93 percent?

A. Yes, that is true, subject to check.

Q. So, when you prefiled your direct testimony in this case, recommending that this Commission allow Washington Natural to earn 13 percent on common equity, other Commissions around the country were allowing an average of 11.93 percent return on equity to gas distributors?

A. I also prepared my testimony in the second quarter, looked at the information available at that point in time. The other Commissions around the country did approve about 12 percent in the third quarter.

Q. But when you prefiled your direct testimony, other Commissions were allowing an average of just under 12 percent?

A. Yes. And also you have to look at the far column which has the amount of common equity. You have to remember the amount of common equity in the capital structure goes hand in hand with the

rate of return. They were recommending 47.2 percent equity in the capital structure at that point.

Q. We'll get to that separate topic in a little bit.

Referring to page 45 of your testimony -- we'll be jumping around in your testimony and exhibits. I assume you have those in front of you?

A. Yes, I do.

Q. The -- if as you say on page 45 of your testimony the cost of equity has fallen by 75 to 100 basis points since you filed your testimony, then would it be reasonable to expect that current allowed returns on common equity would fall into the 10.93 to 11.18 percent area?

A. Not necessarily. You have to look at the time frame that those numbers were put together that were decided by Commissions back in that time frame. People may very well have put the numbers together a year prior based on some information. So, I can't just say that it's going to fall that much. If you do a mathematical calculation, you know, just take one number and subtract another, I assume you can come up with that.

Q. And since that time, interest rates have been falling, have they not?

A. Since which time?

Q. This is during -- your exhibit shows during 1992, but certainly since 1991, interest rates have been falling?

A. Interest rates are lower today than they were in '91 or '92, yes.

Q. Would you accept subject to check that according to Standard & Poor's the yield on A rated public utility bonds averaged about 8.95 percent in the third quarter of 1992 when you prefiled your direct testimony and that the yield on such bonds currently is about 100 basis points lower?

A. I can accept that subject to check.

Q. And as we established, Mr. Torgerson, you have lowered your return on common equity in this case to 12.0 to 12.25 percent. And so referring to page 49, lines 25 to 26 of your rebuttal testimony, there you indicate that your updated cost of equity analysis produced an 11.36 percent bare cost of common equity. Isn't that correct?

A. That's what my testimony says, yes.

Q. And that to kind of summarize what you have done here, that 11.36 percent bare cost of equity is the midpoint of the cost of equity estimates that you derived using both the CAPM and DCF methods?

A. Yes. I used both methods. I used the mid point. And as I state in my testimony, it's very prudent to use at least two methods.

Q. Let me ask you while we're on that subject, you made a correction. That may impact where we go this morning. On 53, line 10, you said you changed your prefiled testimony from using the same methodology to using substantially the same methodology.

What is the difference?

A. Okay. The difference was, when I was looking at the yield component of the DCF formula, I changed it from the standpoint of just taking the previous analyzed dividend for the comparable companies and multiplying it times one plus the growth factor to looking at when they actually paid the dividends and then factored in when they would reasonably pay -- increase the dividend and I assume it would be a year after the last increase. So, I made a minor change, and I think the effect of that change was about one basis point.

Q. If you were doing your original testimony over, you would incorporate that change presumably?

A. Presumably, yes.

Q. Your DCF method produces an 11.9 percent

bare cost of common equity whereas your CAPM method produced an 11.2 percent bare cast of common equity?

A. Yes, sir.

Q. As I understand it to arrive at 12 to 12.25 return on common equity, you made three upward adjustments to your bare cost of equity estimate. The first one was you added 25 basis points for risk associated with third quarter 636?

A. Correct.

Q. You add 25 basis points to the cost of equity should this Commission deny the company's request for weather normalization adjustment?

A. Yes.

Q. And third was you added 36 basis points to cost of equity to account for cost --

A. I'm not sure. It was 3.1 percent of whatever the range of those numbers were. So, it should be in that range, I would guess.

Q. With regard to your -- let's look at first the 25 percent basis point adjustment for the additional risk associated with FERC order 636.

It's true, is it not, you have made no formal studies to support that adjustment?

A. I think as we went through in the

testimony before, I said that I hadn't made a formal

study but that I had talked to a number of analysts, and the conclusion was that there was additional risk and the summary of all the analysts I talked to said it would be in the neighborhood of 25 basis -- actually, the range was 25 to 100, and I chose to use 25.

Q. And it's your testimony -- I think we went through this somewhat in your last go-around. So, I think it's still your testimony that -- even though we now have later more time -- even though more than one year has passed since FERC order 636 was issued you still believe whatever risks are perceived by investors related by that order have yet to be fully reflected in the stock price of Washington Energy Company or other gas distributors that you have studied?

A. Yes. I believe that's still the case. Not all of FERC 636 has even been implemented yet. People, the pipeline are still in the phase where they are getting their orders from FERC, filing their plans, and not all of them have been decided yet. There are many LDCs that are still not aware of what the impacts will be. I think we went through this at some length last time.

Q. Basically you're saying that the risk of

this FERC order won't be incorporated in the stock price until after a number of uncertainties are resolved related to -- are finally implemented?

A. My understanding is most of the pipelines plan to have their filings completed and implemented by this fall. So, I think we should see something at that point. It's not like it's in the very far distant future. The effects may not be known for some period after that until all the LDCs can now react to the new world environment of 636 where they are dealing with, you know, electronic bulletin boards, where they are dealing with transmission costs that they have -- then they have to determine if their utility Commissions are going to pass through those costs.

So, there are a lot of issues that still are unresolved.

Q. Let's turn now to your 25 basis point addition to the bare cost of equity were the Commission to reject the company's proposed weather normalization adjustment.

A. Yes, sir.

Q. Let me refer you to page 21, lines 19 to 21, of Mr. Tulis' testimony.

A. Yes, sir.

Q. That reads, does it not, the market does not seem to be assigning any significant differences in value to companies with and without weather normalization clauses? Is that his testimony?

A. That's what it reads.

Q. Let me refer you to Schedule 7, page 1, of Mr. Tulis' testimony. Next time you guys have to put more tabs in these notebooks. Keep that in mind for your follow-up case.

A. Or more exhibits.

Q. He shows there, does he not, that gas distributors have had -- that have weather normalization clauses on an average of 11.68 percent cost of common equity and have 1.8 average market-to-book ratio.

A. Can you point out where you're referring? I can't seem to see those numbers.

Q. In the summary section on page 1 of 3, Schedule 7.

A. Yes?

Q. The mean. So, it's in effect the last line of the table, second column of numbers at the bottom.

A. Okay.

Q. And that shows a mean average -- pardon me

-- mean market to book, that's 1.8?
A. Yes, I see that.
Q. And the mean return on equity is 11.68 percent?
A. Yes, I see that.
Q. Page 3 of that schedule shows, does it not, gas distributors who do not have weather normalization earned on an average 10.95 percent on common equity and had a 1.9 average market-to-book ratio? Is that correct?
A. Yes, I see those numbers. Now, but you also have to look at when those weather normalizations may have gone into effect for those companies. And I'm not sure that this schedule outlines that, either.
Q. So, according to Mr. Tulis' data, gas distributors without weather normalization clauses less on equity than those distributors that have such clauses, and yet the distributors without such clauses had higher market-to-book ratios? Is that correct?
A. Can you repeat that, please?
Q. According to the data that we just looked at, gas distributors without weather normalization clauses earned less on equity than those distributors that have such clauses, but the distributors without

such clauses had higher -- had a higher market-to-book

ratio on average; correct?

A. I would expect those without it to earn less if it's a warm year because those with the weather normalization would have a higher return because their earnings would be normalized. So, that's not unreasonable.

Q. But they had higher market to book ratios. Those without the clause had higher market to book?

A. 1.8 versus 1.9, it is slightly higher, I agree. You would have to look at the individual companies and see what other businesses they may be in. I'm not sure that these are necessarily all pure utilities. And if you look at those that are -- that don't have the weather normalization, I can tell you for certain that like UGI is 50 percent of propane company. The other one, South Jersey Industries, I don't know what they have or Southeastern Michigan Gas company as far as diversification. So that market-to-book ratio may not be related to strictly a gas company.

Q. So, you would be critical of these tables here?

A. I don't know exactly what those companies do. So, without that knowledge I have a hard time saying that you can derive the conclusion that just because you have a table that the market-to-book ratio is up a tenth of a point higher that it's that significant.

Q. You didn't review Mr. Tulis' exhibit here or compilation of data here in preparation of your testimony?

A. I read it, but I wouldn't say that I reviewed it.

Q. Do you disagree with the conclusions on this table?

A. The conclusions on the table is what it is. They are numbers. They are statistics. I can't disagree with what the numbers say.

Q. Is it your testimony, Mr. Torgerson, that investors are expecting this Commission to grant Washington Natural's request for weather normalization adjustment, and they have been and are currently embodying that expectation in the stock price of Washington Energy Company?

A. I would have to say I'm not sure that the investors know what to expect at this point. I think after what the staff filed for their case with the recommendation there wouldn't be a weather normalization, with the recommendation with a significant decrease, everyone saw the reaction that

our stock price had to that recommendation. So, I'm not really sure what the -- that I can say what investors are expecting.

Q. Let's go back a step then. Let's say before staff filed its case. Would you be -- would it be your testimony that investors were expecting this Commission to grant Washington Natural's request for weather normalization adjustment and that they at that point were embodying that expectation in Washington Energy Company's stock price?

A. I can't say that all investors. I think investors were anticipating fair treatment by the Commission. Whether they believed we would have weather normalization or not, I think they would look to see that other companies have it. Not all companies, but a number of them do. And that they would assume it would be a reasonable request.

Now, whether they embodied that in their determination on the stock price, I'm just not certain.

Q. Just to get on Schedule 7 of Mr. Tulis exhibit and his Schedule 7, he has two pages of companies that do not have a weather normalization clause. Isn't that true? And one page that do? Am I reading this correctly?

A. I believe the companies on page 2 of 3, the ones I know -- I know a number of those -- Bay State I know does not, Cascade does not, Connecticut I'm not sure about. Indiana I thought --

Q. You would accept that eleven of the companies do have normalization clauses and 24 do not in Mr. Tulis' study here? Do you accept that?

A. I'm not sure about those eleven whether they all do or not at this point. I know that -- I know the ones on the first page do. The ones on the second page I know some of them do not.

Q. You would have to talk to Mr. Tulis about this before you would be willing to accept it?

A. Yes, I would.

Q. If the Commission were to reject your proposed 25 basis point markup to bare cost of equity, FERC 636 order, and to reject your 36 percent markup should it reject the proposed normalization adjustment, then what return on equity would be requesting?

A. If we do not receive weather normalization, there ought to be a 25 percent basis increase. It was not what you stated. You had said I think the reverse.

Q. Assuming rejection of both your 25 basis

point markups, and what return on equity would you be recommending?

A. I think the numbers that are calculated show the add-ons.

Q. Wouldn't it be 11.71 percent which is 11.36 times 1.031 for flotation costs?

A. If it's simply a matter of subtracting 25 basis points from I think I used 12, and whatever the flotation cost effect would be on 25 basis points off of 12, that would be a reasonable answer to that math. But if they reject the weather normalization, I think you have to add 25 basis points.

Q. Should the Commission rely solely on your DCF study result that shows the bare cost of equity is 11.09 percent and should it mark this up by 3.1 percent for flotation costs as you recommend, then the return on equity would be 11.43 percent; is that correct? Do you accept that?

A. I would accept it subject to check. But in the first place you're making the assumption that they used DCF solely, and I think --

Q. I understand.

A. -- that that is -- that first off isn't sound. There is very good reasons for using more than one. As a matter of fact, in the New York generic

hearing and in 80 percent of the public utility Commissions across the country use more than one methodology. The New York generic hearing which was just decided, which is a good example of this, they determined that three methodologies should be used: DCF, CAPM, and comparable earnings. And the reason they said that was because the DCF methodology was giving more volatile results than the three combined over the time period they studied it and that the actual allowed rate of return would have been similar with the three methodologies, but with much less volatility. So, they were recommending that you do not use -- they said you shouldn't use solely the DCF methodology.

Q. I think you'll have plenty of opportunity to expound upon this as we move on.

A. Okay.

Q. In applying your version of the DCF method in your rebuttal testimony, you marked up for historic and current debiting by a full year's expected dividend growth before dividing the adjusted dividend by market price; is that correct?

A. For the yield I think I said I changed that. I did not mark it up for the full amount. I looked at it on the yield component -- unless I missed

your question.

Q. You mark each one up by a full year's growth. Isn't that correct?

A. Not necessarily. I mean, I looked at when they raised their last dividend. And if it was the previous quarter, I didn't mark it up until sometime later, like for one quarter. I took what the current dividend was, ran it for, let's say they increased their dividend in the last quarter. Then I would go until the next time a year from then before I would use the growth factor to adjust the dividend rate.

Q. Is this what you're getting at when you said changed to substantially?

A. I didn't say -- I said it was substantially the same. I said it was a minor change. But, yes, that's the change I made.

Q. And you also said that the difference was what?

A. When I looked at it, I think it was about one basis point because there were only a couple companies -- there were two that had recently raised their dividends. The others were due to raise them.

Q. Refer to page 51, lines 12 to 13 of your testimony.

A. Yes, I have it.

Q. You indicate that a primary shortcoming of CAPM is that beta has limitations as a comprehensive measure of risk?

A. Yes.

Q. And what do you mean precisely when you say it has limitations as a comprehensive measure of risk?

A. I think we discussed in the last cross-examination of me, people pointed out about the Fama-French study which had said that perhaps beta had some limitations. Measuring risk for an individual company and that's really what mean there.

Q. And beta plays a critical role in the CAPM methodology?

A. Certainly it does.

Q. If it has limitations as a measure of risk, then how can you or any other analyst be confident in a cost of equity estimate based on this approach?

A. I think any methodology is going to have limitations. And it's a matter of taking a number of them and realizing that they all are basically simplified models that try to reflect the real world. And when you simplify a model, you are cutting down on all the different parameters. And you couldn't assume

that it's going to be exactly correct because it isn't. It is a model.

Q. You referred to the Fama-French article; is that correct?

A. Yes, sir.

Q. And doesn't that go beyond just a limitation, but it attacks the underlying theory?

A. I don't know that I can recite the Fama-French article. I have read it once. And it's very -- a very technical study. I know some people disagree with the conclusions of it. I know Professor Sharp does. Some others probably have, too.

So --

Q. But would you agree that it doesn't just talk about limitations, but talks about theoretical underpinnings?

A. Yes. The Fama-French article does. I agree with that.

Q. Theoretical underpinning is different from limitations?

A. I think the Fama-French article talks about it. There are other people who say the beta is a good methodology and CAPM is a good methodology. I think a number of people use it. The New York

Commission does.

Q. There is a difference between limitation and a theoretical flaw?

A. The Fama-French -- as I said, I haven't studied it thoroughly enough to come to that conclusion.

Q. In applying your CAPM in your rebuttal testimony, you can find a risk free rate of 7.25 and equity risk premium for 7.3 percent? That's on page 53 of your rebuttal testimony.

A. I see that 7.3 on line 3. What was the other number? Just to make sure I have the right numbers.

Q. 7.3 is there. Risk free rate of 7.25 and equity risk premium -- what was your equity risk premium?

A. I believe I have a schedule that lays all that out.

On my Schedule No. 26, page 2 of 3, it shows my equity risk premium of 7.28. And the risk free rate of 7.25.

Q. So, Schedule 26, your calculation is 7.28 percent times .6. And that equals 4.37. Isn't that correct?

A. Just one second. I didn't do that. I

didn't show it, I should say. 4.37, yes, I agree.

Q. And that's your equity risk premium; is that correct?

A. No. The equity risk premium is 7.28. You take the equity risk premium and multiply it by the beta.

Q. What you did in your calculation there was you pump by 7.25 percent plus the product of 7.28 percent times .6, and that led you to the 11.62 percent?

A. Yes, that is correct.

Q. Let's define the terminology. What do you call 7.28 times .6? Does that have a name?

A. That's the product of a multiplication. I call it 7.28 the risk premium.

Q. Can we call that the equity risk premium for purposes of today?

A. No. I don't agree with that. The equity risk premium is 7.28, and you multiply by the beta. If the beta -- the market beta is usually considered to be 1. But in this case they used --

Q. What we'll call it 4.37 percent?

A. That's fine.

Q. So, the 7.28 number was derived as shown on Schedule 26, page 3 of 3?

A. Yes, sir, that's correct.

Q. You arrived at 7.28, you average 67 yearly risk premiums over the 1926/1992 period; correct?
A. Yes. But that's probably 67 years.
Q. What did I say? 62?
A. You said 66.
Q. Well, 67. Yes.
And had you used, say, 1930 to 1992, a period of 63 years, that figure becomes 6.64 percent instead of 7.28 percent. Isn't that correct?
A. I haven't done that calculation, and I don't support doing that.
Q. Would you accept that number -- that mathematical calculation subject to check?
A. Can you give me that number again, please?
Q. 6.64 percent.
A. Assuming you have just taken the average of those, yes, I can accept that subject to check.
Q. If you multiply the 6.64 by a .6 beta, we get a 3.98 percent product, don't we?
A. Yes. But then again I don't accept using that.
Q. I understand. I understand.
Would you agree, Mr. Torgerson, that the current yield on 30-year U.S. Treasury notes is

approximately 6.68 percent?

A. The current yield is, yes. But that doesn't necessarily reflect what should be used in this formula. That's the yield on a spot basis. We're looking at setting rates going forward.

Q. I understand. And if we combined -- if we were to combine a 6.68 risk free rate with an equity -- with a product of why don't we call it equity risk product, equity risk product of 3.98 percent, we get a bare cost of equity estimate of 10.66 percent; is that correct?

A. Adding those two numbers together you get 10.66. But I don't agree.

Q. I understand. We're walking through much in the same way that we did in your cross-examination of your direct case of some of the assumptions and simply asking you to accept a recalculation based on some differences in assumptions. And it's clear from your prefiled testimony that you disagree with some of this. So, I don't think we need to say it all the time. But I understand that.

Could you explain to us why it's critical to your CAPM methodology to use the 1926 to '92 period instead of 1930 to '92?

A. I think I pointed out before that the time frame was appropriate. It picked up all of the known

data from that time frame. To ignore certain periods doesn't serve much purpose because you have the data available for a very long period of time. And by selectively picking out one you can miss recessions. You can miss growth. You can miss a lot of things. So, I think taking the period when the data is available and from the Ibbotson and Sinquefield studies that's when it is available from 1926 to 1992 now.

Q. Does that qualify as a theoretical underpinning of CAPM methodology all the way back to 1926?

A. It is not a requirement of CAPM to go back to 1926. The requirement of CAPM is to come up with a risk premium. And this is a methodology that's been used by a number of people in which I believe very prudent to come up with what the equity risk premium is.

Q. You testified earlier that about volatility of results, using DCF.

A. Yes.

Q. Is this a volatile result of CAPM?

A. I think that what the New York Commission said in the hearing, they said that using CAPM and comparable earnings would present -- would provide less volatile results than DCF. But you're applying

different methodologies and different assumptions. So, yes, you could make anything change by applying different assumptions.

Q. The New York Commission isn't testifying here. So, I'm asking you.

A. I understand they are not.

Q. I'm asking you what your opinion is.

A. If you change assumptions, yes, you can make anything volatile.

Q. Basically you would term this a volatile result changing four years?

A. I didn't say that. I said you're changing assumptions now.

Q. I'm also changing results if we change those four years.

A. That's true. You did.

Q. Is that a problem of volatility in results?

A. I said if you do things consistently, I think you can get more -- you won't get as volatile results if you do things consistently. You're taking one number and saying to use something different and it's going to be a change. Sure it's a change.

Q. Page 21 of your testimony, lines 21 to 22.

You state that investor behavior seems to be at odds

with the underlying assumptions of DCF. Is that your testimony?

A. Yes, sir.

Q. Now, can you point to any scholarly work or article, book, in the financial literature that's concluded that DCF is theoretically or empirically flawed and cannot be properly used to determine the cost of equity capital?

A. No. I think DCF is a valid method for use in determining the cost of equity. My whole point is you need to look at more than one methodology. A lot of people say DCF is a good methodology when used by a practitioner who uses it knowledgeably and with good judgment. But you can't assume and use it solely and say you're going to get a good result.

When I look at a project analysis, we also use a discounted cash flow analysis to come up with an internal rate of return. We look at earnings impact, pay-out ratio, all kinds of different answers because one will not necessarily give you the correct answer all the time.

Q. But let me see if I understand what you're saying: You are not challenging the theoretical underpinnings of DCF? You are not personally?

A. (Reading.) What I'm saying is you can get

volatile results. I'm saying that the theoretical underpinnings of DCF, it's a good methodology.

Q. Now, that's your view. I want -- you have been referring to New York Commission, others. Do you know of any other sources that challenge the theoretic underpinnings of DCF?

A. I didn't say New York was challenging the theoretic underpinnings.

Q. You're testifying to what others have been saying about the use of a variety of methodologies. I want to know if you know of any challenges, whether it be by a Commission or by authors like Fama and French who are challenging the theoretical underpinnings of the DCF method?

A. A lot of people challenge the DCF from the standpoint that you shouldn't use it solely.

Q. I know that.

A. But to say that can I point to an article that says someone says DCF doesn't work, period, no, I can't do that.

Q. Let's turn to the issue of capital structure. Looking at your Schedule 4, page 5 of 6.

A. I have it.

Q. This contains Standard and Poor's

benchmarks as they relate to capital structure?

A. Yes.

Q. And am I correct that the benchmarks as related to capital structure which you are are stated in terms of total debt to total capital ratio, not in terms of the common equity to total capital ratio?

A. Yes, that's correct.

Q. And you would agree, wouldn't you, that the utilities could have the same total debt to total capital ratio and different common equity to total capital ratio because they have deferred preferred stock to total capital ratio?

A. Yes. There are three components there. You have debt, preferred, and common equity.

Q. And Standard and Poor's is aware of that possibility, too, I assume?

A. Certainly. And they also when they look at these capital structures, they look at the preferred stock and determine what kind of preferred stock it is and whether they determine if it's more like debt or more like equity.

So, just to say that preferred stock can wash out whatever the debt is is not necessarily true. If you have debt and then you have a lot of preferred stock that has maturities that are, let's say, ten years or so, they will consider that to be debt.

Q. And I assume then if Standard and Poor's -- we spent a fair amount of testimony in your testimony and also in Mr. Tulis' testimony and your earlier testimony about Standard and Poor's guidelines or benchmarks. Isn't that true?

A. Yes, that's true.

Q. So, I'm looking at this set of benchmarks or guidelines, whatever they are called.

Had Standard & Poor's wanted to state their capital structure which you are in terms of common equity to total capital ratio, it could have done that but opted not to do it?

A. I don't know what Standard & Poor's wanted to do. I know that this is what they have in this paper here. I know what I have been told by Standard & Poor's and the ranges they like to see.

Q. On page 5 of 6 if you look at the text in the right-hand column, the last paragraph begins a layer of preferred stock.

Do you see that?

A. Yes, I see that.

Q. That reads "a layer of preferred stock in a capital structure is usually viewed as equity since dividends are discretionary and because preferred stock is a non-debt alternative to finance assets."

Isn't that true?

A. Yes, I see that. But as I also told you, they look at what kind of preferred stock you have. And it says usually. They just don't say any preferred stock is considered equity or an equity equivalent is more appropriate. They don't call it pure common equity. They call it preferred equity.

Q. Then let's look at Washington Natural. And what in your preferred stock could be considered debt?

A. I think the -- let's see -- it would be the series one, Roman numeral I, which has a very short maturity, and the Series C. Those all have to be retired within the next I think four years.

Which is the bulk of our preferred stock. That's 25 million out of the 32 million we have outstanding.

Q. When Standard & Poor's computed your total debt to total capital ratio, did they consider that to be debt?

A. I didn't say they considered it to be debt. They considered it to be similar to debt. A debt-line instrument. And they factor it in. They don't put it into the total debt calculation. But they keep it in mind as to what the makeup of the

preferred stock is.

Q. So, when they run their calculations, it comes out to be equity?

A. I didn't say that.

Q. It does not come out to be debt?

A. It's somewhere in between. If it has characteristics that are of debt, they consider it more like debt. But they don't -- when you do the total debt to total capital calculation, they just use the debt. It's a judgment call by the rating agencies.

Q. Look at your Schedule 3, page 1 of 11.

A. Yes, I have it.

Q. I'm sorry. I have got the wrong citation. You have a schedule that gives debt ratios for Washington Natural, do you not?

A. Yes.

Q. Do you recall which schedule that is? Can you help us out?

A. No. I'll help you look.

Q. You have got to have more tabs.

A. On Schedule 1 we have Washington Natural Gas for year 1992, which shows percentages if that's the one you're referring to.

Q. That will do. This is a Standard & Poor's

computation. This is just a reiteration of that?

A. This is from Compustat, which is a service owned by Standard & Poor's. It's not Standard & Poor's debt rating service.

Q. What I'm saying is these figures are not yours; they are Standard & Poor's?

A. They ultimately are mine because what they do is they pull them out of annual reports. I mean, from our company.

Q. I understand.

A. I'm not trying to confuse this.

Q. And does any of Washington Natural's preferred stock show up in the -- listing at the very top of that schedule as either long-term debt or short-term debt?

A. No. It's shown as 5.74 percent preferred stock. I'm just trying to make the distinction that preferred stock is its own category.

Q. Now, on page 3 of your rebuttal testimony, starting at line 8, you indicate that "Dr. Lurito's structure is inconsistent with the capital structure maintained and projected to be maintained by selected gas distributors." Is that correct?

A. Yes.

Q. Please turn to your Schedule 1, page 1 of

2, of your exhibit.

A. Yes, I have it.

Q. At the bottom we earlier looked at the very top under Washington Natural. At the bottom you looked at there is a section that's marked proxy group average.

Do you see that?

A. Yes, sir.

Q. And those are the selected gas distributors in Dr. Lurito's testimony; is that correct?

A. That's the average of them, yes.

Q. And there there is a total debt to total capital ratio on average of 49.66 percent; is that correct?

A. For total debt that looks about right, yes.

Q. And Dr. Lurito's proposed capital structure contained 51.5 total debt to total capital ratio. Is that true?

A. That's true. But the more important issue is also the equity which he recommended 41 and it shows 46.5.

Q. You know, you'll have an opportunity to talk about that.

But Doctor --

MR. GRANT: Mr. Goltz, I have to interrupt here. You have now three times indicated what the witness can and can't say. I think the witness has sworn to tell the truth and to testify about what he knows about it so the Commissioners can understand it, and I'm sure that's what he is going to continue to do. I don't think your remarks are going to control or contain his comments. I think he is going to testify completely and truthfully.

JUDGE ANDERL: It does seem to me that the witness answers the question and then proceeds to expound a little bit on things that he hasn't been asked. Particularly this last question is probably a good example. And I think that Mr. Goltz does have a right to structure his cross and that, Mr. Grant, you'll have an opportunity to maybe let your witness talk about some of these things on redirect.

Let's all bear that in mind as we go on.

MR. GOLTZ: Thank you.

Q. So, Dr. Lurito's proposed capital structure contained a 51.5 percent total debt to total capital ratio. Isn't that correct?

A. Yes, that's correct.

Q. The difference between the two is about

1.84 percent more total debt to total capital than the average gas distributor in the group he selected? That's the difference between Dr. Lurito's amount and the average in his proxy group?

A. 1.84? Yes, I agree with that.

Q. But in your testimony -- now we'll get into equity ratio -- you chose to focus on equity ratios -- common equity ratios as compared to that of his selected group of gas distributors; correct?

A. Yes.

Q. And Dr. Lurito recommended the use of a 41.0 percent common equity ratio while the group he selected for analysis had a 46.5 percent common equity ratio in 1992. That's a difference of 550 basis points. Isn't that true?

A. That is true.

Q. And we mentioned earlier that the capital structure benchmark of Standard & Poor's focuses on total debt to total capital ratio and not on common equity to total capital ratio?

A. That one component, yes, does focus on total debt. There are others.

Q. And where are those others that you refer to on that --

A. What I was referring to is the fixed

charge coverage. That's not the capital structure, I understand, but it is an outgrowth of the capital structure in which you're allowed to earn, how you can cover your debt charges.

Q. But as far as the capital structure, my statements are correct?

A. Yes.

Q. Now, the current Standard & Poor's benchmark for an A rating is total debt to total capital ratio of 42 to 50 percent. Isn't that correct?

A. Are you referring to the schedule?

Q. Schedule 4, page 5 of 6. Look down at the second sub table under --

A. On this schedule --

Q. Under A for gas distributors, 42 to 50 percent for an A rating.

A. Yes.

Q. So, the 49.66 percent total debt to total capital ratio for Dr. Lurito's group is barely within the 42 to 50 percent S&P benchmark for an A rating; correct?

A. Yes, it's in that range and --

Q. And Dr. Lurito's recommended 51.5 is

barely outside the range; correct?

A. It's outside the range for an A, in the range for a Bbb.

MR. GOLTZ: I'm handing out what I would like to have marked.

JUDGE ANDERL: Marked for identification as Exhibit 347 what appears to be a page from Standard & Poor's Credit Week dated April 16, 1990.

MR. GOLTZ: The number on this, your Honor?

JUDGE ANDERL: 347.

(Marked Exhibit 347).

BY MR. GOLTZ:

Q. Mr. Torgerson, is this what's been marked as Exhibit 347, does that contain the earlier version of the S&P utility financial benchmarks?

A. This is an earlier version, yes, dated April 16, 1990.

Q. And these were in effect prior to the changes Standard & Poor's made to its benchmark set out in your Schedule 4, page 5 of 6. Isn't that correct?

A. Yes.

Q. And looking down to the similar location on this page that we are just referring to on your schedule, April 16, 1990 benchmark for gas

distributors included a 42 to 52 percent total debt to total capital ratio. And that was sufficient for an A rating; is that correct?

A. It says that 42 to 52 is a range. You also have to look at Bbb, too, which there is an overlap between the two.

Q. So, I gather by that that these things aren't all hard and fast? These things don't draw firm lines in the sand?

A. I admit they change.

Q. The latest Standard & Poor's publication lowered the upper end of the total debt to total capital benchmark by 2 percent from 52 to 50, that's a change; correct?

A. From this one to the one, we have in my testimony, there is a change.

Q. Please turn to Schedule 8, page 1 of 2, of your exhibit. There don't you show the total debt to total capital ratios, the average total debt to total capital ratio for Dr. Lurito's group of gas distributors for 1988 to 1992 period?

A. Yes.

Q. And according to your own data, the five-year average total capital ratio for Dr. Lurito's total debt to total capital ratio for Dr. Lurito's

group averaged 51.6 percent?

A. Yes, it did.

Q. And that's barely inside the old S&P benchmark and is outside the current 42 to 50 percent benchmark?

A. Yes, it is.

Q. And every one of Dr. Lurito's gas distributors in his group has been rated A by Moody's and by Standard & Poor's over the 1988 to '92 period, isn't that true?

A. Yes, it is. You also remember S&P looks forward. They don't necessarily always look at the history.

Q. And turn to Schedule 7, page 2 of 3, of your exhibit.

A. Yes, I have it.

Q. And that shows among other things Washington Natural Gas' total debt to total capital ratio over the '88 to '92 period; correct?

A. Yes, it does.

Q. And that total debt to total capital ratio from '88 to '92 averaged 56.6 percent; correct?

A. Yes.

Q. And that's 510 basis points higher than what Dr. Lurito is recommending in this case. Isn't

that true?

A. Yes, that's true for that average.

Q. And the Washington Natural's 56.6 percent total debt to total capital ratio exceeds the upper end of Standard & Poor's old benchmark by 460 basis points and exceeds the current benchmark by 660 basis points. Isn't that also true?

A. It exceeds those sheets that we have seen, yes. But you also, again, look at -- well, in like 1992, it shows a very high debt ratio, and we issued equity a week later to bring it down somewhat.

Q. So, in Washington Natural's first mortgage debt was upgraded by S&P in January '87 from Bbb plus to A minus, and Moody's upgraded Washington Natural's debt from B double A1 to A3 in 1988. Is that true?

A. Yes, they did upgrade the company. I know about the Moody's one. I was not with the company when S&P did it.

Q. Would you accept subject to check that my upgrade statements are correct?

A. Certainly.

Q. Washington Natural's common equity ratio averaged 36.0 percent over the '88 to '92 period according to I believe it's Schedule 7, page 1 of 2.

I might have that wrong. It might be Schedule 8.

Schedule 7, page 2 of 3. I apologize.

A. Can you repeat your question, please?

Q. Washington Natural's common equity ratio averaged 36.0 percent over the '88 to '92 period according to Schedule 7, page 2 of 3?

A. Yes, that's correct.

Q. And that's shown on five-year average, the last column on the right approximately in the middle of that table?

A. Yes.

Q. Dr. Lurito's recommending a 41 percent common equity ratio, is he not?

A. Yes, that's correct.

Q. So, Washington Natural had only a 36 percent common equity ratio on average from '88 to '92 and its debt was rated A minus by Standard & Poor's throughout that period?

A. Yes, that's true.

Q. Therefore, in assessing what rating to give Washington Natural Gas' debt, the rating agencies focused on Washington Natural's total debt to total capital ratio and not on its common equity ratio? Wouldn't you say that's true?

A. That is one component they look at in determining a rating. You have to factor in all the

other things that the rating agencies are going to look at. You can't just say it's the one item.

Q. I'm juxtaposing two ratios here. The total debt to total capital ratio is 1, and it's common equity ratio is the other. And I'm asking you whether Standard & Poor's between those two which they look at, the benchmarks, they look at the total bench --

A. The benchmark they have is total debt to total capital.

Q. On Schedule 4 of your exhibit -- never mind. We have gone through that.

You focused on common equity capital rather than total equity capital, which includes preferred stock. Isn't that correct, in your comparisons?

A. Can you say that again?

Q. You focused on common equity capital rather than total equity capital, which includes preferred stock, in comparing Dr. Lurito's recommended capital structure?

A. Yes. I was looking at common equity.

Q. Please refer to Schedule 1, page 1 of 2, of your exhibit.

A. Yes, I have it.

Q. Isn't it true that the average total equity ratio including preferred stock for Dr. Lurito's group in 1992 was 50.33 percent?

A. If you add the preferred stock and the common stock components, yes.

Q. Isn't it also true that Dr. Lurito's recommended total equity ratio in this case for Washington Natural, including preferred stock, which is 183 basis points lower than his group's average?

A. If again you just add preferred and common components, yes, that's the correct math.

Q. On page 3, lines -- 11 of your rebuttal testimony, you note, do you not, that "Dr. Lurito's proposed Washington Natural capital structure is inconsistent with projected capital structure ratios to be maintained by his selected gas distributors"?

A. Yes.

Q. And in support of that, you have your Schedule 2?

A. Schedule 2?

Q. Isn't that in support of that statement?

A. Schedule 2 is talking about the projected for Value Line, yes.

Q. And the Value Line projection you show is

1996/1998. Is that correct? That's what Schedule 2 is, projections from '96 to '98?

A. Yes. These are Value Line's numbers, projections.

Q. And that is well beyond the rate year in this case, is it not?

A. Yes. Assuming the rates are determined by September 30 of this year, it is a couple of years later, two or three years later.

Q. At the near end and five years at the tail end?

A. Yes.

Q. And the fact is, Mr. Torgerson, that Value Line's projected common equity ratio of 52.1 percent for the Dr. Lurito's gas distributor group is also far beyond your own 45 percent common equity ratio recommendation. Isn't that correct?

A. Well, keep in mind -- and that's one of the changes I made in my testimony -- Value Line does not use short-term debt in determining their numbers. In their total capital number. So, you would have to adjust that.

You have to look at apples and apples here.

Q. Can you repeat your statement?

A. I said Value Line does not use short-term debt in determining their total capital. So, you need to use an apples to apples comparison. The 45 that I'm recommending does not equate to that same number.

Q. So, you're saying you need to use apples to apples. And your exhibit then is oranges?

A. I'm using it as an example of what's being projected on a comparable basis. If you look at -- I looked at Dr. Lurito's and Mr. Hill's to as though how they compared and what also Value Line was projecting for Washington Energy.

Q. So, the Value Line excluded short-term and Lurito's and Hill's included it?

A. Yes, that's true.

Q. So, it's not exactly apples to apples?

A. No, it isn't. It's just an example of what Value Line is predicting for the future.

Q. And so what is the significance of a projection of common equity ratio given these differences and the fact that it's a '96 to '98 period?

A. Value Line is very widely read, and I think it's something that investors use. And it's important to recognize that Value Line is using and what investors are -- because a lot of people read

Value Line. And so that's where the investor base comes from.

Q. What you're saying is that investors will base their expectations on what Value Line projects will occur in 1996 to 1998?

A. I think they take it into consideration, sure. I also recognize that Value Line reports the debt to capital ratio differently than what either Dr. Lurito or I have used.

Q. And you're suggesting that this Commission then also evaluate its capital structure based on what Value Line projects?

A. I'm simply using it as an example of what someone projects you need to use total debt/total capital, use the -- all debt in your capitalization structure. I don't disagree with that. I think that's what this Commission needs to consider.

This was simply an example to show what is out in the public.

Q. Let's turn to page 29 of your testimony. page 29, lines 21 to 25.

A. Yes, I have it.

Q. There you indicate that Value Line forecasted that the energy company will earn 13.5

percent for years 1996 to 1998 and that on average Dr.

Lurito's group are forecasted by Value Line to earn 13.44 percent on common equity in that same time frame, that's your testimony?

A. I think for Dr. Lurito it's 13.80. For his group of gas distributors. My testimony --

Q. I'm sorry.

A. Okay.

Q. Maybe I misread that. I didn't ask the question correctly.

Value Line forecasts that Washington Energy Company will earn 13.5 for those years?

A. For the 1996 to 1998 time frame.

Q. Correct.

A. Yes.

Q. And Dr. Lurito's group 13.80?

A. Yes.

Q. And 13.44 for witness Hill?

A. Yes.

Q. Referring to Schedule 16 of your exhibit, in 1992 the average return on equity allude to gas distributors by Commissions around the country averaged 12.03 percent?

A. Yes, that's correct.

Q. It would be for gas distributors to earn about 13.5 percent this year or next year given their

allowed return on equity is about 12 percent. Isn't that true?

A. If the average is 12, yes, it would be difficult.

Q. And Value Line's 1996 to '98 return on equity projections, whether accurate or not, have little or nothing to do with what is likely to happen in the rate effective period in this case. Isn't that true?

A. I think you have to realize that this is what investors are looking at. I agree it's outside the time frame for the rate effective period. But investors equate -- they look at Value Line's estimates.

Q. Is the logic here that Value Line estimates lead to investor expectations, and investor expectations should lead to Commission decisions?

A. I think when you use, for example, DCF analysis, you look at a market analysis, and the investors make up the market. I'm not saying that what Value Line projects is what the Commission ought to decide. I'm trying to put in front of the Commission the information that's available to a number of investors.

Q. Aren't you saying that investor

expectations are driven in part -- are a function of Value Line's projections; correct?

A. People read Value Line's projections.

Q. So, their expectations are driven in part by Value Line's projections?

A. They can be, sure. They could.

Q. And are you also saying that the Commission decision is also a function of -- should be a function of investor expectations? Is that what you're saying?

A. I'm saying that you have to look at the market. DCF analysis looks at the market. The Commissioners I don't think are going to look at Value Line and determine what type of return they are going to grant.

Q. I know that.

MR. GRANT: Could the witness finish his answer, please, your Honor?

JUDGE ANDERL: I thought he had. If you're not, go ahead.

BY MR. GOLTZ:

Q. My question is does the -- are you saying that the Commission should look at investor expectations in setting its -- in reaching its decision?

A. I think investors' expectations are implicit in coming up with some of the analysis we do.

Q. Does your DCF result embody the assumption that in 1996 to 1998 investors should earn 13 percent -- that they are expecting the company to earn 13 or 13.5 percent return on equity?

A. I did use Value Line in my DCF analysis for their expected earnings and dividend growth.

Q. And so the answer to my question is yes?

A. I used Value Line numbers. I didn't necessarily take the 13.5. But that's probably a part of Value Line's expectations.

Q. Is it your testimony then that investors are currently expecting to earn 13.5 percent on equity in the rate effective period?

A. No. What I have said is this is Value Line's estimate and a lot of people read Value Line.

So, if you assume that they take to heart what's in Value Line, yes, maybe their expectation is that. And I think a lot of people use Value Line.

Q. Schedule 16 of your exhibit are the annual common equity ratios you show there the common equity ratios the commissions used to set rates in the case shown in that exhibit?

A. That is my understanding from what

regulatory research provided.

Q. Do these include or exclude short-term debt?

A. That I'm not certain of. I believe they do because that's the way most commissions would set the rates. But this is a report taken from regulatory research. And my understanding is it would include short-term debt.

Q. As you mentioned, the source of information is not something you put together; it's based on some research done by Regulatory Research Associates?

A. These are reports they put out.

Q. But you don't know for sure how they do it?

A. It's however the -- it's however each individual Commission does it. And my understanding is most Commissions use short-term debt.

Q. Again you didn't show in that exhibit total equity ratios including preferred stock that the various Commissions used to show rates; is that correct?

A. No, it's not there.

Q. You also show the total debt to total capital the various Commissions used to set rates in

the cases shown; is that correct?

A. Yes.

Q. And you didn't separate out from all the companies you show on Schedule 16 those whose debt is double A rated from the others; is that correct?

A. No, it's not on the schedule.

Q. Look at 16 utilities you show as getting new rates in the fourth quarter of 1992.

A. Yes?

Q. Would you accept that eight of those 16 utilities are double A rated by Standard & Poor's? I can read them to you if you would like.

A. Would you, please?

Q. Peoples Gas Light, Wisconsin Natural, Indiana Gas --

A. I'm sorry. Wisconsin? Okay. Indiana Gas.

Q. Wisconsin Gas.

A. Okay.

Q. Indiana -- you found Wisconsin?

A. Yes, I have it.

Q. And Indiana?

A. Yes, Wisconsin Gas.

Q. Wisconsin Power and Light, Wisconsin

Public Service, San Diego Gas and Electric, and

Iowa/Illinois Gas and Electric. Would you accept that those are all double A rated?

A. I'll accept that subject to check.

Q. And you would accept that had you excluded the 8 double A rated utilities from the average of 43.8 percent common equity ratio you show for the fourth quarter would have been 44.19 percent?

A. I can accept that subject to check.

Q. And will you also accept that had you excluded the double A rated utilities, the average return on equity allowed in the fourth quarter of 1992 would have been 11.5 percent instead of 11.9 percent you show?

A. If that's simply a mathematical calculation, yes, I will accept that subject to check.

Q. And on Schedule 3 of your -- you refer now to page 3, lines 11 to 13 of your rebuttal testimony you state that "Dr. Lurito's proposed capital structure for Washington Natural is inconsistent with the capital structure maintained by companies within the natural gas industry"; correct?

A. Yes.

Q. And in support of that you presented Schedule 3 of your exhibit.

A. Yes, that's correct.

Q. Looking at page 5 of 11 of that exhibit, this is your data; correct?
A. This was data that was from -- it's provided to the AGA and it's sent out to all the chief financial officers.
Q. And this is in 1992 for the period December 31, 1992, the average gas distributor in this country with total capitalization in excess of $200 million had a 53.57 dercent total debt to total capital ratio.
Do you see that? That's in the first column about eight lines down?
A. Yes. That's without regard to rating. Right.
Q. 53.57 percent?
A. Yes.
Q. And that 53.57 total debt to total capital ratio is 207 basis points higher than Dr. Lurito's proposed 51.5 percent total debt to total capital ratio for Washington Natural. Isn't that true?
A. Yes, that's true. As I said, it's without regard for credit rating, too.
Q. Right. But am I correct that the average gas distributor in this country in 1992 was more

leveraged than what Dr. Lurito was proposing for

Washington Natural in this case? Isn't that true?

A. That is for all gas distributors over $200 million in market capitalization, and that is a correct statement.

Q. Washington Natural is above $200 million?

A. Yes.

Q. Now, according to your -- again, according to your data on Schedule 3, page 5 of 11, the total equity to total capital ratio including preferred stock for the gas distributor industry in 1992 is 46.43 percent?

A. Yes, I believe that's correct.

Q. Do you see how that figure is derived?

A. I assume you added preferred stock and common equity together.

Q. Yes. And that comes out to 46.43 percent? Will you accept that?

A. Yes.

Q. Which is 207 basis points lower than Dr. Lurito's recommended total equity to total capital ratio for Washington Natural. Isn't that true?

A. Dr. Lurito's being common and preferred equity?

Q. Yes.

A. I would like to check that, but, yes, I

can accept that.

Q. You would like to check that number?

A. Yes.

Q. That's fine.

And the fact is that Dr. Lurito's recommended capital structure for Washington Natural Gas has less total debt and more total equity than the gas distribution had on average in 1992 that you depict on this schedule that we have been looking at. Isn't that true?

A. Without regard for the rating, yes, and the way you calculated it.

Q. Looking at page 45 of your rebuttal testimony.

Q. You're now recommending a total debt to debt capital ratio for Washington Natural of 52.69 percent. Does that summarize that figure?

A. I'm looking at equity of 45 and preferred stock of 7.69. So, adding the two.

Q. Is 52.69?

A. Yes.

Q. And that recommended total equity to total capital ratio is 626 basis points higher than the typical gas distributor had in 1992 with total capital in excess of $200 million. Isn't that correct?

A. Again, when you're adding preferred stock in, yes. It's equivalent on common equity.

Q. Now, on page 30, lines 23 to 26 of your rebuttal testimony, you indicate, do you not, that the average gas distributor in Dr. Lurito's group of gas distributors is allowed to earn 12.61 percent?

A. Yes, from Schedule 17?

Q. Yes.

A. Yes.

Q. And that's Schedule 17, page 1 of 2?

A. Yes.

Q. That number appears in comparable group average about two-thirds of the columns over at the bottom; correct?

A. Yes.

Q. If included in the 12.61 average allowed return on equity for this group is a 13.25 percent return the Oregon commission allowed Northwest to earn in October '89?

A. Yes, that's one of the numbers.

Q. It also included is it 16.25 percent return the South Carolina allowed Piedmont Natural Gas to earn in October of '81. Isn't that correct?

A. That is a part of it, yes.

Q. Had you excluded those two, the 12.61

average would have fallen to 12.0. Isn't that correct?

A. I can accept that subject to check.

Q. Even that 12 percent average includes 12.9 percent return on equity that the North Carolina allowed Piedmont to earn in July of '91?

A. Yes, it included the 12.9 for Piedmont.

Q. Look at interest coverage.

JUDGE ANDERL: Mr. Goltz, before you change subjects here, about how much time do you have?

MR. GOLTZ: About, oh, I would say at least two-thirds, 70 percent done.

JUDGE ANDERL: Why don't we go ahead and take a morning recess then and come back and pick up with interest coverage. Let's take fifteen minutes.

(Recess.)

JUDGE ANDERL: Let's go ahead and get started again. We'll be back on the record after our morning recess.

Mr. Goltz, you may proceed.

BY MR. GOLTZ:

Q. Mr. Torgerson, moving on to interest coverage, is it your testimony that the 2.82 times pretax interest coverage consistent with Dr. Lurito's recommended capital structure cost rates of capital

and overall cost of capital will not be sufficient for Washington Natural to maintain its A minus S&P bond rating?

A. Are you referring to somewhere in my testimony?

Q. Do you agree with that?

A. The 2.82 is below the S&P benchmark for recovery, yes.

Q. What's not quite my question.

A. Repeat your question, please.

Q. My question was would that 2.82 be sufficient for Washington Natural to maintain its A minus S&P bond rating?

A. Going into the future a 2.82 pretax interest coverage ratio is outside of the S&P benchmark range, and in my opinion that coupled with the capital structure and everything else that S&P and Moody's and all the other rating agencies look at would not allow us to maintain our A minus rating.

Q. Referring to Schedule 3, page 5 of 11, is it the not the case that in 1992 the average gas distributor in this country with total capital in excess of $200 million had a 2.95 times pretax interest coverage and that's in the first column about four fifths of the way down?

A. Yes, I see it. Again --
Q. Line 37, I should say.
A. Yes, I see that. Again, that's without regard to the ratings for all those companies.
Q. So, Dr. Lurito's recommendation is slightly below the industry average?
A. It's slightly below the 2.95.
Q. Schedule 7, page 2 of 3, you set out various financial statistics for Washington Natural, including its pretax interest coverage for each year over the '88 to '92 period. Is that correct?
A. Yes.
Q. And looking at the columns -- and I'm going to read from '88 to '92 -- those coverages are 2.5 times, 2.7 times, 2.1 times, 2.7 times, and 1.7 times?
A. Yes, those are the numbers.
Q. Now, according to Schedule 4, page 5 of 6, of your exhibit, the Standard & Poor's benchmark for an A rating is a pretax interest coverage of 3.0 times to 4.25 times; is that correct?
A. Yes.
Q. And the fact is, isn't it, that Washington Natural's pretax interest coverages over the '88 to

'92 period weren't even close to that benchmark, were

they?

A. They weren't within the range. But you also have to look when they are setting the ratings, they look prospectively. They factor in whether weather was let's say warmer than normal and we didn't earn as much to have the higher fixed charge coverage.

The ratings agencies are always looking forward and that's how they base their ratings.

Q. Obviously I'm looking at these factors one at a time. And as the bottom of all this we will have hopefully looked at a number of them. So, I'm preferring to opt to look at them one at a time here.

A. Yes.

Q. So, am I also correct that Washington Natural retained its A minus Standard & Poor's bond rating throughout the '88 to '92 period?

A. Yes, that's true.

Q. Referring to Schedule 8, page 1 of 2, that also -- that sets out financial statistics for Dr. Lurito's so-called what you referred to as proxy group over the '88 to '92 period?

A. Yes, it does.

Q. And let me read the same columns again down about two-thirds of the way down. I will read from right to left, that is to say '88 to '92. And

those coverages are 2.9 times, 2.7 times, 2.6 times, 2.2 times, and 2.7 times for '88 to '92. Did I read that correctly?

A. Yes.

Q. And also not one of those is even close to the S&P benchmark for an A rating of 3.0 to 4.2 times. Isn't that correct?

A. That's true. Again, you have to factor in the effects of weather on a lot of these companies and also that S&P is looking forward.

Q. And every one of the gas distributors in Dr. Lurito's group maintained an A rating through the 1988 to '92 period. Isn't that correct?

A. I would have to accept that subject to check because I'm not sure.

Q. That's fine. And the five-year average pretax interest coverage for Dr. Lurito's group was 2.6 times; correct? That's also shown on Schedule 8, page 1 of 2? That's the average, five-year average?

A. Well, there is two numbers there. One is -- there is with and without allowance for funds during construction, and the numbers are somewhat different. I guess I failed to point that out the first time. You were using the ones --

Q. We were using excluding. And the numbers

are similar, but you're right, they are off by a tenth here and there?

A. Yes.

Noting that, yes, I accept what you said.

Q. And Dr. Lurito has recommended 2.82 times pretax interest coverage is nearly 10 percent above the average coverage his group experienced over the '88 to '92 period. Isn't that correct?

A. I can't agree with 10 percent. If you take 2.7 times -- that's a little bit too much.

Q. Let's take 2.6. Well --

A. It's higher.

Q. I was looking at 2.6. Okay.

The 2.6 times pretax interest coverage -- and I'm again reading either 2.6 or 2.7, depending upon which row one reads, over the 1988/'92 period is well within. It's about in the middle of the 2.0 to 3.25 S&P benchmark interest coverage for a Bbb rate. Isn't that true?

A. Yes, it's true. Again, I'll just say S&P is always looking forward, and there are effects from weather that could impact those coverage ratios.

Q. But, again, all of Dr. Lurito's group was A rated by S&P throughout that '88 to '92 period?

A. Again, I said I would have to accept that

subject to check.

Q. According to Schedule 6 of your page 2 of 3, S&P affirmed Washington Natural's A minus debt rating October 12, 1992. Isn't that correct?

A. (Reading.) Yes, at that point they had affirmed it. And as you're aware, subsequent to that they changed the outlook to negative from stable in that report.

Q. And that's on that same schedule, page 3 of 3, where it says: "Outlook revised." Is that what you're referring to under Washington Natural Gas?

A. Yes.

Q. But it also says ratings affirmed?

A. Yes.

Q. So, again, on May 10, 1993, the A minus debt rating was affirmed?

A. Yes, it was affirmed. And S&P is waiting for the outcome of this proceeding before they act on moving the rating. I met with Standard & Poor's just a few weeks ago, and they have come back and because they had to rate our medium term note program and they gave the A minus rating but saying that they were waiting for the outcome of this proceeding.

Q. Do you have any notes of that meeting?

A. No, I do not.

Q. On page 10, lines 9 to 10, of your testimony, the overall rate of return -- you testified that your recommended overall rate of return would be sufficient to produce a 3.4 times pretax interest coverage; is that correct?

A. Yes.

Q. And would you accept subject to check that Washington Energy Company's before-tax interest coverage exceeded 3.0 times just once since 1969, and that was in 1985 when its pretax coverage was 3.01 times?

A. You're talking about Washington Energy. I'm talking about Washington Natural Gas. So, you're mixing two different companies.

Q. I understand what you're saying. But would you accept --

A. Subject to check that Washington Energy's has been above 3.0 --

Q. -- just once, and that was -- since '69, and that was in 1985, when its pretax coverage was 3.01 times?

A. I guess I can accept that subject to check.

Q. Would you also accept subject to check that over the 1990 to 1992 period WECO's before-tax

interest coverage has averaged about 3.32 times?

A. Yes, but, again, you're mixing companies because Washington Energy is not the one that's rated. It's Washington Natural Gas.

Q. I'm asking you to accept that subject to check.

A. Yes.

Q. So, Dr. Lurito's recommended pretax interest coverage of 2.82 times is 26 percent higher than the average pretax interest coverage WECO has enjoyed over the '70 to '92 period. Isn't that true?

A. Can you give me the number that you used for the average for WECO again, for the coverage? The average? So I can verify this.

Q. 2.23.

A. Yes, that's about right.

Q. 26 percent?

A. Yes.

Q. And do you know what Washington Natural's Moody's rating was from '70 to '87?

A. Not offhand I do not.

Q. Would you accept B double A?

A. I'll accept that subject to check.

Q. And Moody's upgraded Washington Natural's debt to A3 in 1988, did it not?

A. I thought it was later than that. But let me do that subject to check. I thought it was in 1990, January of '90.

Q. Would you accept 1988 subject to check?

A. Yes.

Q. Would you accept subject to check that for the five-year period prior to 1988 WECO's pretax interest coverage averaged only 2.38 times -- 2.38 times?

A. Again, WECO's may very well have been. But you're adding in other subsidiaries, the effects of weather and all those factors. But, yes, I'll accept that subject to check.

Q. In the first quarter of 1985, Washington Natural was allowed by this Commission to earn 16.25 percent on common equity. Is that your recollection?

A. Yes, that's my understanding.

Q. And would you accept subject to check that since the first quarter of 1985 the yield on A rated public utility bonds has trended downward? Maybe you don't have to check that.

A. It's lower today than it was in 1985. I can say that, yes.

Q. And so there is little reason to believe that between the first quarter of '85 today -- between

the first quarter of 1985 and today that Washington Natural's cost of common equity has been above 16.25 percent. Wouldn't you agree?

A. If during that whole period the rates -- interest rates were always lower than what they were in 1985, I guess I could accept that because as you're well aware interest rates go up and down. And I wouldn't say they have always been going down.

Q. No. But in recent years they have been going down?

A. They are lower today than they were then. I agree.

Q. Wouldn't you agree that, if this Commission grants the Washington Natural the 12 to 12.25 percent return on equity you are now recommending, Washington Energy stock price will decline from its current level of 23 1/8? Do you think that would happen?

A. I don't see why that would happen. You're looking at Washington Energy Company. We have other subsidiaries that are generating income, also.

Q. And are they generating more than 12 percent on equity?

A. Let's see. Offhand I can't say because it's -- I think our oil and gas may very well be. But

I would have to look at that.

Q. Let me ask you a hypothetical: That if, in effect, Washington Natural and Washington Energy were congruent, basically the same, would it be -- and the Commission grants the 12 to 12.25 percent return on equity, that Washington -- that the company's stock would decline from its current level?

A. That's almost impossible to answer. I mean, you're talking about eliminating all the other subsidiaries. You're talking about as our stock currently trades and trade is based on one of the things is the dividend. All of the people who have taken money out of CDs and pushed the prices up of stock. For me to sit there and say just on Washington Natural Gas that it's going to decline, I mean, it's impossible to make that assumption.

Q. You read Mr. Tulis' testimony?

A. Yes.

Q. And it was his opinion that the -- according to the staff recommendation, if the staff recommendation were adopted, the stock price of Washington Energy Company would decline?

A. Yes, that's what he said.

Q. And he predicted $15 per share?

A. Yes. He said that, if the company could earn let's say a dollar a share and if, I think he said, they paid out a dividend of about 75 cents or so, and using an assumption on dividend yield, you could back into what the price could be.

Q. Do you agree with that?

A. That's his --

MR. CEDARBAUM: I mean, it's a logical.

Q. Do you disagree with it?

A. No. I don't disagree. I mean, Mr. Tulis is a well known analyst.

Q. Do you agree with it or you haven't evaluated it?

A. I agree with what he said in his testimony. I don't see that, you know, using the assumptions he made, that could very well occur.

Q. And I assume you have conversed with Mr. Tulis prior to today about your respective testimonies?

A. We have talked about it a little bit, yes. But Mr. Tulis is acting very independently in this, and I had no -- very little input, if any, into his testimony.

Q. And do you know -- do you have any knowledge about what the -- did you discuss any opinion of his regarding a 12 to 12.25 percent return

on equity you're recommending and the impact on stock price?

A. No, we did not.

Q. So, are you saying, based on your at least review of Mr. -- I'm sorry, is it Tulis or Tulis?

A. Tulis.

Q. Mr. Tulis' testimony that in your view a return of 12 percent on equity would have no impact on stock price, but return of 10.5 would have the impact that Mr. Tulis suggests?

A. I think you have got to separate two things. One, I think Mr. Tulis said, if staff's full case was implemented. And that goes a little bit beyond the 10.5. It eliminated the leasing program. It did a lot of different things. It excluded a lot of expenses.

And you have to take all those assumptions into play before you can jump to the conclusion that it's just the difference between 12 and 10.5. With a 12 percent return on equity, I believe our Company would generate sufficient income, and looking at what the other subsidiaries could do, we should be in a position where we could probably retain our dividend. And as long as we keep paying that dividend, then I think the stock price will probably remain where it is

or potentially even go up, depending upon the optimism of our other subs.

I guess I need to add one more caveat on that and that's that we get everything we asked for in our case, which includes attrition and all the other adjustments we made.

Q. So, the answer to your question as to whether or not the stock price will be maintained is basically isolating the variable of return on equity?

A. That's one. And then as I also said, you have to look at our other subsidiaries.

Q. You mentioned dividends. Are you suggesting that, if the staff's case is accepted by the Commission, Washington Energy Company will be forced to cut its dividend?

A. I'm saying if the staff's case is accepted, the board of directors will look at the dividend policy and then determine what's an appropriate action.

Q. But you haven't made an evaluation of that contingency?

A. I believe the case we have presented is a good case. And that's what should be accepted. We need the rate of return we have asked for to give us the rating -- retain the A rating, which even Dr.

Lurito mentioned is appropriate. And I think that's needed.

Q. Mr. Tulis suggested in his testimony that, if staff's case is accepted, Washington Energy Company would be forced to cut its dividend drastically. And I gather you are not accepting that part of his testimony?

A. Mr. Tulis is an analyst for Smith Barney, and he makes those types of conclusions. That's his job.

Q. I'm asking you.

A. I said I do not make that decision. The board of directors would make that decision.

Q. And you don't have a conclusion similar to Mr. Tulis'?

A. If our ability long-term is that we cannot earn the dividend long-term, then I would have to say that we would probably be recommending to the board that we adjust our dividend.

Q. And is staff's case inconsistent with the company's ability to maintain that dividend?

A. In my opinion it probably is.

Q. What assumption does that make about the non-regulated operations of earnings of Washington

Energy Company?

A. If I assume they stay the same as they are right now, without any optimism for future increases, which I think we have, but let's say that stays the same and I could do a similar analysis that Mr. Tulis did and come to a similar conclusion. Holding everything else equal and the only thing is affecting it is that $24 million reduction in revenues as staff has presented, then that translates into a serious deficiency in earnings.

Q. Can you tell me in 1992 what percentage of earnings per share were accounted for by the non-regulated subsidiaries of Washington Energy Company?

A. I don't have that number at my fingertips.

Q. Can you give me an estimate?

A. I think in 1992 we earned, what? $.58 a share? And I think it's probably in the order of 40 to 50 percent.

Q. 40 to 50 percent?

A. If you include the merchandise -- it's a matter of how you account for it also. If you look at operating income, I think it's probably about 40 percent.

Q. How about earnings?

A. Well, earnings, it's a matter of how --

what kind of capital structure the different companies would have and how much debt you want to impute from the parent company down to the different subsidiaries. If it's the same capital structure as Washington Natural Gas, I guess it could be about the same percentage.

But I haven't looked at it. I just don't have the numbers here.

Q. Did you provide such numbers? Or do you know if Mr. Tulis had such numbers in his analysis?

A. Mr. Tulis has access to all public information. So, he could take the same numbers out of our annual report which talks about operating income by business segment. That's the only thing that's provided publicly. We do not provide any net income numbers publicly. It's by subsidiary other than Washington Natural Gas.

Q. Do you agree that the non-regulated subsidiaries should pull their own weight with regard to dividends?

A. When you say pull their own weight, what do you really mean?

Q. Contribute their fair share of earnings.

A. Obviously we wanted to see the

non-regulated subsidiaries generate net income. But

you also have to look at the fact that there are somewhat different businesses, too.

Q. But you wouldn't recommend that Washington Natural's ratepayers subsidize the non-regulated operations?

A. Certainly not.

MR. GOLTZ: Excuse me just one minute.

(Discussion had off the record.)

Q. Let's assume that depending on how you cut it the unregulated subsidiaries or affiliates, I should say, continue to contribute the earnings that you're talking about. Is it your view or what is your view about the necessity, assuming adoption of staff's case, of cutting the dividend, if you can say?

A. I think I already said that, if we, assuming the subsidiaries were generating with the same income they are today and that staff's full case were adopted, it would be a very drastic situation, and then we would probably have to talk with the board about an adjustment to the dividend.

Q. Do you believe that those non-regulated subsidiaries are carrying their fair share of the burden of earnings for the parent for the overall corporate structure, I should say?

A. I mean, you're looking at -- when you say

carrying their fair share, related to what? I mean, you're looking at an oil and gas company, biowaste conversion company, and merchandising. And they are all different.

Q. Some are more profitable than others?

A. That's true. Some of them are in development stages such as the coal and the railroad projects.

Q. Looking at I believe it's Exhibit 157. That's the annual report, 1992.

A. I don't have it here.

Q. Would you accept that the operating income loss before income taxes on biowaste, coal, and other was $4,303,000?

A. What year?

Q. For the years ended September 30, '92.

A. That's operating income loss?

Q. Yes.

A. That sounds about right. But I would have to check it.

Q. So, that would not be carrying its fair share here, would it?

A. Fair share to whatever you're talking about. Some of these are in development stages like the biowaste is a development stage project and we

don't anticipate or at least back then we didn't think it was going to make a whole lot of money right away. It's going to take time to nurture that business and get it developed.

Q. And that overall earnings including that would go into your recommendation or calculation on dividends; correct?

A. Yes. We look at everything, all the different subsidiaries and what they are going to generate as income, what their cash needs are going to be in order to determine Washington Energy's dividend policy.

Q. Would you agree that one of the underlying philosophies of staff's case is that the subsidiaries and affiliates pay their own way?

A. I believe the subsidiaries have paid their own way. I understand that part of staff's case is they believe there has been some subsidization.

Q. And Washington Natural Gas should not support the subsidiaries or the affiliates? Do you understand that as part of the staff's case?

A. I understand that from our case, also. We do not believe Washington Natural Gas should subsidize any of the subsidiaries.

Q. The current market-to-book ratio for

Washington Energy Company is about 1.50, is it not? That's 23 1/8 assuming yesterday's closing, which was 23 1/8 per share?

A. Yes. I think it's a little -- depending on what the book value is.

Q. As of March 31, '93, would you accept that book value to be 15.39?

A. I would have to -- subject to check because I haven't -- that seems high, but if those are the right numbers, then -- it's about 1.5, yes, subject to check.

Q. I'm going to hand you a document. I don't think we need to mark it as an exhibit. I wonder if you could compute the book value on the basis of this document? And you can identify that if you wish.

A. Well, the shares aren't -- maybe they are -- (Reading.) Yes, based on the average shares and the capitalization for March 31, it comes out to 15.39.

Q. So, would it be your testimony that the Commission is responsible for allowing Washington Natural to earn a common equity return sufficient to maintain that 1.50 market-to-book ratio?

A. I think the market-to-book ratio is a function of the market and what the market ends up

doing. I think the Commission has to look at all the evidence that's presented and then determine what a fair rate of return is.

You have to remember the market-to-book ratios today are very high and it has a lot to do with the fact that people have rotated investments out of CDs, which are earning very little, into other instruments, specifically stocks.

I think in a lot of the DCF theory that it states that you can get to the point, using a lot of assumptions regarding consistency of payout ratio and other factors, that some people would say that you ought to have a one to one market-to-book ratio.

Q. You understand that from DCF analysis?

A. I'm saying people have made that assumption. I think 1.5 today is actually probably low for our company relative to our peer group. I think most of them as the evidence has shown are trading much higher than that.

Q. Should it be maintained at that level, in your opinion?

A. I think we have to determine a fair rate of return for the company, and then the market will determine what the market-to-book ratio will be over time.

Q. I guess what I'm saying is that market-to-book ratio is an indicator of the result of that rate of return, is it not?

A. Market-to-book ratio is a result of a lot of things. It's a result of the stock price. It's a result of the book numbers. So -- yes, I mean, I would say that the rate of return certainly enters into it.

Q. You're aware, aren't you, that in the late '70s that the market-to-book ratio wasn't a statistic of concern of Washington Natural Gas Company in its presentations to this Commission?

A. I wasn't around then. I really can't comment on that.

Q. Are you aware of that? Are you familiar with past orders of this Commission with regard to Washington Natural Gas Company?

A. Not very many. I did look at the one from January of 1985, I believe. But I really haven't gone much beyond that.

Q. Are you familiar with the 1979 case U-79-15, September 25, 1979?

A. Was that Washington Natural Gas?

Q. Yes.

A. I couldn't say that I have really looked

at that. It was well before my time here.

Q. Would you accept subject to check that in that case this Commission referred to the achievement of a market-to-book ratio of at least approximately 1.5 to 1 -- 1.15 to 1 as a goal? I refer you to 32 Public Utility Reports fourth at Pages 539 to 540.

A. I can accept that subject to check.

Q. Would you accept subject to check that in 1978 Washington Energy Company's market-to-book ratio was about .90. In 1979 it was about .89?

A. I can accept that subject to check. Again, that was fourteen or fifteen years ago.

Q. But I assume that's among all the available data you have at your disposal?

A. What?

Q. The market-to-book ratios in that time period.

A. I can look it up, yes.

Q. Would you also accept that in that order this Commission was prepared to raise Washington Natural's rates because, among other reasons, the company's return on equity was not high enough to generate a market-to-book ratio in excess of 1.0?

MR. GRANT: Your Honor, can I interject

here? If Mr. Goltz is reading from an opinion of this

Commission and then asking the witness to accept interpretations of that opinion subject to check, couldn't we simply acknowledge that the Commission can take notice of its own decisions? They say what they say. The witness shouldn't have to guess about what they say and accept it subject to check and put us all through the lengthy procedure of having to accept that and sending letters and saying that interpretation isn't exactly right. The opinion says what it says.

JUDGE ANDERL: That might shorten things up a little bit.

MR. GOLTZ: Okay. We'll move on.

BY MR. GOLTZ:

Q. Would you accept subject to check that in the last half of 1979 the yield on Moody's A rated public utility bonds averaged 10.92 percent?

A. I can accept that subject to check.

Q. And currently A rated public utility bonds are yielding about 8.0 percent? Would you accept that?

A. I can accept that subject to check.

Q. And would you accept subject to check that the difference between those two, that is to say current and 1979, is about 292 basis points?

A. 10.92 minus 8 is 2.92.

Q. Would you accept subject to check that WECO's market to book was about .99 in 1984?

A. I can accept that subject to check.

Q. And that in 1989 its market-to-book ratio was about 1.41?

A. Probably have a schedule on that. 1989? In 1989 it was 1.408 percent.

Q. Currently it's about 1.5? Did you accept that subject to check earlier?

A. Yes.

Q. In early 1985 when this Commission allowed Washington Natural to earn a 16.25 return on equity, would it be your testimony that the Commission did so in order to achieve a 1.41 or 1.50 market-to-book ratio for WECO's common stock?

A. I can't testify what the Commission did in 1985.

Q. So, you read the '85 order and you didn't derive that from that order?

A. I said I looked at it at one time. I can't sit here and testify to it right now.

Q. And between 1984 and today, the stock of the energy company rose about 50 percent? Do you accept that subject to check?

A. Yes. I would have to check that.

Q. Can you tell me what that means about the investors and their profit on their investment in that period?

A. It depends when they bought. It depends what -- how long --

Q. Between '84 and today.

A. They bought in 1984 and they still hold it today, they received dividends.

Q. And appreciation on value. Isn't that correct?

A. Yes. But they don't realize that until they sell, necessarily.

Q. I understand. But looking at what they have, today's value, that's a substantial return, as it were?

A. It seems like it would be, yes. I mean, if it's doubled over five years. But, again, they haven't realized any of that. The only thing they have received so far are dividends.

MR. GOLTZ: I have no other questions.

JUDGE ANDERL: Thank you, Mr. Goltz.

Mr. Adams?

MR. ADAMS: Yes, thank you.

CROSS-EXAMINATION

BY MR. ADAMS:

Q. Mr. Torgerson, according to your rebuttal Schedule 7, page 2 of 3, Washington Natural has financed its utility investment with an average level of equity capital of 39.5 percent of permanent capital over the past five years. Would you agree with that?

A. Yes. That's the average of the common equity permanent capital over the last five years.

Q. Just so we're making sure, I understand your use of the word "permanent capital," you're excluding the use of short-term debt?

A. Yes, sir.

Q. When short-term debt is added in, would you agree that Washington Natural's average equity ratio over the past five years falls to approximately 35 percent?

A. Yes.

Q. What bond rating has the company maintained?

A. I established, we established with Mr. Goltz that we have currently an A3 rating at Moody's, an A minus rating for Standard & Poor's. Standard & Poor's I think probably has been in effect for the five years. Moody's I think upgraded up sometime I thought it was about 1990.

Q. Is it up one notch?

A. Yes.

Q. Which would have been a Bbb? B3?

A. Baa 1.

Q. Okay. That's the next level below an A?

A. Below A3.

Q. I try to keep all the numbers straight. Okay.

Now, you're recommending in this case that you move to a 45 percent equity ratio; correct?

A. Yes.

Q. Have you included in your testimony a numerical cost-benefit analysis of the company's proposed change to a 45 percent equity ratio?

A. No, there is not a cost-benefit analysis. I think the analysis I did looked at the bond ratings and how we could maintain our A minus/A3 ratings, and I think I pointed out that, in order that, we would have to be within the range of the S&P benchmarks for not only the total debt to total capital but also on the fixed charge coverage. And that using -- in combination the 45 percent capital structure and the 12 percent to 12.25 rate of return would put us in that range.

Q. So, this was just what? Your analysis,

but it wasn't a numerical cost-benefit analysis. Is that fair to say?

A. It is not a numerical cost-benefit analysis, but that is a significant analysis and it's very important for the company to maintain its A rating.

Q. Now, your Schedule 29 shows that your updated DCF estimate of the company's cost of equity is 11.09; correct?

A. Yes.

Q. Let's just assume that number for discussion purposes. With a Federal tax rate of 34 percent, what would be Washington Natural Gas' pretax cost of equity capital? Would you accept 16.8 percent? Simply the 11.09 --

A. You're simply dividing -- simply dividing 11.09 by 66 you get 16.8. That's equity only.

Q. That's all I was asking about.

A. It has nothing to do with overall return.

Q. Now, you can refer to this schedule if you want. But Schedule 32 shows that a recent issuance of twenty-year maturity debt for Washington Natural Gas had a cost to the company of 7.6 percent. Do you remember that or can you check that?

A. No. We haven't issued that. That was my pro forma estimate of what it might be if we issued a combination of 30-year and 10-year medium-term notes.

Q. Is that still then a reasonable current estimate on your part?

A. Yes.

Q. Now, would you agree that for ratemaking purposes interest expense is subtracted from revenues prior to the calculation of income tax expense? So that pretax and post-tax cost of debt for the company are the same?

A. The benefits --

On a pretax basis?

Q. Yes.

A. Yes.

Q. Now, page 51 of your testimony you discuss some of the shortcomings that are associated with the DCF methodology.

Am I correct that you did not mention any of these shortcomings in your direct testimony?

A. No, they are not in there.

Q. What has changed with regard to DCF theory between your direct testimony filing and your rebuttal testimony?

A. Keep in mind this is rebuttal. In my

direct testimony I'm using the same methodology that I'm using here. I'm rebutting the fact that Dr. Lurito and Mr. Hill were using just one methodology. And I'm saying you can't just use one. You need to use more than one as is evidenced by the things I mentioned earlier with the fact that about 80 percent of the utility Commissions use more than one, the -- in the New York generic hearing they said that all the New York utilities will now be using three.

So, again, this was rebuttal testimony. I had no qualms before about using DCF in combination with another methodology.

Q. Okay. So, there has been no change in your approach other than some of the numbers changing due to the time frame?

A. That's correct.

Q. Am I correct that one of the shortcomings which you point to in the DCF is that it is grounded on the efficient market hypothesis?

A. I think all methodologies are grounded on efficient market hypothesis.

Q. CAPM is as well?

A. Certainly.

Q. I wonder if you would turn, please, to your Schedule 25. This is the three pages from an

A.G. Edwards and Sons Securities Research Report.

A. Yes, I have it.

Q. Will you just indicate who is A.G. Edwards?

A. A.G. Edwards is a brokerage firm, one of the larger ones in the country. They are headquartered in St. Louis.

Q. Their research is fairly widely circulated?

A. Yes, I believe it is.

Q. Is this a monthly publication that they put out or quarterly?

A. I believe they do it quarterly.

Q. Now, I note that you have attached pages 1, 4, and 5 from that report. Would you agree or accept subject to check that that's an 18-page document?

A. I think you have my document now.

Q. Why don't I give it back to you if you don't have it.

A. (Reading.) Yes. They have 18 printed pages.

Q. Would you agree with my characterization that approximately the first seven pages are what I'll call industry discussion, and then they -- relating

specifically to the gas industry, and then they move into selected analyses and recommendations?

A. Well, the first seven pages do have discussion of the industry. Then they have a number of pages that have their comparable groups of companies. And then the last couple pages are devoted to individual companies and their recommendations.

MR. CEDARBAUM: Your Honor, I would like to have marked as the next exhibit in line four pages from this A.G. Edwards report.

JUDGE ANDERL: Could you say just tell me what pages those are?

MR. CEDARBAUM: Yes. They are Pages 2, 3, 6, and 7, which are -- make up with the witness's Exhibit 1, 4, and 5 the first seven pages of the analytical portion for the industry.

JUDGE ANDERL: I'll mark that for identification as Exhibit 348.

(Marked Exhibit 348).

BY MR. CEDARBAUM:

Q. Mr. Torgerson, would you just check to just confirm that what I have handed you are the same pages from that document so that the bottom line is between your Schedule 25, which contains page 1, 4, and 5 of the document, and what has been marked as

Exhibit 348 containing Pages 2, 3, 6, and 7, we have the total of the first seven pages of that report?

A. Yes, that appears to be the one from the report.

Q. Let me direct your attention --

MR. CEDARBAUM: First let me just move for the admission, I guess, of Exhibit 348.

JUDGE ANDERL: Are there any objections from the company?

MR. GRANT: No objection.

JUDGE ANDERL: Mr. Goltz, have you intended to offer 347?

MR. GOLTZ: I'm sorry. Yes.

JUDGE ANDERL: Does the company have any objection to that exhibit, the previous one, the single page from S&P Credit Week?

MR. GRANT: No, no objection.

JUDGE ANDERL: Thank you, Exhibits 347 and 348 will be admitted as identified.

(Admitted Exhibits 347 and 348.)

JUDGE ANDERL: Go ahead, Mr. Adams.

BY MR. CEDARBAUM:

Q. I want to direct you to page 3, which is the second page of Exhibit 348, to the, I guess we'll call it the lower left-hand corner bullet, which is

eight above the figure 2 graph declining allowed returns on equity. The report indicates that interest rates have led to lower returns on equity by state regulators. And with corresponding reduction in the growth of common dividends and there is a continuation with stable interest rates.

Do you agree with that conclusion?

A. They have it here the fact that there are lower returns today than there were previously, I have to agree with that, yes.

Q. Turning to the next page, which is No. 6, at the bottom of that page, let me just read you from the left-hand column entitled: "Price/Book Value."

Do you see that? Looking at the second of the two paragraphs --

A. I have it.

Q. -- in the middle of that paragraph indicates: "Higher priced book to value equity as fast as the required rate of return by investors has fallen. This concept is often referred to as reverse regulatory lag will continue only until interest rates continue to fall. Once we catch up to interest rates, we would expect to see market to book value ratios begin to fall."

Do you have any reason to disagree with

that analysis?

A. That's their conclusion.

Q. Finally, if you would look at page 7, the last page of this document, on the right-hand column under "Industry total return projections," you'll note that the projection for the industry has fallen to 7.8 percent from I guess a previous number of 8 percent, which they have been recommending in December.

Again, do you have any particular -- any reason to disagree with that conclusion?

A. I mean that's what's printed in the report. You're talking about total return, which is dividends and price appreciation. That's what Mr. Hime, who is the author of this, has in his report. I know I have discussed this with Mr. Hime, and I also know that his assumption on allowed rate of return is a lot higher. The last time I talked to him he was assuming something in the order of 12 percent.

Q. But this is what -- this document is circulated to potential investors in Washington Natural as well as any other regulated utility; is that correct?

A. It's circulated to A.G. Edwards customers.

MR. CEDARBAUM: Thank you. I have nothing further.

JUDGE ANDERL: Thank you, Mr. Adams.

Any questions from the Commissioners for this witness?

COMMISSIONER CASAD: I have no questions.

CHAIRMAN NELSON: Pass.

COMMISSIONER HEMSTAD: I have no questions.

JUDGE ANDERL: Anything on redirect?

MR. GRANT: I have just a few questions, your Honor.

REDIRECT EXAMINATION

BY MR. GRANT:

Q. Mr. Torgerson, you have answered questions all morning concerning Washington Natural Gas Company's long-term debt rating.

Why is it important to you from your perspective as the chief financial officer of Washington Natural Gas Company that the company's long-term debt rating of A minus be preserved?

A. Well, one of the primary reasons is we are a growth utility, so to speak. We're adding a lot of customers. We need to have access to the capital markets.

But maintaining an A rating, that will

allow us to have access to the capital markets even in times when credit markets get tight. There are times when the credit markets can get tight and the Bbb rated companies do not have the access.

I'll admit it's not very frequent.

But also the fact the Bbb companies will pay more in terms of debt and equity because the equity investors look at the debt ratings when they are making their opinions and judgments upon which companies to buy.

So, I think over the long-term, it's beneficial for the ratepayers that we maintain an A rating.

Q. When you say that Bbb companies will pay more, what do you mean by that?

A. The cost of their debt is higher than single A -- than any A rated companies. And also when you look at equity, again, the people buy the equity of triple Bs or As, they do factor into consideration what the bond rating is. It is something they consider.

Q. What is the current status today of Washington Natural Gas Company's long-term debt rating of A minus?

A. As I think I pointed out before, Standard

& Poor's has affirmed our rating at A minus with a negative outlook pending the outcome of this proceeding.

Moody's is reviewing it right now. In light of our medium-term note program, we have it, we are rated A3 at the moment. Discussions I have had with them indicate they are also looking at what is going to be the outcome of this proceeding. But they are going to be rating it I believe this week for the medium-term note program.

Q. Mr. Torgerson, as the chief financial officer of the company, what is your understanding of what Washington Natural Gas Company needs to do to preserve that long-term debt rating of A minus?

A. We have to look at I think the fact that the business risk for LDCs has been increasing with FERC 636. The gas on gas competition we have today, the growth we're experiencing. I mean, these are all affecting the business risk of the company.

And as business risk goes up, the traditional management response is to decrease the financial risk. Investment risk is made up of two components, business risk and financial risk. So, by decreasing the financial risk means lowering the debt ratio or conversely increasing the equity in the

company.

This will allow the company to be able to pay off its debt and pay its interest over time.

I think in combination with the allowed rate of return where I'm requesting and our capital structure, I think those are very important steps that will allow us to be a financially viable company going forward and being able to serve the needs of our customers.

MR. GRANT: No further.

JUDGE ANDERL: Anything else, Mr. Goltz?

MR. GOLTZ: I don't have any further questions.

MR. CEDARBAUM: No.

JUDGE ANDERL: Anything else?

Thank you, Mr. Torgerson. You may step down.

Will the company call its next witness then.

MR. GRANT: Yes, Judge. The company will call Mr. Daniel L. Tulis.

JUDGE ANDERL: Let's go off the record for a moment while he takes the stand.

(Discussion held off the record.)

JUDGE ANDERL: Let's be back on the

record.

While we were off the record we identified Mr. Tulis' prefiled rebuttal testimony as Exhibit T-349, and we identified his Exhibit DLT-1 as Exhibit 350. That contains several schedules.

(Marked Exhibits T-349 and 350.)

JUDGE ANDERL: Would you raise your right hand, please, sir.

Whereupon,

DANIEL L. TULIS,

having been first duly sworn, was called as a witness herein and was examined and testified as follows:

JUDGE ANDERL: Go ahead, Mr. Grant.

MR. GRANT: Thank you, Judge.

DIRECT EXAMINATION

BY MR. GRANT:

Q. Will you state your full name for the record?

A. Daniel L. Tulis.

Q. Mr. Tulis, what is your occupation?

A. I'm a managing director and natural gas analyst at Smith Barney Harris Upham Company.

Q. Where were you employed prior to your employment with Smith Barney?

A. Prior to Smith Barney I was employed for roughly 30 years at Shearson Lehman Brothers.

Q. Have you prepared rebuttal testimony in this testimony, Mr. Tulis, that has been prefiled?

A. Yes, I have.

Q. Is there a copy of that prefiled rebuttal testimony before you previously marked as Exhibit T-349?

A. Yes.

Q. And is that rebuttal testimony true and accurate to the best of your knowledge?

A. Yes.

Q. In addition, Mr. Tulis, have you prepared exhibits with your rebuttal testimony?

A. Yes.

Q. And actually that one exhibit with various schedules has been pre-marked as Exhibit 350. Is that a copy before you?

A. Correct, yes.

Q. Are those schedules within Exhibit 350 true and accurate to the best of your knowledge?

A. Yes.

Q. Were these proposed under your direction and supervision?

A. Yes.

MR. GRANT: Your Honor, the company moves for admission into evidence of Exhibit T-349 and Exhibit 350.

JUDGE ANDERL: Mr. Goltz, any objection?

MR. GOLTZ: I have no objection.

JUDGE ANDERL: Mr. Adams?

MR. CEDARBAUM: No.

JUDGE ANDERL: Those two exhibits will be admitted as identified.

(Admitted Exhibits T-349 and 350.)

JUDGE ANDERL: Mr. Goltz, I know that you have more cross than fifteen minutes. We'll go until about noon and break for lunch.

CROSS-EXAMINATION

BY MR. GOLTZ:

Q. Good morning, Mr. Tulis. Have I got that right?

A. Good morning.

Q. I apologize for mispronouncing your name. Let me ask you first, what is a sell side analyst?

A. A sell side analyst as contrasted what we would call a buy side analyst is one who works primarily for an investment banking or brokerage institution that markets securities to clients as

opposed to those who work for a financial institution such as a bank, insurance company, et cetera.

Q. And Smith Barney has sell side analysts that know buy side analysts?

A. Smith Barney in its research department has all -- sell side analysts, but in their money management operation, they would have -- they would be defined as buy side analysts if they were performing the analytical function.

But in my area, we're all sell side analysts.

Q. I guess what I'm asking, though, is does Smith Barney, is there also a preferable term for a buy side analyst?

A. Yes. But primarily that would be for let's say a bank as opposed to a brokerage firm such as Smith Barney.

Q. So, when you make your analyses, who -- just tell me how you go about it. Who do you talk to?

A. We do our analysis typically, you know, we follow a number of companies, make our recommendations and typically publish our conclusions in a report.

The report is distributed to our representative or our sales people who then distribute that to their client base.

That's one part of our client base which we would what we call the individual investors.

The other group would be the professional investor, the portfolio manager or the buy side analyst, who would be working at Sea-First or Chemical Bank.

Typically the report also is sent to him by a special sales force.

Most of us on the sell side on a professional basis deal directly on the largest institutions world-wide, and we talk to them directly on the phone on a regular basis.

Whereas the individual investors primarily are reached through our individual brokers.

Q. I guess I was looking for some process a little bit upstream from that. You just described how you disseminate your recommendations. What I was looking at was the process you go through to formulate your recommendations. Who do you talk to in formulating those? What do you read? What do you review and so forth?

A. Well, it would encompass -- and there is some of that in the testimony -- it's basically a top down approach. We look at in the case of this industry -- and I cover the entire segment of the gas

industry, not just the retail distribution side of it. I cover the pipelines. I cover a wide area -- we look at the economic situation. We look at interest rate trends. We look at gas price trends, regulatory situation both on the federal and state levels. We look at definitely on a company basis the earnings dividend outlooks.

In doing that, I talk to everybody from people that work at the FERC, directly with FERC commissioners, with company managements at the highest levels and also operating people. Probably subscribe to every trade association magazine, newsletter, et cetera, that's written. We deal every day with people like Reuters, Gas Daily -- I don't think there is a source of information that I don't use in coming to a conclusion in terms of the overall picture of the industry.

They are all important. If the industry outlook is poor, if the economic picture is poor, that would affect our decision or my decision on what kind of conclusion I would come to the individual company.

So, it's basically I would say more of a top -- we start with a macro and end up with the individual companies, and typically I would monitor just about every company that's in the business. The

larger ones we spend much more time. The smaller market caps we tend to monitor.

Q. How many companies do you monitor?

A. I would say we have a publication that 60 to 65 that are published, but basically we track every company that has a market capitalization of at least $100 to $150 million. 65/70.

Q. You didn't mention state regulatory commissions. Is that something that you read?

A. Yes. Over the years I was responsible for all the regulatory industries at Shearson at one point and its prior firms.

At Smith Barney, we follow the regulatory side. I don't publish directly on the regulatory area. We have another group that does that that's part of our electric utility group that basically ranks the Commissions.

We also subscribe to the various differences including Duff and Phelps and the group that was referred to by Mr. Torgerson in terms of some of his testimony.

Q. I guess what I'm asking you is, in your evaluation of a given company that is regulated by a state Utility Commission, in the course of your evaluation, would you review and read the most recent

decisions of that regulatory Commission?

A. Yes.

Q. Now, when I say review and read, I assume that included in that you don't -- well, let me ask you: Do you just look at the bottom line, the numbers? Or do you read the opinion?

A. Because of the time it takes, we typically, if I can read the whole opinion, I'll read the whole opinion.

But we get summaries of the conclusion of the opinion because, basically, I'm responsible for all the states. And so the answer is I look at just certain areas that are important to me in terms of the conclusion, but I do review every one that affects my company.

Q. But in a perfect world with perhaps more time to do your job properly, you would read the opinions?

A. Yes. But I have people who work for me that do read the opinions that I have access to all the time.

Q. And so your opinions then are based on not just you, but conversations with some of the people that have absorbed all this information?

A. Always.

Q. Let me -- you mentioned that you had no corrections to your testimony.

A. There is only one -- and I just looked at it briefly in one of the exhibits that Mr. Torgerson had in terms of the weather normalization and the average yield. It looked to me that one of the companies on the one with -- I think with/without had 8. something yield. That's Schedule 7, page 1 of -- page 1. It shows 8.39 percent yield. That looks high. That probably 8 should be a 4. So, it should -- that should be double checked.

JUDGE ANDERL: Let's all find out where you are here. Would you say it again, please?

THE WITNESS: Exhibit 1, Schedule 7, page 1 of 3, Exhibit 350, analysis of impact of weather normalization clauses on equity valuation.

JUDGE ANDERL: And you're with the third company down?

THE WITNESS: I'm with the third company down, market value 233.6, market to book 1.8. That 8.39 I'm sure is wrong.

JUDGE ANDERL: For the indicated dividend yield?

THE WITNESS: Yes. I think that should be a 4. I haven't calculated it.

BY MR. GOLTZ:

Q.   Let me refer you now to page 24 and 25 of your testimony. And here you talk about financial risk to Washington Natural; correct, starting at line 10?

A.   Yes.

Q.   And you apparently endorse the approach taken by the Hawaiian Public Utility Commission in the case that you quote from on pages 24 to 25?

A.   Generally in principle as it relates to a growth utility.

Q.   I gather in there, I see starting on line 24 that you -- is it your -- in testimony here that basically the Hawaiian Commission uses a starting point 10.77 percent and adjusted that upward because of financial risk?

A.   Just in this particular area using that primarily as an example as much as anything else to just demonstrate some similarities without specifically relating the numbers to Washington Energy or Washington Natural Gas. In other words, I don't subscribe to these numbers as being -- that wasn't -- the point was basically to show a similarity that there was a risk premium.

Q. You aren't saying that obviously you

should move from --

A. No, no.

Q. I don't know what the difference is there.

A. No, no.

Q. It's a couple anyway.

Let me ask you if you have checked your quote before you put it in your testimony or had it checked?

A. Which one is that?

Q. The quote from the Hawaiian case.

A. I would like to just go over that subject to check, but I'm pretty sure it was taken correctly.

Q. Well, I received this morning a copy of that case. What I would like to do is have you refer down to line 24. And do you see where it says the average of 10.77 percent?

A. Right.

Q. Ask if you would accept subject to check that the sentence reads as follows: "The average of 10.77 percent" -- and here I have an omission -- so, it would read "the average of 10.77 percent and 12 percent is 11.38 percent. We believe that the 11.38 percent" -- that's the end of the omission -- "serves as a reasonable starting point in determining the cost of

HELCO's cost of common equity.

The last word on line 27 should be economies, not economics?

A. Yes.

Q. So, instead, the comparison in the Hawaii case would not be 10.77 to somewhere between 12 and 13, but it would be 11.38 to 12 and 13?

A. Subject to check.

JUDGE ANDERL: Mr. Goltz, would this be a good time to break?

MR. GOLTZ: That would be fine.

JUDGE ANDERL: Why don't we take our lunch recess now. We'll be back at 1:30.

(At 12:00 noon the above matter was recessed until 1:30 p.m. of the same day.)

AFTERNOON SESSION

1:30 p.m.

JUDGE ANDERL: Let's be back on the record after our lunch recess.

Mr. Goltz, would you like to continue your cross-examination of Mr. Tulis?

CROSS-EXAMINATION (Continued)

BY MR. GOLTZ:

Q. Good afternoon.

A. Good afternoon.

Q. You're aware that the company's case at this point on return of equity is now in the range of 12.0 to 12.25 percent. And, in your opinion, were this Commission to set rates based on that Company's recommendation on return on equity, what would be the effect of this action on the price of WECO's common stock?

A. My sense is again, looking at it on an overall basis in terms of other concerns regarding what has been the staff suggested be removed of certain expenses in the rate base side of it, I would say that that allowed return in that area would be within a range of reasonableness that would maintain the stock price at least at current levels and would enable the

company at a minimum to maintain, I believe, the dividend rate.

That to me is key. And I would say that that rate of return based on the numbers that I have done, again, based on -- depending on what base you're relating that to, falls in the range, I believe, of my testimony. I would say that the average appears to be in '93 an average of 11.5 to 12.5 in terms of the country or various states.

My sense would be that the stock price, all other things being equalled, could be maintained with that kind of a return at this point in time.

Q. Did I just hear you say that -- again, you have this problem. We have got a number of variables, and we have to look at them sometimes separately.

Did I just hear you say that, if this Commission were to set the rate of return on equity at, for lack of a better term, the prevailing rate being set by commissions, that would be sufficient?

A. Yes.

Q. Let's say that that would be coupled with the rest of staff's recommendation. Does that impact your analysis?

A. When you say the rest of staff's, you mean the reduction of all those expenses, et cetera?

Everything stays the same and granting the 12.2? No.

Q. In your opinion, would the stock price fall with that scenario?

A. Yes, yes.

Q. Is that because you would issue a sell recommendation?

A. That would be because I would have to really come to a -- some sort of a decision based on all the facts as it comes out on a final basis, looking at it in its entirety, on whether or not the company can maintain the current dividend rate.

If I felt, again, looking at everything, including the return and also what was in the balance of the staff's recommendation, if it held, my feeling at this point would be that the dividend could not be maintained or the likelihood of the dividend being maintained would be questionable. And if it were questionable, just questionable in my mind, it would -- it could very well trigger a sell recommendation.

Q. And in that statement, how do you incorporate the earnings prospects of the non-regulated subsidiaries of Washington Energy Company?

A. Well, the non-regulated energy -- that part of it to me is -- I mean, to me the core of the

company is Washington Natural Gas. And that's where my level of comfort comes from with respect to the financial integrity and the ability of the company to maintain its ratings, to maintain its dividend, because the other businesses are commodity related. The oil and gas business last year gas prices were a dollar. Now it's $2. Six months from now it could be back to $1.50. It's very, very unpredictable.

Also, that side of the business very rarely pays a dividend or very low dividend.

So, I can't really count on that. If that would be the case, then I would view Washington Energy -- it's not the largest part of the company -- Washington Natural Gas to me, I perceive it in terms of the client base that I have contributed to buying the stock have bought it primarily on its utility business rather than the other businesses.

The other businesses really weren't earning that much money up until recently. So, I would put a low factor on the other side. It's important, no question about that, and I like to see diversification in terms of the parent growing.

But if I felt that the original, the core, the mainstay of the company were less than healthy, that would be more important to me than the other side

of the business.

I'm not sure what the oil and gas division is going to earn in the second half of '93 or '94/'95, and I look upon that totally separately from the utility business.

Q. So, if you were to perceive some, to use your term, health problems in any of the subsidiaries, you look to the health of the Washington Natural Gas to overcome those?

A. Well, without question. I mean, I originally recommended Washington Energy as an investment to our clients when the oil and gas side was not earning money. When it was actually, you know, on a net basis losing money, but building up to a break-even, and I felt comfortable with the utility.

So, that was the motivation, with the idea that the stock was attractive as -- potentially attractive as a utility. And if the other side materialized, that would be an added value to the buyer.

But I could withstand some ill health as long as it's not major on the non-regulated, but not on the regulated.

Q. You had stated or described some of the activities of the non-regulated operations. Would it

be fair to say that you perceive those operations as being more risky than the regulated operations?

A. Oh, yes.

Q. Mr. Tulis, in March of this year the energy company's common stock price had a high of 24 and a quarter and a low of 22 and seven-eighths. Would you accept that subject to check?

A. Yes.

Q. In April Washington Energy hit a high of 26 and three-eighths and a low of 21 and three-quarters. Would you accept that subject to check?

A. Yes.

Q. Between March and April the market price of WECO's common stock rose by 8.75 percent at the high end; is that correct?

A. Yes.

Q. And that's a substantial price increase?

A. Yes.

Q. And was that increase in WECO's stock price typical of gas distribution companies, or was it unique to WECO?

A. I would say it was probably typical of the industry, of the group, at that point in time, more than WECO itself.

Q. Would you accept subject to check that the

typical gas distributor in Dr. Lurito's group of six experienced a high stock price in '93 that was 16.9 percent higher than its December '92 high price?

A. Yes, subject to check.

Q. Would you also accept subject to check that Washington Energy Company's high stock price in 1993 was 18.5 percent above its December '92 high price?

A. Yes, subject to check.

Q. Can you tell me, you have had 32 years of experience in the investment business?

A. Yes.

Q. And ten years as a financial sell side analyst?

A. No. I have been a financial sell side analyst all my career. Just following the gas industry for that point in time.

Q. And we got into this a little bit before lunch. But I note that you make recommendations to Smith Barney concerning what investments it should make for its own account?

A. Well, what investments it should be recommending to the public.

Q. Doesn't Smith Barney also make purchases for its own account?

A. No, not in anything that I'm involved in.

Q. In things that you aren't involved in?

A. No. I'm saying that Smith Barney's trading desk at some time could take a position as part of its normal functioning, an institution has a block of stock they may take down.

But as far as what I'm doing, basically I assume that most of the transaction is done on an agency basis. If an order comes in, they sell the stock. They don't buy for their own account.

Q. Let me refer you to your Schedule 2, page 1 of 3.

Am I reading this correctly --

A. Where is this?

Q. Your Schedule 2 in your exhibit, page 1 of 3.

A. 349?

MR. GRANT: 350.

MR. GOLTZ: 350. I'm sorry.

THE WITNESS: This would be?

Q. Exhibit 350, Schedule 2, page 1. It's entitled Ownership Analysis of Washington Energy Company as of May 21, '93.

A. Right.

Q. Just to clarify: This ownership analysis

is dated 21, '93. That's the date of the analysis. But the data as shown for the quarter ending March 31, 1993; is that correct?

A. Correct.

Q. Or actually for some of the companies I see on the right-hand side it's for the quarter ending December 31, 1992?

A. Right, correct.

Q. So, I can't from this determine the stock ownership as of May 21?

A. No. There is a lag. This is done quarterly, the end of the quarter.

Q. Right. And I look three lines from the bottom, I see Smith Barney down there.

A. (Reading.)

Q. Do you see that?

A. Right. Okay. This would be as a matter of clarification, I believe Smith Barney as I mentioned has an asset management division that functions as an independent mutual fund. We have a mutual fund. And they obviously bought some stock at that point in time.

But that's not Smith Barney, Inc. We have a stock mutual fund, utility fund. So, they obviously bought some stock at that point in time,

which they do. Every firm has that.

And they use our research like they would use anybody else's research.

Q. Are you telling me that that is an acquisition by Smith Barney for its own account?

A. No. That's an acquisition by the Smith Barney investment asset management subsidiary of Smith Barney, which is separate. I mean, I don't know how it's structured specifically, but it's not -- the differentiation would be that Smith Barney would buy for its own capital account the shares and hold it that way.

This is basically bought for a fund where the individuals buy the fund. I mean, it's part of a utility fund that Smith Barney manages.

We don't -- Smith Barney does not own those shares. Smith Barney asset management, the same way that Dreyfus asset management or Fidelity would buy it for its clients as I would understand that.

Q. Am I correct -- forgive me if I'm not in step with everything that goes on in Wall Street --

A. Okay.

Q. -- am I to gather that somebody at Smith Barney made a decision to acquire some shares of

Washington Energy Company?

A. Correct, correct.
Q. Now, the page of Schedule 2 also shows under the column headed Change a Figure of 20,120 shares. What does that mean?
A. That just means that they didn't -- from the data source they did not have a position prior, and this would represent -- or they had a very small position. So, they added 20,000 to 10,065. So, they are holding as of the end of the quarter was 20,000.
Q. The numbers in the change column --
A. Purchase or sales?
Q. Purchase, the sales shown in parentheses?
A. Correct.
Q. Were you in any way consulted prior to Smith Barney's purchase of Washington Energy Company common stock?
A. No.
Q. So, they didn't even call you up?
A. No. Based on the number, it's not a large purchase. I don't know if they would, you know, unless they intended to buy more. They are aware of our research. They might have made that decision based not only on my recommendation; they might have made it on somebody else's recommendation, not mine.

So, they are totally independent.

Q. So, I guess large is relative. But 20,000 shares is not a large, quote unquote, purchase?

A. No.

Q. And that likewise would not be a large sale?

A. Typically it would be an initial purchase, and I would have to check the dates. It may have been acquired on the underwriting as part of the underwriting. I'm not sure at some point in time.

But a hundred thousand shares is considered to be more meaningful in a company of this size and major stature in the industry.

But it's not insignificant, I mean, for an individual. But for a fund, it's not a large position for a fund.

Q. So, for an institutional investor, a purchase or sale of 50,000 shares, say, is no big deal?

A. Depends on the institution. For some it would be insignificant. But, also, it would be relative to the float of the company. I mean, 50,000 shares for Washington Energy would be very different than 50,000 shares for Pacific Enterprises.

In other words, it would be relating --

the relation of the size -- I mean, 50,000 shares for

Washington Energy would be significant. At certain point in time of the market, depending on what's happening in the market, the purchase or sale of 20,000 shares could be significant at any point in time, depending on what the shares trade each day.

But in terms of the total industry institutional market, 20,000 shares for Sea-First or a large institution is not one that would probably trigger a call to me.

Again, unless it's initial position and they want to buy more.

Q. Do you know what price Smith Barney purchased the 20,000 shares?

A. No, no.

Q. Or any of the shares that it currently holds?

A. No, I don't.

Q. Now, you testified in your testimony that the day after the Commission staff filed its case there was a drop in the stock price. And you also testified, I believe, that the average volume is 50,000 shares per day. What I hear you saying is the average -- well, you also testified that the volume on that day was about three times normal?

A. Correct.

Q. And so volume was -- is that a high volume or low volume?

A. High volume at that point in time relative to the average trading.

Q. Didn't you testify that that drop -- starting at line 19, here severe price drop in relatively light volume of trading. I'm confused as to the whether the volume of 156,000 shares, which I see up on line 12, is light or heavy.

A. Well, light in relation to the total shares outstanding, but when in terms of a very short time frame, if everybody is selling at the same time, it had a significant impact on the price. I mean, the price did go down, and the volume was higher.

I mean, that occurred. I don't know to define -- light and heavy depends on, you know, on a day-to-day basis.

Q. Approximately, Washington Energy Company has approximately 20 million shares outstanding. And so the 156,000 shares traded on that day comes out to approximately 3/4 of one percent?

A. Yes. That could happen if a specialist saw that come across the tape, and all of a sudden the orders started to come in. The reaction is very sudden, very quick, and it could be very different than

the same numbers of shares trading over -- in a more normalized basis where you have -- the specialist has an opportunity, maybe has some stock or he can make stock available.

But when all of a sudden, if there is an event, the event itself can drive the price down.

Q. You testified earlier that for these institutional investors, large institutional investors, purchase or sale of 50,000 shares of stock is insignificant?

A. Well, I didn't say insignificant. I said it could be significant depending on the timing of when it's done, not insignificant in general.

50,000 shares with the average trading volume in Washington Energy is one thing. 50,000 shares for another company, I just responded to what you said 50,000 shares was significant or 20,000 significant in general. And I said that for an institution a 50,000 share position in any stock, if it's a major institution is not large. When it comes to Washington Energy to trade 50,000 shares a day, then it would be significant.

Q. Basically you're telling me that in looking at your ownership analysis of institutional investors of three pages, three of these trading 50,000 shares

each could have by itself be attributable to the total of that stock sale on that day?

A. It could be or could not?

Q. Could be.

A. Could be. But we don't know if that were the case or whether or not there were a whole significant number of individual smaller trades that totaled up, which is probably the case.

Q. Based on your experience over the years, do you remember that there was a period of time in the '70s and '80s when WECO's common stock was selling at a market-to-book ratio below 1.0?

A. I don't believe -- I don't recollect that entirely.

Q. How about other utility companies or gas companies in general?

A. Rarely. There have been times on selected companies in the early '80s when interest rates were very high, when you would find a few that did sell at market-to-book. When interest rates were higher. I would say in the last two or three years the market to book definitely has moved up contra-cyclical with interest rates.

Yes, there have been periods when all

utilities have sold at book or below book. But more

recently, as was testified with Mr. Torgerson, with money rates low and the yields relatively attractive, market-to-book ratios in the last few years have gone up.

Q. Let's enter into a little bit of theory here.

Do you think it would be appropriate for regulation to set a utility rate sufficient to produce a market-to-book ratio of, say, only .8?

A. I believe that the rate should be set at such a level that would allow the company to cover its fixed obligations and to earn a reasonable profit for its investors, and the market-to-book ratio will take care of itself.

People like myself will influence the market-to-book ratio. A lot of it is psychology. A lot of it is anticipation. A lot of it is the feeling about the fairness of the regulatory treatment to the utility.

If I felt that there was going to be a major change in a particular state and so made that aware to clients, the market-to-book ratio would be effective. A lot of it is prospective rather than trying to set a return to get a certain market-to-book ratio.

I think it's more, as Mr. Torgerson testified, that it should be a fair return that allows the shareholder just to see a benefit.

Q. You aren't rejecting market-to-book ratio as an indicator?

A. No. But I wouldn't determine the rates on the market-to-book ratio. If that would be the case, then I would recommend to you today that the market-to-book ratio should be between 1.7 and 2. And I don't know if that's -- you know, that's not the -- we're not saying that, although there might be a rationale for that.

The average market-to-book ratio, as shown here, is about 1.5 or -- no. I think it should be based on a level of return that's compensatory with interest rates and other -- covering costs so that we can see an earnings growth and dividend growth pattern.

Q. Just to clarify: You have been following Commission orders around the country for utilities since the '70s and '80s?

A. Yes.

Q. Do you recall Commission orders at that time for utilities where their descriptions of companies arguing that market-to-book ratios should

be boosted up above 1?

A. If it did, I don't recollect that argument. I'm not saying it didn't happen. I just don't remember.

MR. GOLTZ: Excuse me, your Honor. I'm trying to maybe eliminate some of the examination here.

Q. Page 2, lines 18 to 22, of your testimony, you indicate that your role in this case is to argue against the inequitable treatment of the common stock holders proposed by Commission staff? It's at line 20 and 21. Is that accurate?

A. Correct.

Q. Precisely what do you mean by inequitable treatment?

A. What I meant by that was, for a company that's adding as many customers as Washington Natural is adding and basically having to, you know, maintain the system in the manner it has to and dealing with some of the risks -- and there will be risks relative to the unbundling of the pipeline industry -- for a company that hasn't been in for a rate increase in ten years and saw its gas costs go down dramatically and I believe managed well, to be asked to refund $22 million to me doesn't make any -- is just inequitable.

That's, you know, that to me was very extreme.

If you look at the company's record, they did not earn their dividend -- they earned $.58 last year. If you go back over the last few years, the company -- and it's in the testimony -- added something like over the last ten years $475 million of net plant, and their return on that is 1.3 percent.

I think a utility is entitled to earn more than 1.3 percent on its investment for its shareholders. If you go back over the last -- this would be over the last five years. Over the last ten years it's 3.1 percent. They haven't earned their dividend. They have earned their dividend three out of the past seven years.

This is not a record that would call for refund. This is a record that would call for consistent rate increases for the company to stay whole.

I think they have been basically -- they have had to face regulatory lag. And I just don't think the shareholders in terms of that decision or that recommendation by the staff can look for the dividend -- to get the dividend going up.

My concern is the dividend being

maintained. And that's why I'm out here. I'm out

here. I flew in from New York because we own, you know, a lot of stock, and we think this is a very good company, and we have always considered the State of Washington regulation to be fair.

I think the reaction of the stock to the staff's recommendation -- and I must say that there is not a total understanding in the financial community as to how the staff works independent of the Commission -- this might have been perceived as almost a Commission decision -- that this was sort of a message that the company cannot continue to not earn its dividend, and the dividend would have to be examined.

For that reason, I cut my rating on the stock as a precautionary move, which I felt bad in doing because I have been a supporter of this company for many years, went from a buy to a hold. And that I believe triggered some of the selling, but not much.

But we were disappointed in that. And, again, if you don't earn your dividend for a period of years, that sort of is tantamount to the dividend not being maintained unless there is some rate relief in terms of a regulated company.

I'm concerned about that dividend.

Q. You referred to the term a message that

may be contained in staff's case. And the message that you think is maybe being communicated is important in your recommendation; is that correct?

A. Correct.

Q. Did you read staff's case?

A. Yes.

Q. You read all of staff's case?

A. I read the key points, the summaries of the staff's case that was presented to me. I didn't get the whole thing. But I read the basis of it, yes.

Q. What did you read?

A. I read basically the items that were -- the staff was recommending being removed. I read about the rate of return recommendation. I read about the concern about marketing, leasing, allocation of costs, those areas.

But mainly the items that were recommended to be removed in terms of expenses and the allowed rate of return being, I believe, what? 10.9 percent?

But most importantly, the $22 million rate refund recommendation.

Q. Did you read the testimony of Mr. Elgin?

A. I went over it briefly, but I did not read the whole testimony.

Q. Did you read the testimony of Miss Thomas?

A. Looked over it briefly but did not go into detail.
Q. Did you read the testimony of Mr. Russell?
A. Again, I just read the summary of the proceedings.
Q. The summary?
A. The conclusion.
Q. The bottom line?
A. Bottom line.
Q. You used the term refund. Is that the term you wanted to use?
A. The $22 million that was the terminology being what -- revenue decrease perhaps is a better terminology.
Q. And you were issuing buy recommendations recently for the stock?
A. Excuse me?
Q. You were issuing buy recommendations for Washington Energy Company?
A. For a period of years, sure.
Q. And was it -- I gather from your testimony that there should have been some rate proceeding since between 1984 and now?
A. I think so.

Q. And there were none?

A. No.

Q. And were you issuing buy recommendations all during that time?

A. Yes. Well, until -- up to the point when I started to recommend. Not during the entire -- I didn't recommend the stock during the total ten years. But let's say during the last two or three or four years would be probably the time period that I got involved with the company in terms of recommending it.

Q. The past two or three or four years you were making buy recommendations?

A. Yes. I don't remember exactly when. At Smith Barney it was the second half of '91, I recollect, that I recommended the stock.

Q. And in making those recommendations, you were aware of the company's earnings history; correct?

A. Yes. But I was also assuming that there would be some rate relief down, you know, down the road.

Q. I want to ask you a little bit about regulatory lag, Mr. Tulis.

You said that the company was experiencing regulatory lag, and, therefore, it should have come in -- there should have been a rate proceeding between

1984 and now?

A. I would assume so, based on the number of customers that were added and the fact that you use I guess an historical test year.

Q. And so the Commission should have initiated a rate proceeding between that time?

A. Either the company, perhaps the company should have or the Commission or whatever.

Q. And so are you critical of the company for not having initiated a rate proceeding in that time?

A. Yes.

Q. And what would have been the -- what would you have suggested the company request in that rate proceeding?

A. I would have suggested that the company go in on a timely basis and structure their rate request in such a way, either through some sort of an attrition allowance, in other words, a rate of return that was reasonable, but some sort of an attrition allowance, some sort of an indexing perhaps of certain kinds of certain operating and maintenance expenses, so that they could keep up with their growth so that they would not have to go in perhaps as regularly, but also make sure that shareholders are whole.

Ten years, I think ten years for a company that's growing as rapidly one was who serves this

market is a long time.

Q. Now, when did you have or did you formulate your opinion that the company should have come in for a rate increase between 1984 and the present?

A. Late in '91.

Q. Late in '91. Did you have discussions with the company along that line at that point?

A. I don't recollect. I have discussions with the company all the time in terms of ongoing business. I don't recollect discussing that specific issue at that point in time.

But my assumption was that, based on the outlook at that point in time, especially in early '92, when it looked as though the earnings would be low, that the company would reach a decision to raise its rates.

Q. Mr. Tulis, have you ever testified before a state or federal regulatory body on the issue of fair rate of return or cost of equity capital or revenue requirements?

A. No.

Q. Do you consider yourself an expert in the cost of equity capital or revenue requirements for public utilities?

A. No.

Q. Are you aware that in 1984, just prior to the Commission order and the company's last rate case, Washington Energy Company's average high/low common stock market price was 11.25 -- $11.25?

A. I accept that subject to check.

Q. And that I would ask you to include in that subject to check an adjustment for the three for two stock split in 1987.

A. Correct.

Q. So, between 1984 and today, Washington Energy Company's common stock has risen by over a hundred percent. Isn't that true?

A. Correct.

Q. This means, does it not, that over the roughly nine years since 1984, investors have enjoyed an 8 percent per year appreciation on average in the price of WECO's common stock?

A. I accept that subject to check.

Q. And in addition to that 8 percent, WECO's stockholders have also received dividends each year, have they not?

A. Correct.

Q. And, in fact, between '84 and today, WECO investors have received at least $11.47 in common dividends? Isn't that so?

A.   Correct.

Q.   So, if we add those figures, 11.47, 11.75, investors received about $23.22 in price appreciation and dividends between 1984 and today; is that correct?

A.   Subject to check.

Q.   That's in excess of a 200 percent return on investment over the nine-year period. Would you accept that subject to check?

A.   Correct.

Q.   Is it your testimony that investors in WECO's common stock were entitled to a 200 percent return on investment over the 1984/1993 period?

A.   Well, if you use that period of time. But if you use 1987 to 1992, if you bought the S&P 500 you would have gotten 14 percent per year rather than the 8. I'm not sure that investors would have done as well in WECO's common stock as they would have if they bought the S&P 500. The market has risen. Interest rates have come down.

And analysts like myself basically were responsible for that increase. And what I'm concerned about, I believed in this company. I believe that if they needed a rate increase, it was something that they felt should be done, that they would be -- they would receive favorable treatment.

My concern and the reason I'm here is not what happened between 1984 and 1992. I know what I did in 1988, '89, and '90. What I'm concerned about is what might have to be done if this decision is the wrong decision. I'm more concerned about 1993 October going forward. Then I have a problem.

And I just want to make sure that the Commission recognizes that some of this appreciation is due to the industry, lower interest rates, a favorable opinion on the part of people like myself to the growth of this market, to the fact that this was not a good market for gas companies necessarily prior to the point where public power started to diminish and electric rates went up.

There was a very positive macro development that occurred here in the Pacific Northwest. And one of the reasons that I waited as long as I did in waiting for the company to show some strong earnings has been the fact that they have been adding all these customers, and my assumption was that the Commission and the State would accommodate the growth.

If that's not to occur, then there will be a major change in investment perception relative to

Washington Energy, and I believe other utilities in the

state, as well.

Q. Were you aware of the exceptions taken by in Commission to a number of budget items submitted to the Commission by Washington -- by the company over the past three to four years?

A. Not specifically, no.

Q. Page 2, lines 2 to 27, you state that "your attempt to defend the interests of the retail institutional purchasers of the company's common stock who have essentially subsidized the Washington Natural Gas ratepayers -- Washington Natural ratepayers and financed the growth of the natural gas distribution system, which has provided meaningful economic benefits to the State of Washington."

Is that basically the essence of your purpose here today?

A. Yes.

Q. Now, in your view, who should defend the interests of the ratepayers if you're here to defend the interests of the retail and institutional purchasers of the company's common stock?

A. My perception has been, if the company is treated fairly and rates are given on a timely basis -- I'm not asking for excessive rates -- that there isn't a material lag between the costs and the

revenues coming in; that it will be easier for the company to finance at lower interest rates. They will have a higher market-to-book ratio. And the financial costs to a utility, as you know, is a very, very big part of the cost to the consumer.

My experience has been that the companies that have been receiving fair treatment over a period of years, the rates have tended to be lower in many cases and have been for the benefit of the ratepayers as well as the shareholders.

I try to point out that it doesn't have to be -- it doesn't have to be a separation. I'm a ratepayer. I think that it's in the interests of all concerned that Washington Energy does not come to market next year and have to try to sell stock at 18 when they did the last offering at 22/23. You cannot do that.

First of all, it's very difficult to sell stock when you sold stock previously and the investors are losing money. 80 percent of the stock that's held by most distribution companies are held by retail clients. It's very difficult for me to go back to these people and say, "buy some more" unless I can see a reason for them to buy some more.

You talked about the rating agencies. The

rating agencies are particularly sensitive now to any sign of regulatory change on the negative. These rating changes are going to be important.

So, if they are downgraded and if their stock declines -- and I would say now that it's very, very tenuous -- if we were to change our rating to a sell, then I think it would have extreme implications because it would affect not only our clients but other analysts would see it. And I just don't see how ratepayers benefit if the company tries to sell stock at such a low price.

So, all I'm interested in is I would like to see the shareholders make a reasonable return and have that translated into -- it's to our interests to have rates here on the low side, have it stable, to have a bigger gas market here in the Pacific Northwest.

I would rather see natural gas priced under oil or electricity.

So, my interests are the same. It's all in one. I just don't want to see the company pressed to the point where they might have to adjust their dividend or take other measures that would be in nobody's best interests.

And there is no question about it: We

represent a lot of stock, a lot of the stock that we

have is in this state and in the service area. And I just wouldn't want to see that happen without having an opportunity to present the views of the financial community as we see it.

And if the staff's recommendations were to hold as I have seen it, I think it would be very difficult for me to persuade the investment policy committee of Smith Barney -- that will be Smith Barney Shearson that also has a very large position in Washington Energy because that's my predecessor firm and that's where I originally recommended it -- to continue to maintain a hold recommendation in the face of a possible change in the dividend rate. I don't think that they would accept that.

MR. GOLTZ: I was going to object, your Honor. The answer wasn't responsive. But I can't remember what the question was.

Q. I would appreciate it if you would try to keep it within the confines of the question, and certainly feel free to qualify your answer.

You testified in your written testimony that retail and institutional purchasers of common stock have "subsidized" Washington Natural's ratepayers. Do you recall that?

A. Yes.

Q. Are you telling us that investors in Washington Energy Company should earn more than a 200 percent return in their investment over the '84 to '93 period?

A. I would say that I would like to see them earn a fair -- if interest rates go the other direction, which they can, and conditions become more difficult, I would say that, if they could get a 200 percent return over a similar period, it would be very, very nice.

I can't predict what the conditions would be. I just -- I'm just interested in the company being able to grow its earnings, grow its dividend on a reasonable basis. And whatever the market valuation is placed on that, so be it.

Q. I gather that you're saying that a 200 percent return would be nice for the investors, but from what you said earlier that would also be nice for the ratepayers. True?

A. Could be. They are not mutually exclusive.

Q. Is it your testimony that utility rates should always go up?

A. No. I just believe that my testimony

should be that utility rates should go up when they

should go up, when they have to go up. I would rather see them go down.

Q. Staff is recommending a decrease. And it can be -- would you agree that from time to time, depending on the economic circumstances and the required cost of capital that it's appropriate for Commissions to order a rate decrease?

A. If circumstances -- if they over earn, sure.

Q. You state on page 2, lines 20 through 27, that the institutional purchasers, retail and institutional purchasers of stock have financed the growth of the company's -- of Washington Natural Gas' gas distribution system, which has provided meaningful economic benefits to the State of Washington.

Is that your testimony?

A. Correct.

Q. Now, let me ask you this: Are depreciation, deferred taxes, and deferred investment tax credits investor-supplied capital?

A. I don't understand that.

Q. Isn't the answer to that no? Depreciation, deferred taxes, and deferred investment tax credits.

A. That's operating.

Q. Don't ratepayers pay for that in rates?

A. That's part of it. That's in the rates, sure.

Q. And these are non-cash expenses which provide the company with cash to finance its capital expenditures? Isn't that correct?

A. Partially.

Q. So, ratepayers also help finance the growth of Washington Natural Gas Company?

A. Every utility's ratepayers do. Yes, sure.

Q. Now, as mentioned earlier, Washington Energy Company's common stock price hit a high of $24.25 in March of '93 and 26 and three-eighths in April 1993; is that correct?

A. Correct.

Q. That's an 8.7 percent increase in one month; is that correct?

A. Correct.

Q. Do you know why Washington Energy Company's stock price rose 8.7 percent in just one month?

A. I believe during that month that was the average -- pretty much the average. I think it reflected also the decline that interest rates had come off a bit. There was some indicators that might have

come out that showed that the inflation numbers were better.

But also it was pointed out this morning that there is just a lot of money going after yield. And the yield of Washington Energy is higher than the industry average. And so it's not surprising as long as, you know, the company is reasonably rated by firms such as ours, that there will be buying coming into it.

Q. And Washington's current market price is around $23 per share. Isn't that correct?

A. Correct.

Q. And would you accept subject to check that WECO's current market price of $23 per share is equal to or higher than its high price in 13 of the last 18 months?

A. Accept that subject to check.

Q. On page 5, lines 10 to 12 of your testimony, you note, do you not, that WECO's stock price rose 19 percent between the start of 1992 and April 19, 1993?

A. Correct.

Q. Was this 19 percent rise a windfall to WECO's investors? Or is it your testimony they were entitled to that capital appreciation because the cost

of equity rose?

A. I believe that was an average pretty much, for the average distribution company it reflected just, you know, a better overall environment.

One of the things that, you know, should be recognized, I think, is that not all retail investors are students of the market. One of the interesting phenomena that we find is that the rising tide takes everything. And when gas prices rose, you would think that distribution company stocks would suffer because they really don't benefit from rising gas prices.

But studies have shown that, when gas prices rise and the gas market is firm, not only do exploration companies that sell gas rise, pipeline stocks, but also gas distribution stocks.

You couple that with a low interest rate environment and bank and CD rates in the 2 to 3 percent area. I don't think it's that unrealistic -- I don't attribute that particularly to Washington Energy per se. But I just attribute it to all the stocks that I recommend. I mean, I would have to look, but I don't know if this is any better or worse than anybody else.

Q. But if all the ships rise, as you say, why

would it be that Washington Energy Company's stock would go down if the staff's recommendation is adopted?

A. Could you repeat that?

Q. If all the ships rise in this environment, why would Washington Energy Company's stock fall?

A. Because the rise will never be that high that it will sustain a perception that the dividend will be reduced significantly. And my feeling is that it will. Or it's very likely to be that the staff's recommendation holds. And I'm more interested -- I have no problem with the company during the period of time that you mentioned. This is a good area to invest in, the Pacific Northwest. I have no problem with that.

The company has one of the highest growth rates in customer additions and it has handled that very, very well. The fact they haven't gone in for ten years I think says something for the management of this company.

What I'm concerned about is that now they do need rate relief in my opinion, and also sustain the kind of rate base growth that's necessary. I'm more concerned about the next six months.

Q. Is your evaluation of the company and your

appearance here premised on your assumption that the company has handled its growth in a prudent fashion?

A. Yes, prudent -- I would say only to the extent that I would have liked to have seen it. I'm not an expert. I'm a Wall Street person. I'm an analyst.

Q. Let me get that quote down.

A. I look at it -- I'm on the outside. I have no control over what management -- I mean, these folks have been doing it a long, long time. And they have done it very well. I think any company that could grow the way they have grown and have held down rates says something.

Atlantic Gas Light is another fast growing company. They are adding now about the same number that you're adding here in this particular state. They go in every year.

Most of the growth companies recognize that a more aggressive -- to accommodate the growth, that there is a certain revenue requirement that's necessary. And I guess that the company put it off as long as they could.

But I think the point is reached now where, if you want to provide the service and maintain the growth, that you just have to do it.

And so I would say the prudency, the answer is yes. But I would have liked to have seen a little more aggressive action on the rate relief so they would not reach the point now where the dividend is a question or earnings increases are a question or that they would have to rely on non-regulated businesses for the growth.

Q. Is it your belief that Washington Energy Company's cost of equity rose 19 percent between January 1, '92 and April 19, '93?

A. Excuse me?

Q. Referring back to I what I think was my last question, which related to the increase in stock between the start of 1992 and April 19, 1993, was 19 percent.

A. Right.

Q. Is it also your belief that the cost of equity rose 19 percent during that time period?

A. I'm not sure.

Q. Do you think it went up at all?

A. Well, the cost of equity now is very reasonable. But, you know, it's been higher and it's lower and it can go higher again. I think right now equity is very reasonable at these ratios.

Q. But do you know if in that time period it

went up, down, stayed the same?

A. I would say the last year or so with market to books that we have talked about probably has gone down.

Q. And have you made a study of Washington Natural's cost of equity capital and what return on equity this Commission should reflect in rates in this case?

A. I haven't done, you know, that kind of work, and I'll rely on the work done by the company. If you're asking me what kind of a rate of return should be granted by the Commission.

Is that the question?

Q. I'm asking you if you made an evaluation of that?

A. The only evaluation was that, you know, based on our forecasts, that an allowed return and, you know, in the 12.5 percent return would allow the company to show some growth in earnings and perhaps maybe be able to raise the dividend modestly.

Q. Do Washington Energy Company's non-regulated operations contribute to its earnings per share?

A. The oil and gas subsidiary does. It's probably close, but probably could contribute as

mentioned this morning something. But I'm not exactly sure what the numbers are as of June.

Q. Would you describe the non-regulated subsidiaries as profitable ventures?

A. Not totally.

Q. What do you mean?

A. Well, the oil and gas subsidiary is profitable. If you were to -- the Unisys has not been profitable as the numbers that I have seen. But it's a development project as I have understood it. But the oil and gas has done very well recently.

MR. GOLTZ: Your Honor, I'm trying to skip over some of this to expedite things.

JUDGE ANDERL: How much time do you have left?

MR. GOLTZ: I think I have about fifteen minutes left.

JUDGE ANDERL: Fifteen minutes?

MR. GOLTZ: Yes.

BY MR. GOLTZ:

Q. On page 18, lines 10 through 15, you indicate that Washington Natural has not been earning the return it's entitled to in its rate base additions over the last eight years.

Do you see that?

A. Page 18, did you say?
Q. Yes. Lines 10 --
A. Yes, I see that.
Q. What do you mean "entitled to"?
A. Well, I believe I alluded to that before. If you go back -- and I just did a just quick calculation. But if you go -- if you go back over the 1982 to 1992 period, the incremental return, the increase in operating income relative to the increase of net plant investment has been on the order of 3 percent.

And over the past five years has been 1.3 percent.

So, if the company's -- the company was allowed in its last rate case certainly a much higher, 16.25 or whatever the current rate is, you know, whatever the allowed rate of return is decided on this case, it would appear from the arithmetic that there is a relatively small amount of income that's been generated on that increased investment. And that cannot be -- I can't see how you can sustain that kind of situation.

And at some point it becomes -- it could become a negative number. And over the last five years, 1 percent, I mean, you're basically not earning

on your investment.

And included in that item in that number in the last couple of years has been the non-regulated income. So, to some extent one might say that the non-regulated side has helped the company at least to maintain some sort of earnings that it would not have had if it was strictly relying on the -- on its regulated return.

But the company invested over the last ten years $475 million, and my calculations are that they earned 14.6 million increment -- I'm talking about incremental, not the embedded.

So, I think they are entitled to more than 3 percent.

Q. But is your testimony they are entitled to the rate of return established in the 1984 rate case?

A. No. I wouldn't go back to 1984. I'm saying whatever would be reasonable in the current environment and the current interest rate environment, current stock market environment. I would like it perhaps, but, no. I say the reasonable -- what would be considered reasonable in today's climate would be acceptable, which should be at least 12, I would think.

Q. Please turn to Schedule 16 of Mr.

Torgerson's exhibit. Do you have that?
A. Page 16?
Q. I'm sorry. Schedule 16.
JUDGE ANDERL: Mr. Grant, you can help him find that if you want.
Q. Do you see that --
A. What page did you say of 16?
Q. Page 1.
A. Okay.
Q. And you see the column that's headed Authorized Return on Equity?
A. Yes, okay, thank you.
Q. And you see at the bottom it says 12.03?
A. Correct.
Q. So, basically what that shows is that in 1992 the typical gas distributor in the United States was allowed to earn about 12.0 percent on equity?
A. Right.
Q. Do you think that institutional investors are aware of this reality?
A. I'm not sure.
Q. Were you aware of it?
A. No; because these companies, some of them don't -- aren't really what I would call strictly gas

companies. Some of them are combination companies,

Long Island Lighting has Shoreham. This is a different base of companies than I have used.

So, I wouldn't know how to relate -- this return here wouldn't necessarily relate to the returns, let's say, in my universe.

So, it's probably correct for this. But I don't --

Q. Your universe is a subset of the total?

A. Yes. My universe would include companies like New Jersey Resources, Yankee Gas, you know.

Q. And I apologize, Mr. Tulis, because obviously I have just asked you to jump right into this.

But as I understand this exhibit, it shows those companies which have been through, in fact, have authorized rate of returns during calendar year 1992. So, a number of the companies in your "universe" may not have been through that?

A. I would say the analysts that followed the regulated utility industry electric and gas would have this available to them the way that Mr. Torgerson had it available to him.

I would again assume that investors who are specialized in this, such as managers of utility funds, would be aware of this. I'm not sure whether

or not the average investor would be aware of this. I doubt it, to tell you the truth.

Q. The average yield in 1992 on A rated public utility debt was just about 9.0 percent. Isn't that correct? Or would you accept that?

A. I would accept that.

Q. Currently A rated public utility bonds are yielding about 8 percent, are they not?

A. I accept that.

Q. So, the yields on A rated public utility bonds have fallen about 100 basis points between 1992 and today; is that correct?

A. Right, right.

Q. And institutional investors who buy WECO common stock have a judgment about what return on equity Washington Natural is likely to be allowed to earn?

A. Correct.

Q. So, WECO's stock price reflects whatever expectations investors have as to what return on equity this Commission will allow Washington Natural to earn?

A. As part of many factors that go into a decision on, you know, on an investment.

Q. Do you have an expectation as to what

return on equity this Commission was going to allow Washington Natural to earn?
A. I don't have any -- it's been so long -- that's one of the difficulties. Since it's been like 1984 you mentioned since the company has been in, I don't know what the expectation really is at this point.
Q. On page 28 -- I have one other brief line of questions -- page 28, lines 11 to 12 you tell us that the WUTC ranks in the top 20 percent of all state Commissions from an investor perspective; is that correct?
A. Correct.
Q. And that's based on the analysis of the regulatory research association group?
A. Correct.
Q. And it's rated above average/3?
A. Correct.
Q. And there is only five other Commissions ahead of this Commission?
A. Correct.
Q. Tied for sixth is pretty good, isn't it?
A. Very good. I just want it to stay that way.

Q. And you're telling us that recent events

such as this Commission's decision to reconsider Puget's PRAM, P R A M, and the difference between staff's case and Puget and Washington Natural have raised investor concerns about the direction of regulation in Washington. Is that your testimony?

A. Correct.

Q. To what extent should this grading, this report card, by the regulatory research association impact the decision of this Commission?

A. Well, I think the regulatory research, they have -- they do this. And they, I'm sure that some of the Commission is aware of it, that's their specialty. And they rate Commissions, as do most firms' utility analysts. I guess our electric people do it.

I think it's important for investors to have a good comfort level about the fairness and the consistency of regulation in a particular state. And my feeling is that this is very positive for ratepayers and shareholders.

My experience has been that, you know, when -- it's very volatile when there is uncertainty, when decisions are extreme; that the -- that there is a problem and problems to follow.

My sense is that the Commission should

take this very seriously because this is only one group that does it. But I'm sure that, you know, if you were to look at other people that do this type of thing, you would find that those states that do have -- and it doesn't necessarily mean that they give the highest ROEs. I think there are a lot of elements. I think among them are consistency, fairness, reasonableness, responsiveness to all concerned.

I think it's important because there have been times that I followed the utility industry when Commissions have not had this, such as California at various times, such as perhaps Illinois now, where it has widespread ramifications on all the utilities.

And I think it's important that investors perceive this as a positive because this state needs capital. And, you know, Seattle is not Chicago where it's not mature in terms of growth. You're growing. And to me the most important part is that a growth utility have a Commission that understands the requirements of maintaining the growth.

So, I would say that that's a very important consideration, and that's why it was entered in as testimony, not because I wanted the Commission to recognize that this has been well received.

And the uncertainty relates to the fact

that, as far as Washington Energy, they haven't been in a rate case for awhile. And we do have some -- a new member of the Commission that people are watching to see what will happen here.

So, I think that this decision is going to be watched perhaps much more closely than it would be under other circumstances because any sign of uncertainty is going to be negative.

Q. I just have two further questions: One is I gather you're not suggesting anything other than this Commission fulfill its statutory obligation to balance the interests of ratepayers and investors?

A. Correct.

Q. And can I assume also from your testimony that you will, because this is a watched proceeding, that you personally will read the opinion of this Commission, the Commission in this case?

A. Very closely.

MR. GOLTZ: Thank you very much. I have no further questions.

JUDGE ANDERL: Thank you, Mr. Goltz.

Mr. Adams? About how much do you have?

MR. ADAMS: About ten minutes. I can probably finish before the break.

JUDGE ANDERL: Go ahead.

CROSS-EXAMINATION

BY MR. ADAMS:

Q. I want to start off with a point of clarification. And that is, first off, just in terms of your appearance here, is Washington Natural or WECO compensating you or Smith Barney for this appearance?

A. No.

Q. So, this is being done -- your presentation as a part of your responsibilities?

A. Well, let me just say I have never done this before in terms of volunteering. You know, I have a full schedule. I'm just very concerned. I just want to make sure that whatever it's worth that my input is heard because I'm sort of on the spot on the investment side.

So, this is entirely voluntary on my part. And the company accepted my coming.

Q. So, in other words, if you will, this is out of your pocket, not out of Smith Barney's pocket?

A. No. It's out of Smith Barney's pocket.

Q. There are no free lunches. I wanted to make sure.

A. They don't know that yet.

Q. They will see the bill when it comes in.

Would you turn to Exhibit 350, please. And all I really wanted you to do here is, looking at your Schedule 1, which is the first of the schedules in your exhibit, the last entries you have there are basically in April. I wanted you to update us on some of the rates. The interest rate trends have continued down some since then?

A. Correct. And the LDCs have also trended in a favorable path. It hasn't dropped. It's pretty much been --

Q. Are you able to give us some specific numbers within the last month so, for instance, the ten-year treasury rate currently?

A. I just don't have that in my mind. I'm sorry.

Q. Would that be true -- I wanted to ask you --

A. I had some people put these together as of the end of June. And I have been away. So, I haven't -- I would assume that the trends have sort of being a flash line. I don't know for sure.

Q. Wasn't there an announcement there was a record low of the 30-year T-bill rate?

A. I believe so.

Q. So, it would be fair to say slightly lower

but not a great deal lower?

A. I think that's fair.

Q. And then if you would turn to your Schedule 6, 2 of 2. There you show the spread between A and Bbb rated utilities? Do you recall that?

A. Right.

Q. And that one is as of year-end '92. Do you have a more current comparison? That shows --

A. I believe it's in the text where -- but I just don't have it on the top of --

Q. Are you saying that there is a figure --

A. There might be. I would have to doublecheck that. You know, --

Q. Let me have a moment here.

A. It should have been updated to the most recent.

Q. The text is at the bottom of page 13 and 14. And it says on line 6 on page 14, "this study does not purport to quantify the cost in today's market."

That's kind of what I'm asking you to do. You show a 20 point differential for 1992, and I just wondered --

A. I don't have that with me. But we can --

Q. That's the most recent information you have?

A. We can make that available. I just don't have it with me.

Q. Are we currently in about that same relationship?

A. I would say so. I don't think there has been that much of a change.

Q. As I understand the figures for both A rated and Bbb, those are the average for all issuances in that range; is that correct? From, if you will, an A plus to an A minus?

A. I believe that's correct.

Q. Same thing for the Bs.

MR. ADAMS: Actually, that's all I had except for an observation if you don't mind. As an Oberlin graduate I was surprised. I don't know that Antioch grads went to Wall Street.

THE WITNESS: There aren't that many of us. We're dinosaurs.

JUDGE ANDERL: Do the Commissioners have any questions for this witness?

CHAIRMAN NELSON: I pass.

E X A M I N A T I O N

BY COMMISSIONER CASAD:

COMMISSIONER CASAD: I just have a couple.

Many say there is a lot to be said for a good solid C. And in rating utility commissions, a good solid C probably is a pretty good place to be where you're not above average and maybe you're not below average. And I felt a little badly about that until I saw some of the other states who were ranked with us and above us and now I feel more comfortable?

THE WITNESS: Yes.

COMMISSIONER CASAD: Your view of that, I gather from your testimony, in your view substantial damage has already been sustained by the company as a product of the staff's recommendation in this rate case. And that whether -- and perhaps due to ignorance to some degree, the action has been viewed as a final Commission action by some and, therefore, confidence in fair treatment for the company has been eroded.

If that's the case, what do you believe or how badly do you believe the damage that the company has sustained is? And even if this Commission issued what many would consider a fair order has the company not still been hurt? And would this not still potentially affect their ratings?

THE WITNESS: If I could just maybe elaborate on that.

I believe that in the case -- in this

particular case there is a wait and see and a willingness to see what comes of it. And just in our own reaction. My reaction was originally I was -- I try to clarify that the staff's recommendation is not necessarily the Commission's decision. That was the first thing that I had to address.

Basically I have taken the position and our investors by and large have followed it as recognized by -- and others -- that the stock has held in this area -- is that this was not the final decision and that, you know, we would expect a fair hearing.

And so my sense is that, while there was damage and there was an element of uncertainty introduced, that investors are waiting and holding on now.

I don't sense a panic. I think that the concern would be if the staff's recommendation holds.

It depends -- I don't know what Moody's will do with the notes that Mr. Torgerson talked about. Maybe they may react.

But the fact that I gather Standard & Poor's have held. We did not sell the stock. We tried to take a rational approach and tried to calm it.

So, I would say that the damage is not

perpetual. It's not irrecoverable. I think right now based on the writings that I have done and others that there are enough people out there that understand that the process is going on and that we'll know in September.

That's the key. And if it's reasonable, I believe that the company will recover and do reasonable.

I was, however, really taken aback by the reaction, too, that decision as it hit the tape and the quickness of that reaction. And so that disturbed me. But it is repairable.

COMMISSIONER CASAD: Do you believe that most analysts have attributed an increase in the risk to the operations of all LDCs as a result of 636?

THE WITNESS: I think we're in the process of making that determination. The pros -- and I attend, you know, a number of industry meetings -- including myself believe that there is a risk factor that's been introduced. But the process of, as you know, is just beginning in terms of the transferral of these responsibilities. This winter will be important to see how it will -- how it shakes out.

My sense is that the low interest rate

environment, the euphoria among investors that the gas

industry, quote, "is a hot area to invest in," now attractive, and the low rates available and other opportunities, it sort of masks some of the concerns that we who follow this industry have and hope don't materialize.

But certainly it has to be watched closely. It hasn't shown yet. But the process hasn't started yet. And most of the pipelines now -- I think there are only a number of them that have completed their negotiations. So, it's very early -- my concern is that there are a couple of problems that erupt that could trigger a concern.

It's just something to watch very closely. But it's early.

COMMISSIONER CASAD: Your observations that you were impressed by the fact that the company was able to sustain growth from 1984 until the present time without coming in for rate relief makes me ask: Are there other reasons why the company might not have come in for rate relief in that period?

THE WITNESS: There might have. There are maybe some that I'm not aware of, frankly. But the increase in the customer base from the base that it was in the early '80s and this dramatic rise so quickly, if there are other reasons that I'm not aware

of, I'm sure there probably are some -- but the fact that that growth could be accommodated is kind of rare in the industry to be honest with you. This might be one of the few companies that have been able to sustain it to go from, you know, a thousand to twenty some odd thousand and sustain that kind of growth is rare in the U.S., I think.

So, I think from that standpoint they have done a really good job.

COMMISSIONER CASAD: Thank you very much.

JUDGE ANDERL: Mr. Hemstad?

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

COMMISSIONER HEMSTAD: You testified of the importance of the ability of the company to maintain its dividend rate. In a climate of steadily declining interest rates or at least now low and let's assume stable interest rates at a low rate, does the marketplace collectively expect that the dividend rates of utilities will be maintained at their current level?

THE WITNESS: Yes, yes. I would say that the area of 2 to 3 percent a year -- our projections for the overall market in terms of dividend growth over

the next three years is somewheres between 2 and 3 -- something like 2.5 percent a year.

To be competitive, if that's a correct forecast, then I would say that a 2 to 3 percent growth rate is a rate that I think investors believe that even in a lower interest rate environment would be sustainable.

COMMISSIONER HEMSTAD: Let's take a hypothetical. Let's assume that interest rates continue to fall over the next several years.

THE WITNESS: Right.

COMMISSIONER HEMSTAD: Would it be the market's expectation that dividend rates would continue to rise?

THE WITNESS: Yes. I think we -- they look at it more or less on a total return basis. So, the answer is that the market in terms of the individual securities expect that dividends should increase every year, even if it's modest; that there should be a growth element to the investment.

COMMISSIONER HEMSTAD: But that inherently means that the price of the utility stocks would have to be rising, wouldn't it? Let me phrase it another way: If utility stocks tend to be valued more like bonds, if interest rates are falling, aren't utility

stock values going to rise?

THE WITNESS: Yes. But I think that going back in terms of an equity investment, gas utilities -- I'm not so sure about electric utility -- gas utility investments haven't been generally perceived as closely as surrogates for bonds. There has always been a fairly wide spread between the two.

I think that in this particular environment with the growth of gas demand and the emphasis on the environment and everything that's been talked about in terms of being positive for natural gas, that investors today more so maybe than in past years when we have had much more mature -- we didn't have much growth -- look at it as much for capital appreciation and dividend growth than they did as a surrogate for bonds, as a bond investment.

Most of the people that I'm familiar with expect stock appreciation, that there will be a growth element in it. That's been I think my experience.

COMMISSIONER HEMSTAD: Changing to a different matter, on page 13 of your testimony, at line 14 you say: "Although many factors influence common stock valuations, Washington utilities are being clearly differentiated from their non-Washington peers." The reference there is to your Schedule 5.

That lists Washington utilities with a utility market-to-book ratio of 1.62. And the other classification electric utilities combinations and other LDCs are higher.

To what do you attribute the fact that Washington utilities as a group are lower -- are priced lower than those other categories?

THE WITNESS: I'm not entirely sure. Of course, it would include the electrics. It may be in the case certainly of Washington Energy that perhaps the fact that I would guess that the fact that the dividend wasn't covered last year by a wide margin by the fact that over the last few years dividends have not been covered or that they were marginally covered; that there is this concern about the dividend.

And so it sells at a higher yield, offers a higher yield and a lower market-to-book ratio.

So, I would say that was -- that might be part of it. There might be other factors.

I'm not sure about the electric companies or what went into that. But my guess is that that since this was done also I guess subsequent to the decision that it also reflects the stock drop --

COMMISSIONER HEMSTAD: That was going to

be my next question.

THE WITNESS: It would probably look a lot better if it were done in March of '93 than when we did it now.

COMMISSIONER HEMSTAD: So that would be a current rather than some kind of historical set of relationships?

THE WITNESS: Yes. I would have to go back and look at it. But I don't see any reason why Washington securities would be valued below the peer group other than maybe, you know, in '93. I may be wrong. I might be wrong on this. But '93 being maybe some elements of concern have sort of reflected in this.

COMMISSIONER HEMSTAD: Finally, Mr. Goltz cited a figure to you of, well, an increase in price over the last nine years from 11 to 23, which is roughly 100 percent increase in value. Plus dividends during that same period. I think the figure is around a 200 percent return.

Do you have an estimate of what has been the inflation rate over that nine-year period?

THE WITNESS: I would have to go -- I don't have that right at in my head.

COMMISSIONER HEMSTAD: Let me phrase it

another way: If you factor in inflation, the

investment return in real dollars, of course, would be substantially less than a hundred percent, isn't it?

THE WITNESS: Correct. But I would also say that we and my collective firms represented a substantial part of the volume, and I have been very positive about the future of this company up until April. And so the reality of it is that a few of us that have maintained our buy recommendations on Washington Energy have contributed I would say substantially to that price increase because we have maintained the faith, so to speak.

And my concern is going forward. I know what went into the hundred percent increase. I was there. I just don't want to have to be faced with a hundred percent or 50 percent decrease. That's the purpose of my coming out because, you know, there is a lot of securities held by -- the retail ownership is very, very large in gas distribution companies, and particularly large, I think, in Washington Energy. And this is very good because retail holders are very, very good, particularly if they are local, which is a large percentage.

If on the other hand, if they see that dividend go or may go, they move very quickly, as you know.

So, I would say the inflation factor definitely contributed. But the factor -- other factors, including support of analysts -- and I'm not the only one -- like myself who have supported this company for a number of years contributed substantially to this company. And also, as you know, they went on the stock exchange, which was helpful.

COMMISSIONER HEMSTAD: The only point I was attempting to make here was, looking at the question of return on investment to an investor, you have to really look at real dollars rather than nominal dollars.

THE WITNESS: Exactly.

COMMISSIONER HEMSTAD: No other questions.

COMMISSIONER CASAD: Just one quick one.

THE WITNESS: Sure.

E X A M I N A T I O N

BY COMMISSIONER CASAD:

COMMISSIONER CASAD: Triggered something that I thought was a very interesting observation if that's what you meant to say.

Do you feel that residential -- I don't mean to use that term -- that individual investors react more rapidly to market conditions than

institutional investors?

A. No. I think they are more tolerant. I think the institutional investor will act much more quickly initially. In other words, generically, the institutional investor may have been more responsible for the decline after the staff's recommendation. The retail investor will hold, I believe, until there is a reason not to hold. And so they represent -- but if it looks like the dividend stream is in jeopardy, then you see the big outflow. And that's what I'm concerned about. The institutionals, those who want to get out will get out. They are moving out now because they may not want to wait and see.

The retail investor I would say probably will hold on until they get a signal from people like myself that we're concerned and a drop in the rating would be that signal, you know. That would do and then you would have, you know, all the fiduciaries, they would be forced to sell.

That's where we are now with Washington Energy stock. The prudent thought is if a company doesn't earn its dividend for a few years, it's too high a dividend; that it should be cut. That's the general initial reaction.

So, I just wouldn't want to see a period of

a year or two or three where this company doesn't earn its dividend because the yield will reflect the fact that it probably will have to cut it and then it's academic.

E X A M I N A T I O N

BY JUDGE ANDERL:

JUDGE ANDERL: Mr. Tulis, I just have one question by way of clarification. This may be addressed to counsel as well as it is to you.

You provided in all your graphs two which have more than one line on them. And it may be that in the original which is on file in the record center which I have just not looked at yet those lines are distinguishable from one another.

THE WITNESS: I have seen the original. Maybe we can provide the originals.

JUDGE ANDERL: It's downstairs. I just haven't looked at it yet. If you can assure me that the lines are distinguishable in the original on the official copy?

THE WITNESS: My recollection is they are distinguishable.

JUDGE ANDERL: For example, Schedule 1,

page 1?

THE WITNESS: Yes, I believe that they are. I believe they are.

JUDGE ANDERL: Okay. I will perhaps check on the break. And if they are not, get you to provide a copy where I can tell them apart.

Is there anything on redirect?

MR. GRANT: Just two questions, your Honor.

REDIRECT EXAMINATION

BY MR. GRANT:

Q. Very quickly, Mr. Tulis, there have been a number of questions from Mr. Goltz about your experience and so forth. Over the years have you been rated or evaluated as an investment analyst by your peers or by any other rating organizations that looks at the work that you have done?

A. Yes. The Institutional Investor magazine has what they call an all star team, which is basically the ranking of all of us in our end of the business, both buy and sell side. And for the past ten years I have been part of that.

I have ranked near the top of that consistently.

And then the Greenwich Research Associates,

which is another group that basically also this is an interview with institutional banks, insurance companies, the Greenwich Research Associations interviews about a thousand institutions, and in their ranking I have been ranked No. 1 for the past five years in covering the gas distribution industry.

And last year I was No. 3 in the institutional all star team.

Q. You also mentioned during your testimony, Mr. Tulis, that you would be making your recommendations known to Smith Barney and to Shearson? Can you complain what you were referring to?

A. Well, two years ago I left the Shearson after thirty years and joined Smith Barney. And this week or next week Smith Barney is merging with Shearson.

So, I am now back -- I will be back with what will be one of the major firms. And my only reference to that with respect to Washington Energy is that we're very active with the company in terms of recommending it just prior to my leaving my former firm. And now I'm back.

We have -- the combined company will have a huge interest in Washington Energy at the time that this decision is forthcoming.

So, that's my -- that's a major concern of mine is that the combined entity holds a lot of stock. And Shearson bought Foster and Marshal, which has been a local firm, and they had a big position in Washington Energy.

So, the audience now is very, very large.

MR. GRANT: No further questions.

JUDGE ANDERL: Anything on recross?

MR. ADAMS: I just have one question.

RECROSS-EXAMINATION

BY MR. ADAMS:

Q. You indicated in response to one of the Commissioner's questions that you were surprised by the market response on whatever the day it was in April.

What was it that you responded to? Was it the company press release that came out? Is that what the market responded to?

A. Yes. I think the company put out a release -- I was out to lunch or something. When I came back I saw the stock had just, for this stock or any utility stock was down about 2.5 points. And I wasn't sure what had happened.

But then I saw what was on the tape.

But it was in a way surprising that the reaction was as quick and as dramatic. And that's why I was concerned about the interpretation of that event as opposed to that it was part of a process, not the end of a process.

MR. CEDARBAUM: Thank you.

JUDGE ANDERL: Anything else for this witness?

Thank you, Mr. Tulis, for your testimony. You may step down. We'll take an afternoon recess. But first let me make sure I know who the company's next witness is going to be.

MR. GRANT: The company's next witness will be Ms. Heide Caswell.

JUDGE ANDERL: Fifteen minutes.

(Recess.)

JUDGE ANDERL: Let's be back on the record, please.

Mr. Grant, before we go to your next witness, I understand that those graphs from Mr. Tulis, the lines are not distinguishable one from the other.

MR. GRANT: Mr. Lott informed me of that. And we'll see to it that a colored copy is directed to your attention, Judge.

JUDGE ANDERL: I'll include that as the official copy so that anyone who checks the file will be able to tell. I would appreciate that.

Your next witness is Heide Caswell, and she is on the stand. The testimony of this witness will be identified as T-351, and she has several numbered exhibits. To begin with HCC-1, which will be Exhibit 352. HCC-2 is Exhibit 353. HCC-3 is Exhibit 354. And HCC-5 is Exhibit 355.

(Marked Exhibits T-351, 352, 353, 354.)

MR. CEDARBAUM: I think we skipped one, Judge.

JUDGE ANDERL: Did I?

MR. GRANT: We have got HCC-1 as 352? Okay.

JUDGE ANDERL: HCC-4 is Exhibit 355, and HCC-5 is Exhibit 356.

(Marked Exhibits 355 and 356.)

Whereupon,

HEIDE M. CASWELL,

having been first duly sworn, was called as a witness herein and was examined and testified as follows:

JUDGE ANDERL: Go ahead, Mr. Grant.

DIRECT EXAMINATION

BY MR. GRANT:

Q. Will you state your full name for the record?

A. Heide Marie C. Caswell, H E I D E, M A R I E.

Q. What is your occupation?

A. I'm an engineer.

Q. And by whom are you employed?

A. Washington Natural Gas.

Q. Have you prepared prefiled rebuttal testimony in this proceeding?

A. I have.

Q. Do you have a copy of that before you?

A. I do.

Q. That has been pre-marked as Exhibit T-351?

A. That's correct.

Q. Have you reviewed that?

A. Yes.

Q. Does that appear to be a true and accurate copy of your prefiled rebuttal testimony?

A. It is.

Q. Are there any changes or corrections that you need to make to that?

A. No, I don't.

Q. In addition, Ms. Caswell, have you prepared

various exhibits that have been pre-marked as Exhibits 352 through 356?

A. I have.

Q. Are those exhibits true and accurate to the best of your knowledge?

A. They are.

Q. Are there any corrections that you need to make to them?

A. I don't believe so.

Q. Did you prepare those exhibits or were they prepared under your direction and supervision?

A. Yes, they were.

MR. GRANT: Your Honor, I would move for admission into evidence of Exhibit T-351 and Exhibits 352 through 356.

JUDGE ANDERL: Mr. Goltz, any objection?

MR. GOLTZ: No objection.

JUDGE ANDERL: Mr. Adams?

MR. ADAMS: No objection.

JUDGE ANDERL: Those exhibits will be admitted as identified.

(Admitted Exhibits T-351, 352 through 356.)

MR. GRANT: Your Honor, Ms. Caswell is available for cross-examination.

JUDGE ANDERL: Thank you, Mr. Grant.

Go ahead, Mr. Goltz.

MR. GOLTZ: Judge Anderl, first a preliminary matter. It's my understanding that there are some outstanding -- some data requests outstanding that are being responded to by this witness, and we have not yesterday received them. It would be my request that, should those data requests come in in the next -- in the very near future before the close of the record in this case, as I understand they likely will, then I would like to reserve the opportunity to if we wish to introduce any of that to attempt to stipulate to the company that we be allowed to introduce these data request responses or reserve the opportunity to briefly recall this witness at the end of the hearing for that purpose.

JUDGE ANDERL: Mr. Grant?

MR. GRANT: I will stipulate to the admission in evidence of those responses. And I will also check to see if it's possible to get a copy of those for you before you finish your examination because I think it would be unfortunate to have to bring any witnesses back. If we could get a copy. My understanding is that the copies which are due today are on their way down right now. But if we can get a copy of that for Mr. Goltz before he finishes his

examination, we'll do that.

JUDGE ANDERL: Thank you, Mr. Grant.

MR. GOLTZ: Otherwise, if it's not, I will ask for that relief at the end of today.

JUDGE ANDERL: That's fine. He has agreed to stipulate to have them come in. So, calling the witness back again may not be necessary.

CROSS-EXAMINATION

BY MR. GOLTZ:

Q. Good afternoon.

A. Hello.

Q. You reviewed Miss Thomas' testimony?

A. I did.

Q. And you're testifying today in response to the concerns raised by Miss Thomas in her testimony?

A. I think I'm testifying today partially due to that. I'm also testifying to try to clarify the company's position insofar as its policy on line extensions.

Q. That would be including its so-called CIA analysis?

A. It could encompass that.

Q. And could you state what CIA refers to.

A. CIA is an acronym for a Capital Investment

Analysis. It is a process the company goes through in evaluating its line extensions.

Q. Now, in the course of this proceeding, you're aware that staff submitted to the company data requests regarding its main extensions; is that correct?

A. It did.

Q. And the staff analysis of main extension profitability was based upon data supplied by the company for 1984 through 1991 for all main extension projects for which the initial extension was estimated to cost more than $25,000. Isn't that correct?

A. As a point of clarification: The data that was supplied was for all jobs whose total value exceeded $25,000. That could have been $24,000 in main extension and $1,000 in service extension. So, that was what we supplied.

Q. And the original -- the database staff developed was based on all the projects for which the company provided information?

A. I have to assume so.

Q. Are you aware that staff's original request was for all projects from 1981 over $10,000?

A. That's not my understanding. My original copy of the data request indicates otherwise. But

that could be incorrect.

Q. What is your understanding?

A. That it was for January 1, 1980, through December 31, 1991, for all projects which exceeded $25,000.

Q. So, are you aware that staff -- you're saying that you're unaware that staff originally requested data on projects with a threshold of $10,000?

A. That's correct.

Q. This is the first you have heard about that?

A. No. The first I heard of it was actually in Ms. Thomas' testimony, and I was surprised at that statement since it didn't reflect all of the information I had available in front of me. Neither does it reflect what in subsequent conversations Company personnel recollect -- have in their records.

Q. So, in the course of developing staff's analysis, were you the primary contact with Miss Thomas?

A. I was not.

Q. Who was?

A. It could have been any of three people:

Randy Schultz --

Q. I don't need the names.

A. Okay.

Q. But you dealt with all three of those people?

A. Yes.

Q. And are you aware that in reading Miss Thomas' testimony that staff backed off the original request because of the burden it would have placed on the company to respond?

A. Are you alluding to the 1990 through 1984 issue?

Q. I'm alluding to the $10,000 issue.

A. I don't believe the staff backed off on its requirement of that burdensome request. I believe -- my understanding -- and I think it's reflected in my testimony -- indicates that staff asked for all jobs from 1980 through 1991. And insofar as a rate case had been filed in 1984, it was agreed upon by the parties that 1990 through 1983 essentially would be eliminated.

Q. And are you aware that the suspension period in this case was lengthened by three months to give the company adequate time to respond to staff's original request?

A. As a matter of fact, I'm not aware that

that was any reason -- that that was a reason for

any suspension. I am aware that that was a data request and was responded to by our counsel. That's one of the packets that's on its way down.

Q. What is on its way down?

A. That same question was a data request that we just responded to.

Q. And so you're not aware of the response or you are?

A. I'm aware of the response. We responded -- the company responded no.

Q. On page 12 of your testimony, you stated that staff's analysis of main extension costs was flawed because staff's data was only 17 percent of line extension project additions for the 1984 through '91 period; is that correct?

A. As a clarification, line extension is a term that seems to have arisen through this proceeding on staff's behalf. Line extension in this sense is main extension. It is strictly 17 percent of the mains that the company installed. 17 percent of the main jobs which the company completed.

Q. The difference between mains and lines is what?

A. Based on the requests, I assume it's

basically the service onlies that are done of service

extension -- all service extensions plus all main extensions and service extensions would equal the line extensions.

Q. So, main extensions is a subset of line extensions?

A. That's my understanding.

Q. So, basically your testimony is on page 12 that staff studied only 17 percent of the total number of line extension projects; correct?

A. I think I just clarified. 83 percent of the total main extensions are not represented and the subsequent statement hopefully clarifies that.

Q. Actually, it doesn't.

A. Okay.

Q. Because is the 17 plus 83 intended to equal 100 and that's the total number of projects?

A. That was the intent.

Q. So, on one hand the 17 is of the total number of line extension projects, and that does not include 83 percent of the main extension projects?

A. Excuse me. As I -- okay. The 17 percent is actually reflective of all main extension projects as a subset of those line extension projects.

Q. So, basically on page 12, line 12, the term "line" should be stricken and the term "main" should

be inserted?

A. Essentially, I guess, and also in the question then. Right?

Q. So, whoever asked this question here also got it confused like I did.

MR. GRANT: I guess I did, Mr. Goltz. But now you and I are both clear.

Q. You state at page 11 lines 12 to 24 that staff's conclusions regarding line extension construction performance based on the data it reviewed is flawed because staff did not review the construction projects for all types of plant, including non-revenue producing plant.

Is that your testimony?

A. (Reading.)

Q. Page 11, lines 12 through 24.

A. Right. My testimony indicates it's not representative of all of them, one of which could be non-revenue producing. But it also includes service only, short main extensions, others.

Q. And non-revenue producing facilities include what?

A. Non-revenue producing would be a project such as a system reinforcement or a main replacement project.

Q. A system reinforcement would be an expansion of a main, enlarge its capacity?

A. Generally it wouldn't be that we would install a bigger main in its place, but we would try to identify another place that could supply a gas source.

Q. But I guess my question is when you say reinforcement, you don't mean physically reinforce the existing main. You mean expand capacity in some way or another?

A. Right. It's intended to reinforce the supply to an area.

Q. Is it not usual for the company to do a pre-construction economic justification analysis for non-revenue producing plant such as it is required to do for revenue producing plant?

A. It is, and it does.

Q. So, what is the problem with only looking at 17 percent of main extensions?

A. In order to develop conclusions about the company's policies in terms of plant investment, it's my opinion that it's important to look at all types of plant investment that the company engages in. And not only are large projects one of those items, but small projects and non-revenue producing projects, others

are part of that.

It's particularly, I think, important when you take such a relatively short slice of time for the company.

Q. So, it's your testimony that staff conclusions regarding construction costs overruns based on its database is flawed because it only looks at 17 percent of the main extensions?

A. I think the reason the conclusions about cost overruns, I believe, are invalid is not associated with the sampling of the jobs that it looked at, but more some of the failings that are associated with the way that the actuals were requested of us, the actual costs.

Q. The actual costs were requested of you?

A. Right.

Q. That's a question.

A. The company was asked to provide actual and estimated costs for all of these projects. The company does not individually track actual costs for small items such as a service to a residence. It tracks averages in that case. And the company informed staff of that policy or of that practice, and because of the sampling approach that staff took they didn't end up with a representative slice of the

company's investments for a given year. And that non-representative slice influenced the actual costs, the average actual costs that were reported to staff.

Q. So, basically the staff, would it be fair to say, was looking at the larger projects and what it missed -- the $25,000 and over and did not look at the under $25,000 projects?

A. They looked at the $25,000 and over and any subsequent job in that -- off of that main.

Q. And the deficiency was not looking at the under $25,000?

A. It's my opinion was the deficiency was not getting a random sample across all the populations. And one of the population sets would have been small jobs as well.

Q. But the staff looked at all of the over $25,000 subset; is that correct?

A. Can you clarify that question?

Q. Is it fair to divide the universe up into two sets: $25,000 and over and under $25,000?

A. If you have some reason to believe that $25,000 is an important set, I guess.

Q. Well, I guess because that's what was requested, as you testified, and that's what you provided. So, we only analyzed what was provided.

And it's my understanding what you provided was $25,000 and over.

A. We were asked to provide the $25,000 and over. The company suggested that a random sampling approach would be a far preferable mechanism to determine the company's plant investments. And that suggestion was determined to not be what staff wanted, I guess, and we provided all of the $25,000 and over and subsequent projects.

Q. Right. So, I want to take that as one subset. All right? The $25,000 and over that you just described. Assume that's one subset of your universe.

A. Okay.

Q. I'm saying, then, the other -- the reason for the flaw is that the staff didn't look at the under $25,000, the residual, the remainder?

A. No. It's my opinion the reason that it's flawed is the fact that the $25,000 represents non-revenue projects, it represents new construction developments, it also represents existing residential developments, and does not in any way allow for that population to be looked at.

And those are important populations rather than just an arbitrary dollar limit that's been set.

Q. And in your analysis, you looked at -- you took a representative sample of all projects?

A. No. The company does not analyze its projects that way. It analyzes its performance as I have demonstrated in I believe it's Exhibit 356.

Q. You concluded that the company came in close to its goal in every year; is that correct?

A. I concluded that on aggregate across that time frame the company performed very well.

Q. Let me look at the universe the staff looked at, which is the over $25,000.

A. Okay.

Q. And you're saying that staff's analysis shows that you were over budget on average.
The other part of the universe of projects was under budget? Can I derive that from your testimony?

A. From Exhibit 356?

Q. No. I guess I'm saying that you said -- yes, from Exhibit 356. This is the aggregate rate of returns on all projects, small/large?

A. Right.

Q. Let's look at Exhibit 353. Estimating accuracy.

A. Okay.

Q. Correct? Exhibit 353 shows estimating

accuracy overall? You're saying over the time period '84 to '91 you were pretty close?

A. I believe that 2.86 percent off is very close.

Q. And my question is: Is staff's study showed that for the $25,000 and over showed that there was an underestimate of the costs of the project.

Does that mean the corollary to that is for the under $25,000 there is an underestimate of the project?

A. No, I don't believe you can conclude that from this information. We don't have those other ones, estimates, in front of us to identify that.

Q. Your analysis in response to staff's database reflects analysis of data for all main extension projects by individual project? Or is it based on the total construction budget for main extensions over the period?

A. Can you clarify that? Can you repeat that?

Q. Did your analysis reflect analysis of data for all main extension projects by individual project? Or is it based on total construction budget numbers for main extensions over the period?

A. You mean this 2.86 percent on the

aggregate?

Q. Yes.

A. It is for the jobs within staff's sample, for all mains within staff's sample.

Q. So, overall you're saying it's 2.86 percent. Some may have been up. Individual projects may have been up. Some may have been down?

A. Correct.

Q. And you have a variance for each individual year; is that correct?

A. That's correct.

Q. And, again, within each individual year, you state that some are up -- in effect you're saying some are up and some are down, but you don't know which ones?

A. Which individual projects?

Q. That's right.

A. Certainly. I mean, those -- in order to get these dollars summarized on the individual basis, those were calculated. And that data was supplied to staff in my workpapers.

MR. GRANT: Judge Anderl?

JUDGE ANDERL: Yes, Mr. Grant.

MR. GRANT: We have now received by messenger the responses to the data requests that are due today that Mr. Goltz had asked about. So, we have

one copy of these.

MR. GOLTZ: Maybe we could take about five minutes, maybe we'll look through that and expedite this.

MR. GRANT: Anything to expedite your examination, Mr. Goltz.

JUDGE ANDERL: Off the record for five minutes.

(Recess.)

JUDGE ANDERL: During our break, Mr. Goltz had an opportunity to look at the responses to the data requests and is ready to proceed with his cross.

MR. GOLTZ: The second part of that is true.

BY MR. GOLTZ:

Q. On page 15 of your testimony, you assert that main reinforcement costs should not have been included in the staff database; is that correct?

A. A facility upgrade is not a reinforcement if that's the conclusion you're trying to draw. Is that what you're asking?

Q. What's a facility upgrade?

A. Okay. As I described it in the paragraph preceding, a facility upgrade is a long-range facility. When we install main in a contract that

has been designated as having a long-range plan component, we install the size of component that was called for.

So, for instance, the long-range plan calls for a four-inch main. A two-inch main would serve that customer totally adequately. We will install the 4-inch pipe, the main in the street, in accordance with that plan, and that facility upgrade cost should have been removed from the analysis in order to accurately identify the costs associated with those individual projects.

Q. Those individual projects that are installed prior to the need for the upgrade? In other words, you're saying you're installing 4-inch main instead of the 2-inch main because over the long term you'll need a 4-inch?

A. Correct.

Q. What you're saying is the staff should not have included any of that main?

A. Not for analysis of these particular -- on a job-by-job basis, no.

Q. Because you're in effect building in excess capacity for the future, and it would be unfair to include some of that cost in an analysis of the near-term projects?

A. Right. The capacity that's being provided is not being provided to those customers. It's the system that's being supported.

Q. At some point later it would be appropriate to include the costs when you actually need 4-inch main to provide the service?

A. I'm not sure I understand your question.

Q. Am I correct that at some point you intend to use the 4-inch main?

A. It is in use, yes.

Q. And that's because over time the area has been developed with other projects?

A. Could be. Or may provide a source to another area.

Q. It's going to be part of the gas distribution system?

A. Right.

Q. My question is: At some time should that enhanced capacity be incorporated into your analysis, the cost of that?

A. Into my analysis of these particular projects?

Q. No. Into a cost analysis of the justification for a given project or not.

A. No, I don't believe so.

Q. And that's what your testimony is that staff's testimony -- staff's study is flawed because it included that?

A. Yes.

Q. Now, staff did not recommend an adjustment for uneconomic main extensions in this case, did it?

A. No, it didn't.

Q. Do you think it is appropriate for staff to make reasonable recommendations to the Commission so that the company will not be facing a staff adjustment to disallow a large amount of plant in service in the future?

A. Can you restate that?

Q. Do you think it's appropriate for staff to make reasonable recommendations to the Commission so to allay staff's fears that the company will not be facing a potential adjustment to disallow plant in service in the future?

A. After it ensures that that position is correct, yes.

Q. In fact, hasn't the company already changed its evaluation of main extension projects?

A. In what regard? Or which regards?

Q. Based on your testimony, page 27, line 17.

And the answer following that.

A. And as well in staff data request 830 I respond to some of those changes or some improvements, not necessarily as a result of staff's concerns.

Q. Your testimony on line 8 or the question is on line 18, 19, and 20, has the company already anticipated and adjusted for some of these same concerns? The answer to that is yes.

A. That's correct.

Q. So, you're testifying that you anticipated and adjusted for some of these concerns, but your anticipation and adjustment wasn't necessarily a function of staff's concerns?

A. No. It was a function of the company reviewing its processes itself, which it does, and during the time frame 1984 through 1991 some changes were made, and I answered to those changes in that data request.

Q. And some of these changes took place as late as April 1993. Isn't that correct?

A. Certainly.

Q. And that's when staff filed its testimony?

A. That's when the company determined that that change was appropriate.

Q. Several months after staff's investigation was underway?

A. I believe more appropriately after we concluded our study.

Q. And one of these changes is to require that initial hook-ups on main extensions meet a minimum return level of 7.75 return with an eventual rate of return of all customers with 7.75 percent, that's your testimony on page 28, lines 6 through 11?

A. That's correct.

Q. On what is the initial required return of 7.75 based?

A. It's based on the immediate customers.

Q. Is it based on your -- on some cost of capital capital structure?

A. No. I believe the 10.75 is reflective of that.

Q. How did you decide 7.75 was not?

A. I think we decided 7.75 and 10.75 was enough.

Q. I know. But what was the process you went through? How did you come to those numbers? Why not 8 and 12 or 6 and 10 or whatever?

A. I was not party to that decision. So, I can't really answer that one.

Q. You don't know?

A. That's right.

Q. And do you know that it's sufficient?

A. I don't know it's insufficient.

Q. And when was the policy adopted?

A. I believe it was April, as well. I could be wrong.

Q. I'm sorry?

A. I believe it was April, as well. I could be wrong.

Q. And the policy is embodied in a document somewhere?

A. I believe that's correct.

Q. Is the current policy for line extensions embodied in rules 6 and 7 of your tariffs on file with the Commission?

A. Is the level, the hurdled rate, embodied in them?

Q. Yes.

A. At no time do I believe it's been embodied in them.

Q. I'm having trouble hearing you. I'm sorry.

A. I don't believe that at any time it's been embodied and rule 6 and rule 7 as clears the hurdle rate. I could be wrong on that.

Q. Isn't it true that Schedules 6 and 7 are,

in effect, proxies for the CIA analysis?

A. Can you clarify that question?

Q. Well, these are -- they are, in effect, notice to customers as to what the hurdle rate is?

A. I don't think that that's correct. That's not my understanding of these two documents.

MR. GOLTZ: Your Honor, I would like to have two documents marked.

JUDGE ANDERL: I have been handed a multi-page document which is entitled Fifth Revision Sheet No. 16. It appears to be a tariff sheet from the company. I'll identify that as Exhibit No. 357.

Mr. Goltz, how am I going to distinguish this first one?

MR. GOLTZ: The date stamp in the upper right-hand corner.

JUDGE ANDERL: Okay, thank you. Exhibit No. 357 has a date stamp in the upper right-hand corner of February 5, 1993. The next, Exhibit 358, is a similar document which has a date stamp of October 31, 1991.

(Marked Exhibits 357 and 358.)

Q. Miss Caswell, you have documents marked Exhibit 357 and 358 before you?

A. Yes, I do.

Q. Would you accept subject to check these documents -- that Exhibits 357 -- let me ask you:

Do you recognize what's been marked as Exhibit 357?

A. I do.

Q. You do?

A. Yes.

Q. Is it the current versions of Washington Natural Gas Company's Rule 6 and Rule 7, Schedule 7, as filed with the UTC?

A. I'm checking it against my version.

They appear -- it appears to be, yes.

Q. And you probably don't have the others. But your own version of the others. But would you accept subject to check that Exhibit 358 is a true and correct copy of prior versions as reflected by their date stamps of Rule 6, Rule 7, and Schedule 7? I guess there is Rule 6. Would you accept that subject to check?

A. Subject to check, yes.

MR. GOLTZ: Your Honor, I would like to offer these into evidence.

JUDGE ANDERL: Does the company have any objection?

MR. GRANT: No objection.

JUDGE ANDERL: Mr. Adams?

MR. ADAMS: No.

JUDGE ANDERL: Those two exhibits will be admitted as identified.

(Admitted Exhibits 357 and 358.)

BY MR. GOLTZ:

Q. You state at line 22 to 23 of page 28 that the required return, that is to say, your 7.75 and 10.75 numbers, will be reevaluated after the Commission decision in this case. Is that correct?

A. That's correct.

Q. And do you know how the Commission's decision will be incorporated into these numbers if the Commission adopts Dr. Lurito's recommended rate of return and capital structure?

A. I don't.

Q. Do you have an opinion on that?

A. No.

Q. Do you have an opinion on how it would be changed if the Commission adopts Mr. Torgerson's recommended rate of return and capital structure?

A. I don't.

Q. Is the relationship between your 7.75 and 10.75 percent numbers and Mr. Torgerson's numbers?

A. Pardon me?

Q. Is there a relationship between your 7.75 and 10.75 on the one hand and Mr. Torgerson's recommended return numbers on on the other hand?

A. I don't know.

Q. You state at lines 19 through 22 of page 28 that the company is enhancing its procedures for monitoring and periodically updating estimates of construction costs, projected revenues, and required rate of return; is that correct?

A. That's correct.

Q. Is some of this in response to staff's recommendations?

A. No. I believe it's in response to concerns the company has had and has been attempting to address themselves.

Q. So, in that sense the company shared the concerns of staff?

A. I don't know if we shared them. We had similar concerns or we had concerns which preceded this study that were incorporated during the '84 through '91 time frame.

Q. So, the company did have some concerns about these issues?

A. The company considers it its

responsibility to review all of the components that

will determine how it will invest its plant. And in properly addressing that responsibility, it evaluates such components.

Q. You state that the company is enhancing its procedures for monitoring. Could you describe what you're doing in that regard.

A. Well, yes.

Q. Would you do so?

A. A more frequent review of actual to estimated costs is being done, and information regarding those costs is being shipped back to the people that were making them.

Q. Anything else?

A. Additional review of costs, capital costs, is being incorporated -- is being evaluated and incorporated into the up-front estimate that's done when we determine whether a customer will be served by gas or not.

Q. Is the Company improving its internal processes for dealing with possible construction cost overruns?

A. As part of those two processes I just described, it does that.

Q. How does it do that to ensure against cost overruns?

A. Okay. In evaluating the actual costs at the end of a job and then finding out or conveying that information to the persons that were responsible for, I guess, generating those costs, those pieces of information are given to those people to be able to monitor. I mean, to be able to refine any processes.

Q. Could you explain with what, if you know, with what frequency the company intends to update its estimates of projected revenues for CIA purposes and how this will be accomplished.

A. By projected revenues, what specific components do you mean?

Q. The CIA analysis looks at costs and revenues; correct?

A. That's correct.

Q. And you look at obviously revenues. The revenue side, that's an estimate?

A. Of course.

Q. And that's going to evolve over time, the revenue estimate?

A. I don't understand the question.

Q. You make an initial up-front revenue projection?

A. We make a projection that looks at the number of therms we believe we will sell and the price

for those therms.

Is that where you're going?

Q. And that gets -- that changes as time goes on? Therm usage changes?

A. Both of those components can change, yes.

Q. In the course of beginning and actually completing even a given project or extensions of that project; is that correct?

A. That's not correct.

Q. Do you know with what frequency the company will update the cost of capital for use in CIA analyses and how this will be accomplished and documented?

A. No.

Q. You state in your testimony that the company has responded to staff's concerns regarding the results of its analysis by designing a new computer system that will give tracking of all line extension costs by project and will provide better information for developing estimates of future revenue.

Is that correct?

A. Can you restate the beginning of the question?

Q. Why don't we go to the bottom of page 28

and the top of page 29. I'm just asking you -- I'm just giving a reference to your testimony.

A. It is not in response to staff's concerns that the company is designing this system. The company identified the need to develop this computer system to handle these types of information sometime back and has been developing that system.

Q. Aren't you going to give staff a little bit of credit here this afternoon?

A. They came in after the fact.

Q. And this computer system will consist of a construction and project cost database which would make tracking of estimated and actual costs and estimated and actual customers easier in the future?

A. That's its intent, yes.

Q. And I fear to ask this, but has the company attempted to discuss with staff what staff believes such a database should include?

A. I had a discussion with Miss Thomas regarding that specific, I guess, concern. And that's all to my knowledge that's there.

Q. Do you know what information is going to be included in the database?

A. Not specific fields if that's the question.

It should have information which should exceed that

which was requested of staff --

Q. Requested by staff?

A. -- requested by staff with the exception of the actual therm counts that were done, since it was a somewhat unfamiliar way for the company to evaluate its sales.

Q. Will it be possible from your system to determine how accurate the company's estimates of costs, revenues, and return have been by project from this database?

A. That should be part of it. Hopefully that's available.

Q. You claim staff's recommendations that refundable CIAC deposits, page 29, lines 16 and 17, there you claim that staff's recommendation that refundable CIAC deposits is not reasonable because it would require an enormous effort to monitor the actual costs versus the estimated costs.

Is that your testimony?

A. It would require a significant amount of effort and a very low amount of value, in my opinion, based on the 2.86 percent accuracy that we have.

Q. Can you be more specific as to the amount of effort? Have you attempted to quantify that in any way or elaborate on that?

A. You want me to try to --

Q. If you can do it briefly.

A. I would conclude that it would take basically time to gather two parts -- two bits of information that are not currently kept in similar areas of the company. For contributions, they are collected up front. And costs, actual costs associated with jobs, are captured after the job is completed obviously.

Those costs may not come in very quickly, and getting them correlated back to that original customer that contributed that money would not be in my opinion a very simple matter.

Q. Did the company provide such information for the years 1986 to 1991 in response to data requests?

A. We provided information that was -- that identified for each customer what contribution did they provide. We did not, however, tie that back to the physical plant in that specific data request in the workpapers that I supplied and the database that were part of those workpapers. We supplied it back, tying it back to the piece of plants that it covered. And that was a significant amount of effort.

Q. But would it be possible to put this in as

part of the database that you're developing at this moment?

A. I suppose it could be. But once again, remember that not all charges come in very quickly and having a contingency hanging out there for up to a year on a customer is not very reasonable, I don't think.

Q. Lines 25 through 27, page 29, you state requiring in addition that these customers be at risk for construction contingencies would be a tremendous disincentive to having gas installed.

It appears from that that the company does not want to make customers who hook up pay their own costs, but would rather shift those costs and risks to the existing ratepayers. Is that a correct interpretation of that?

A. No, that's not correct.

Q. Who bears that then?

A. I think shown by the 2.86 variance, there is basically next to nothing to bear. The company --

Q. And the aggregate.

A. In the aggregate.

Q. But individual costs for individual subsets of the universe there may be? Yes?

A. There could be.

MR. GOLTZ: I have nothing further.

(Discussion held off the record.)

BY MR. GOLTZ:

Q. Do you know of any discussion -- we have had some testimony today and in the prefiled testified of Mr. Torgerson about a follow-on rate case.

Do you know of any intent on the part of the company to produce studies in such a follow-up rate case which would show these decisions with regard to revenue producing plant to construction projects are prudent and reliably cost effective?

A. I don't know of any intent.

JUDGE ANDERL: We'll just pause for a moment.

MR. ADAMS: I don't have any questions.

CHAIRMAN NELSON: Thank you for your testimony.

JUDGE ANDERL: No redirect?

MR. GRANT: No, your Honor.

JUDGE ANDERL: Thank you, Miss Caswell, for your testimony. You may step down.

Let's go off the record for just a moment and see what we're going to do here.

(Discussion held off the record.)

JUDGE ANDERL: Back on the record. We'll

identify Mr. Gustafson's prefiled rebuttal testimony

as Exhibit T-359 and his Exhibit JWG-1 revised will be Exhibit 360, his Exhibit JWG-3 will be Exhibit 361. Just a minute here. And there are then exhibits JWG-4 through 8, which will be numbered as Exhibits 362 through 366 inclusive.

(Marked Exhibits T-359, 360 through 366.)

MR. ADAMS: Your Honor, what happened to JWG-2?

JUDGE ANDERL: I guess we're going to find that out. It may be that these are revisions to previously numbered or filed ones and it didn't have a change. I don't know.

MR. JOHNSON: I can address that. JWG-1 revised was a revision to what's been introduced as Exhibit 39, but what was originally JWG-1 during Mr. Gustafson's direct testimony. We began the remaining exhibits with 3, 4, 5, 6 because the first two exhibits that were introduced were marked were JWG-1 and 2 during the direct phase.

Probably an inartful way to do it, but that's why we did it.

JUDGE ANDERL: It makes sense. That's fine.

JUDGE ANDERL: Mr. Gustafson, would you

raise your right hand, please.

Whereupon,

JAMES W. GUSTAFSON,

having been first duly sworn, was called as a witness herein and was examined and testified as follows:

JUDGE ANDERL: Go ahead, Mr. Johnson.

DIRECT EXAMINATION

BY MR. JOHNSON:

Q. State your full name for the record, please.

A. James W. Gustafson.

Q. Mr. Gustafson, what is your occupation?

A. I am senior vice president of operations for Washington Natural Gas Company.

Q. Have you testified previously in this proceeding?

A. Yes, I have.

Q. Have you submitted prefiled rebuttal testimony in this proceeding?

A. Yes, I have.

Q. Is that what's been marked for identification as Exhibit T-360?

A. I have -- is it 360? I had 359.

JUDGE ANDERL: 359.

MR. JOHNSON: Excuse me.

Q. And you have a copy of your testimony in front of you?

A. I do.

Q. Was that testimony prepared by you or under your supervision and direction?

A. Yes, it was.

Q. Are there any corrections that you wish to make that your rebuttal testimony?

A. No.

Q. Is that rebuttal testimony then true and correct to the best of your knowledge?

A. Yes, it is.

Q. You also have before you what's been marked as Exhibits 360 through 365.

JUDGE ANDERL: 366.

MR. JOHNSON: Excuse me.

Q. Do you have those exhibits?

A. Yes, I have those.

Q. Were those exhibits prepared by you or under your supervision or direction?

A. Yes, they were.

Q. Are there any corrections that you have to any of those exhibits?

A. No.

Q. Are those exhibits then true and correct

to the best of your knowledge?

A. Yes, they are.

MR. JOHNSON: Your Honor, the company would move for admission of Mr. Gustafson's prefiled testimony and the exhibits that he is sponsoring.

JUDGE ANDERL: Is there any objection from the staff or any of the other parties? Mr. Goltz? I'm sorry. It's Mr. Cedarbaum.

MR. CEDARBAUM: Mr. Adams and I may have the same objection. Let me state it and Mr. Adams can follow along.

I do have an objection to a part of Mr. Gustafson's testimony beginning on page 31 under the subheading Comparative Performance, which runs through page 34. In that testimony he refers to a NICOR, N I C O R, survey, and then in Exhibits 362, 363, and 365, he graphically illustrates some statistics from NICOR.

The basis for the objection goes to the portions of the exhibits referring to the NICOR and his testimony referring to NICOR statistics. And the reason for the objection is the company's response to staff data request No. 783 in which we asked Mr. Gustafson to provide a copy of the NICOR survey upon which he relied to prepare his comparisons discussed on

Pages 31 through 33 of his testimony. And the response

is that the NICOR report is a confidential report on 35 large LDCs.

We have permission to only use summary and average type data. We cannot reveal relative information about specific companies in the NICOR report. Attached are pages from the NICOR report that were used to prepare Exhibits JWG-4, 5, and 7. The names of the companies other than Washington Natural Gas Company have been blocked per our agreement with NICOR. The source of the NICOR data is primarily the American Gas Association uniform statistical report. These data can have small differentials from FERC form No. 2 data.

Basically what the company told us was we can't have the underlying statistics for the NICOR -- for the conclusions that Mr. Gustafson derives from the NICOR data. It's impossible for us to know the basis for those statistics. We can't cross-examine on it. And so to the extent that he refers to that study in his testimony and in exhibits I would object.

JUDGE ANDERL: Is that your objection, too, Mr. Adams?

MR. ADAMS: Yes. I might indicate that we by our data request No. 261 asked for the same study and were cited to the staff response that Mr. Cedarbaum

just recited. We also got given that response.

JUDGE ANDERL: Comments from the intervenors?

Any response from you, Mr. Johnson?

MR. JOHNSON: Your Honor, my understanding of the data request response that Mr. Cedarbaum is referring to -- and I think he even mentioned this -- that there was substantial statistical information. Your Honor is welcome to look at the response -- that was provided in that data request response which came from the NICOR study. The deletions that occurred in the data request response were the names of the individual companies.

I believe -- Mr. Gustafson can certainly speak to whatever his understanding was with the NICOR organization -- but the deletions that occurred in that sheet were not data. The deletions were the names of the companies.

I think we have given statistical information in response to the data request, and I think that statistical information backs up the testimony and exhibits that Mr. Gustafson sponsored.

So, I would oppose the objection.

JUDGE ANDERL: Don't the deletions kind of have an impact on whether or not the staff could check

and verify the information?

MR. CEDARBAUM: I have two comments. One, we were only given two pages of the data. Not the whole survey as we requested. And I would like to see the whole survey.

And, secondly, as your Honor indicated, we don't know who these companies are. We can't check them or make any comparisons with Washington Natural Gas or Cascade or Northwest Natural or whoever.

JUDGE ANDERL: Mr. Johnson, I'm inclined at this point, unless you have something else to say, to kind of agree with the staff, I'm not saying there is any reason to believe that Mr. Sullivan's information is incorrect, but I think staff and public counsel have a right to verify that for themselves and have sufficient information on which they can construct some cross-examination questions.

It doesn't sound to me like they have been provided with that.

MR. JOHNSON: Would it be possible, your Honor, if Mr. Gustafson can do this, I'm assuming that we're going to be back here tomorrow morning.

JUDGE ANDERL: Yes.

MR. JOHNSON: To make an inquiry of NICOR to see if that NICOR agreement can be released in its

entirety? I understand your Honor's concerns. But we are obviously not trying to withhold something. We are simply abiding by the wishes of NICOR. If we can be released of that and maybe Mr. Gustafson can check before we go on tomorrow.

I understand your Honor's concerns. And if we can't use it we can't use it.

JUDGE ANDERL: Okay. I don't know. Is that going to address staff's concern? Or would that be kind of not enough time?

MR. CEDARBAUM: I think at this point it isn't enough time. We asked the data request. We were given a response. We were told we can't have it. We stopped. And now it's 5:00. We're going to be back tomorrow at 8:30, I guess.

JUDGE ANDERL: Yes. I think at this point I would grant the staff's motion. But I would be open to reconsider that should there be some sort of an agreement between the parties.

Of course, I just can't imagine, given the objections raised and the comments of staff now in response to your offer to check with NICOR that I should withhold ruling, although I could if you wanted me to. But my inclination at this point is to grant the motion or the objection, to sustain the objection

to those portions of the written testimony and the exhibits.

MR. JOHNSON: Can your Honor then be specific as far as the portions of the testimony in particular that are being excluded? The graphs are relatively easy because there are lines drawn on these graphs that are representative of being from NICOR. But can your Honor be more specific as to what sections are being excluded?

JUDGE ANDERL: Mr. Cedarbaum, can you help me out?

MR. CEDARBAUM: I'll try. As I look at the testimony on page 32, line 1, the sentence beginning with the information through the rest of that paragraph refers to -- that refers to the NICOR report.

JUDGE ANDERL: The sentence --

MR. CEDARBAUM: The three sentences beginning on line 1, sentence beginning with "The information" through the remainder of that answer. So, through "the year 1991."

JUDGE ANDERL: That seems to me to be the proper subject of the objection. So, that portion would be excluded.

MR. CEDARBAUM: Page 32, line 17.

JUDGE ANDERL: Excuse me. I was going to say I suppose you would also want lines 17 and 18 on that same page?

MR. CEDARBAUM: Yes. And then at line 22, the sentence beginning with "The company has also been consistently lower than the 35 companies in the NICOR report."

JUDGE ANDERL: Okay.

MR. CEDARBAUM: On page 33, line 4, the sentence beginning with "the line."

JUDGE ANDERL: Okay.

MR. CEDARBAUM: Line 10, after the comma so the sentence would end with "QLDCs."

JUDGE ANDERL: All right.

MR. CEDARBAUM: I think that's it.

MR. ADAMS: I note something on page 31, line 21, "we have reviewed comparative data for the other LDCs in this state," and it goes on and for, and I would assume after the state there should be a period.

JUDGE ANDERL: That seems to make sense since the 35 LDCs refers to the NICOR study.

Does that cover it, then, Mr. Cedarbaum, in terms of the written testimony?

MR. CEDARBAUM: I think so. Then as I

indicated in my motion, on Exhibit 32, there is a line for --

JUDGE ANDERL: 362?

MR. CEDARBAUM: Excuse me -- 362. 32 was a long time ago -- there is a line for NICOR.

Exhibit 363 there is a line for NICOR. And the same with 365.

MR. ADAMS: Your Honor, I think it might also be appropriate to ask Mr. Gustafson if there is anywhere else in his exhibits or testimony that that information is reflected. I don't know if Mr. Gustafson was paying attention.

THE WITNESS: I was following you. It appears that everything -- you have covered everything that relates to the NICOR study.

JUDGE ANDERL: And, Mr. Johnson, I think that the portions pointed out by counsel are consistent with what the intent of my ruling was. And so I would grant their motion or objection to exclude those portions of the testimony and the exhibits. If you're able to reach some sort of agreement between now and tomorrow morning, you're certainly welcome to bring that in.

Anything else then? I will admit the

exhibits and the testimony subject to the deletions

that we have covered on the record. And they can then begin with cross of this witness in the morning. 8:30. Stand in recess.

(Admitted Exhibits T-359, 360 through 366.)

(At 5:10 p.m. the above hearing was recessed until Friday, July 9, 1993, at 8:30 a.m.)