Exhibit No. ___T (RCM-1T)
Dockets UE-111048/UG-111049
Witness: Roland C. Martin

BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**DOCKET UE-111048** **DOCKET UG-111049** ***(Consolidated)***

TESTIMONY OF

ROLAND C. MARTIN

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Electric Results of Operations for Ratemaking Purposes,
Revenue Requirement Adjustments and Deficiency

December 7, 2011

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I. INTRODUCTION

Q. Please state your name and business address.

A. I am Roland C. Martin. My business address is The Richard Hemstad Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, Washington 98504. My e-mail address is rmartin@utc.wa.gov.

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

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

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

A. I have been employed by the Commission since 1982.

Q. Please state your educational and professional background?

A. I graduated from the University of the Philippines in 1975, receiving a Bachelor of Arts degree in Business Administration with a major in marketing management. I also received a degree of Bachelor of Science in Commerce, with a major in accounting, from University of Pangasinan in 1980. On an ongoing basis, I attend classes on regulation and ratemaking.

During my employment at the Commission, I have performed accounting and financial analyses of regulated utility and transportation companies either as lead or as member of a Staff team. I have testified in numerous general rate cases, including the last combined general rate case of Puget Sound Energy, Inc. ("PSE" or "the Company") in Dockets UE-090704 and UG-0090705. Among other matters, my testimony in that case addressed the recovery of Mint Farm and Wild Horse electric generation costs deferred in accordance with RCW 80.80.060(6). Most recently, I participated in the review of PSE's natural gas general rate case in Docket UG-101644 and Avista Corporation's general rate case in Dockets UE-110876 and UG-110877.

I have presented Staff recommendations on accounting and revenue requirement issues during open public meetings. I have reviewed numerous other regulatory filings, including mergers and acquisitions, petitions for declaratory orders and waivers of rules, accounting petitions, transfers of property, periodic cost adjustments, tariff rider and tracker mechanisms, PSE Power Cost Only Rate Cases, and periodic compliance reports. I have also served as the Commission's accounting advisor.

II. SCOPE AND SUMMARY OF TESTIMONY

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

A. I present Staff's adjusted pro forma results of operations for PSE's electric service for the test year ended December 31, 2010. That presentation supports the revenue requirement increase Staff recommends for PSE's electric operations. This recommendation is based on the my own analysis and the analysis of several other Staff members and Mr. Ralph C. Smith who testifies on income tax issues for Staff.

My testimony will also explain Staff's proposed ratemaking adjustments within my area of responsibility. Two adjustments I recommend that are not proposed by the Company relate to renewable energy credits and deferred costs for the Lower Snake River Wind project.

Finally, I explain how the recommendations of Mr. Smith are portrayed in the Staff results of operations.

Q. Please provide a brief summary of Staff's electric revenue requirement recommendation.

A. Staff recommends a revenue increase for PSE's electricity operations of $38,919,352. This recommendation compares with the Company's proposed revenue increase of $152,928,499, before allocation to Firm Resale and Large Wholesale Firm customers.

Staff's revenue requirement deficiency was developed using Mr. Elgin's 7.59 percent overall rate of return and a pro forma adjusted net operating income and rate base for the test year ended December 31, 2010.

Q. Have you prepared any exhibits in support of your testimony?

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

- Exhibit No. ____(RCM-2), Electric Results of Operations For The Twelve Months Ended December 31, 2011

- Exhibit No. ___ (RCM-3), Calculation of Electric Revenue Requirement Deficiency

- Exhibit No. ___ (RCM-4), Comparison of PSE-Staff Revenue Requirements

- Exhibit No. ___ (RCM-5), Power Cost Rate

- Exhibit No. ___ (RCM-6), Combined Working Capital

III. ELECTRIC REVENUE REQUIREMENT

Q. Please describe Exhibit No. __ (RCM-2), Electric Results of Operations For the Twelve Months Ended December 31, 2011.

A. This exhibit portrays Staff's electric results of operations for ratemaking purposes for the test year ended December 31, 2010. The starting point for the development of all Staff electric ratemaking adjustments is the Company's Supplemental Testimony and Exhibits, filed September 1, 2011.

Page 1 of the exhibit presents an overview of the electric results of operations including the test-year actual, unadjusted data, the restating and pro forma adjustments developed by Staff and the adjusted results before and after the revenue requirement deficiency is applied. The last column of page 1 shows the increased revenues that will yield a net operating income and a fair return on rate base of 7.59 percent. Pages 2 through 5 show the individual adjustments in the same order as the Company's, using an identical numbering system for ease of comparison. Pages 6 through 38 contain each separate adjustment's separate calculation and the resulting net operating income and rate base impacts, as applicable.

Q. Are any adjustments on Exhibit No. __ (RCM-2) uncontested between Staff and PSE?

A. Yes. The following Company adjustments were reviewed by Staff and are uncontested:

- Adjustment 13.04, MT Electric Energy Tax
- Adjustment 13.06, ASC 815 (Prev. SFAS 133)
- Adjustment 14.01, Temperature Normalization
- Adjustment 14.02, Revenue & Expenses
- Adjustment 14.03, Pass-Through Revenue & Expense
- Adjustment 14.07, General Plant Depreciation
- Adjustment 14.08, Injuries & Damages
- Adjustment 14.09, Bad Debt
- Adjustment 14.12, Excise Tax & Filing Fee
- Adjustment 14.14, Interest on Customer Deposits
- Adjustment 14.16, Deferred Gains/Losses on Property Sales
- Adjustment 14.17, Property and Liability Insurance
- Adjustment 14.18, Pension Plan

Q. Are any adjustments on Exhibit No. __ (RCM-2) contested between Staff and PSE?

A. Yes. The following adjustments were reviewed by Staff and are contested, but only to reflect the rate of return recommended by Mr. Elgin:

- Adjustment 13.05, Wild Horse Solar
- Adjustment 13.08, Remove Tenaska
- Adjustment 13.09, Chelan Payments

In addition, the following adjustments are also contested, as discussed in the cited testimony of the responsible Staff member:

- Adjustment 13.02, Lower Snake River -- Exhibit No. __ (RTA-1T)
- Adjustment 13.03, LSR PPD Transmission Deposit -- Exhibit No.__(RCM-1T)
- Adjustment 13.01, Power Costs – Exhibit No. __ (APB-1T)
- Adjustment 13.07, Storm Damage – Exhibit No. __ (RTA-1T)
- Adjustment 13.10, Regulatory Assets and Liabilities -- Exhibit No.(RCM-1T)
- Adjustment 13.11, Production Adjustment – Exhibit No.__(RCM-1T)
- Adjustment 14.04, Federal Income Tax – Exhibit No.__(RCS-1T)
- Adjustment 14.05, Tax Benefit of Pro Forma Interest – Exhibit No.__(RCM-1T)
- Adjustment 14.06, Miscellaneous Operating Expense – Exhibit No.__(BAE-1T)
- Adjustment 14.10, Incentive Pay – Exhibit No.__(BAE-1T)
- Adjustment 14.11, Property Tax – Exhibit No.__(RTA-1T)
- Adjustment 14.13, Directors & Officers Insurance – Exhibit No.__(BAE-1T)
- Adjustment 14.15, Rate Case Expenses – Exhibit No.__(RTA-1T)
- Adjustment 14.19, Wage Increase – Exhibit No.__(BAE-1T)
- Adjustment 14.20, Investment Plan – Exhibit No.__(BAE-1T)
- Adjustment 14.21, Employee Insurance – Exhibit No.__(BAE-1T)

Q. Please describe Exhibit No.___(RCM-3), Calculation of Electric Revenue Requirement Deficiency.

A. This exhibit details the calculation of the electric revenue requirement deficiency supported by Staff. The exhibit first determines the net operating income requirement by multiplying the pro forma adjusted electric rate base by the Staff recommended overall rate of return detailed on page 2. The resulting amount deducts the pro forma adjusted net operating income to arrive at the net operating income deficiency. The conversion factor of 0.620749, shown on page 3, converts the net operating income deficiency to the total revenue requirement deficiency. Allocation of the share of large wholesale and firm resale customers results in the retail revenue requirement deficiency.

Q. Do Staff and Company agree on the conversion factor used to develop the electric revenue requirement deficiencies?

A. Yes.

Q. Please describe Exhibit No.__ (RCM-4),Comparison of PSE versus Staff Adjustments?

A. This exhibit compares the revenue requirement effects of all adjustments used to determine the respective revenue deficiencies proposed by the Company and Staff. This exhibit serves as a ready reference for identifying Company and Staff adjustments that are either uncontested or contested.

Q. Please describe Exhibit No.___(RCM-5), Power Cost Unit Rate.

A. This exhibit calculates the power cost rate that serves as the baseline for determining power costs variances subject to the sharing process in the Company's Power Cost Adjustment ("PCA") mechanism. Mr. Story provides a detailed discussion regarding the power cost unit rate beginning on page 58 of Exhibit No.___ (JHS-1T).

Staff Exhibit No.___ (RCM-5) shows the calculation of the PCA power cost unit rate using Staff's pro forma power costs as input data. Staff is not proposing a change to the mechanics of the power cost unit rate determination. The difference between Staff and Company power cost rates results from contested elements of power cost-related expenses and rate base. The power cost rate should be recalculated as part of the compliance filing, in accordance with the Commission's final order.

IV. ELECTRIC PRO FORMA AND RESTATING ADJUSMENTS

Q. Please list the ratemaking adjustments shown on Exhibit No. ___ (RCM-2) within your area of responsibility that are uncontested as between Staff and PSE.

A. I reviewed the following adjustments proposed by PSE and found them to be reasonable and appropriate for ratemaking purposes:

- Adjustment 13.06 – ASC 815(Prev. SFAS 133)
- Adjustment 14.01 – Temperature Normalization

- Adjustment 14.02 – Revenues and Expenses[1]
- Adjustment 14.03 – Pass-through Revenue and Expense
- Adjustment 14.09 – Bad Debts
- Adjustment 14.12 - Excise Tax & Filing Fee
- Adjustment 14.14 – Interest on Customer Deposits

Q. Please list the adjustments within your area of responsibility that you contest.

A. The following is a list of contested adjustments that I will explain later in my testimony:

- Adjustment 13.01 – Power Costs (Jackson Prairie Reclassification)
- Adjustment 13.03 – Lower Snake River Prepaid Transmission Deposit
- Adjustment 13.10 – Reg. Assets & Liabilities (Colstrip 1&2 Prepayment, Contract Major Maintenance, REC and Deferred LSR costs.)
- Adjustment 13.11 – Production Adjustment
- Adjustment 14.05 – Tax Benefit of Pro forma Interest
- Adjustment 14.22 – Working Capital

Q. Do you present any adjustments for which there is no Company counterpart?

A. Yes. Staff's proposes adjustments for renewable energy credits ("RECS") and deferred costs related to the Lower Snake River Wind Project ("LSR Phase 1") that are both added to the regulatory assets and liabilities listed in Adjustment 13.10. The

[1] I also reviewed and accept the Company's corresponding Adjustment 6.02– Revenues and Expenses for its gas results of operations.

Company has no corresponding adjustment in its direct case. I discuss the reasons supporting my adjustments for LSR Phase 1 later in this testimony.

1. Adjustment 13.01 – Power Costs (Jackson Prairie Reclassification)

Q. Turning to the first contested adjustment, are you responsible for the entirety of Staff Adjustment 13.01 – Power Costs?

A. No. I am responsible only for the Company-proposed Jackson Prairie Reclassification included in the adjustment. Mr. Alan P. Buckley is responsible for all remaining elements of the Staff power cost adjustment.

Q. Before you proceed, please explain page 6A of Exhibit No.___ (RCM-2).

A. This page serves the same purpose as PSE Exhibit No.__ (JHS-5), Page 5.01A. It provides a reconciliation of pro forma power costs proposed by the Company and Staff's pro forma power costs. It shows the power costs provided by PSE witness Mr. David Mills and the adjustments Staff recommends to arrive at Staff's pro forma expense levels.

Q. Please explain PSE's proposal for Jackson Prairie Reclassification.

A. As explained by Mr. Story on pages 14 and 15 of Exhibit No. ___(JHS-1T), the Company entered internal agreements to reserve excess Jackson Prairie storage for electric power generation. The rental costs were recorded in FERC Account 505 for power production operation and maintenance ("O&M") expense, which is classified as a fixed cost in the PCA. The Company proposes to reclassify the expense to fuel for power, which is a variable cost component of the PCA. The Company's reason for the proposed re-classification is to align its electric operations treatment with the gas operations treatment of the rental revenue, which is a variable cost in the Purchased Gas Adjustment mechanism ("PGA").

Q. Please explain the significance of reclassifying a power expense from a fixed cost to variable cost.

A. Under the PCA, the level of fixed power expense included in base rates does not vary until it is reset in the next general rate case, while variable expenses are used at their actual levels in the determination of the allowed versus actual variance that is subjected to the sharing provisions of the PCA. Since variable costs are allowed at their incurred levels, reclassifying the rental expense from fixed to variable cost enables PSE to true-up to actual the estimated amount in the power cost rate.

Q. Why does Staff oppose the Company's proposed reclassification of Jackson Prairie rental costs?

A. The Company's proposal should be rejected because there is neither a need nor a sound basis for the reclassification. Aligning the electric and gas treatments of the storage rental transaction is not a valid reason for the change because the PCA and PGA are not similar cost recovery mechanisms.

Moreover, rental expenses to reserve excess Jackson Prairie storage for electric power generation have all the hallmarks of a fixed cost. They are booked monthly as O&M expenses and remain at a constant level until revised pursuant to the provisions of the rental agreement. The rental expense is paid whether or not a gas powered electric generating plant is operating. Finally, PSE's rent will not vary regardless of the purpose for the storage service.

Q. Besides recommending denial of the proposed reclassification, does Staff have any additional recommendation regarding the rental expense?

A. Yes. In addition to recommending that the current classification of the rental expense remains a fixed cost, Staff recommends the test year level of rental costs should be adjusted to a pro forma level that is reflective of the current agreed rent.

Q. What is the amount of rental expense that was recorded during the test year?

A. The test year rental expense for calendar 2010 was $1,130,625.

Q. What is the amount of rental expense currently in effect?

A. Company witness Mr. Clay Riding states on line 3, page 5 of Exhibit No. ___(CR-T1) that the current monthly payment is $68,900. The annualized level at this monthly amount is $826,800 before application of the production factor.

Q. What is the amount of adjustment that Staff recommends?

A. Staff recommends that the test year recorded expense should be reduced by $303,825, the difference between the test year amount and the current annualized rental amount. This adjustment satisfies the definition of a pro forma adjustment because the reduction is known and measureable and not offset by other factors.

The effect of the lower expense is to increase net operating income by $197,486 before application of the production factor. This adjustment is reflected on page 6A of Exhibit No. __(RCM-2).

2. Adjustment 13.03 - LSR Prepaid Transmission Deposit

Q. Please discuss the next contested adjustment on your list.

A. Although Staff does not disagree with PSE's recommendation regarding this item, Staff listed it as contested adjustment only because Staff used the updated adjustment provided by PSE in response to Staff Data Request No. 197. The impacts of this updated adjustment, as shown on page 8 of Exhibit No. ___ (RCM-2), decrease net operating income $726,666 and increase rate base $110,846,093.

3. Adjustment 13.10 - Regulatory Assets and Liabilities

Q. Please discuss the next contested adjustment on your list.

A. The next contested adjustment is Adjustment 13.10- Regulatory Assets and Liabilities. There are several regulatory assets and liabilities included in this adjustment; some are acceptable and some are not. Staff does not contest the following items because they were addressed by the Commission in prior rate proceedings:

- Bonneville Exchange Power
- White River Plant Costs
- Proceeds from the Sale of White River Assets
- Deferred Federal Income Tax -White River Reg Asset
- Hopkins Ridge Prepaid Transmission
- Goldendale Fixed Cost Deferral
- Hopkins Ridge Mitigation Credit
- Westcoast Pipeline Capacity-FB Energy
- Mint Farm Deferral
- Wild Horse Expansion Deferral

Q. What components of Adjustment 13.10 are contested by Staff?

A. The following seven items listed on page 15 of Exhibit No.__(RCM-2) are contested by Staff:

- Lines 14 and 35, Colstrip 1&2 (WECO) Coal Contract Prepayment;
- Lines 17 and 38, Sumas November 2010 HGP Inspection;
- Lines 18 and 39, Freddy 1 July 2009 HGP Inspection;
- Lines 19 and 40, Goldendale May 2009 Combustion Inspection;
- Lines 20 and 41, Sumas November 2008 Combustion Inspection; and
- Lines 21 and 42, Mint Farm June 2010 Combustion Inspection.

I explain later in my testimony why the Company's proposals with respect to rate base and expense amounts associated with these items also should be rejected.

As noted earlier, there are two new added items with no Company counterpart, namely, Renewable Energy Credits and Lower Snake River Deferred Costs.

Q. Please discuss the first issue related to the Colstrip 1&2 (WECO) Coal Contract Prepayment.

A. The issue concerns the amortization period of the $5 million dedication fee that was paid to the coal supplier at the time the 2007 coal purchase and sale agreement ("CPSA") was executed between PSE, PPL Montana, LLC and Western Energy Company ("WECO"). The Company proposes to amortize this payment over nine years beginning January 2011 even though the coal contract period began one year earlier on January 1, 2010. PSE argues that the one year delay in amortization is appropriate because the nine year amortization period matches the benefit period of the lower coal cost.[2] The Company excluded 2010 because WECO, at that time, was also supplying coal to another buyer under another contract.

Q. Why does Staff disagree with the shorter amortization period?

A. The CPSA became effective in January 1, 2010. Coal deliveries started on that date and continue through December 31, 2019, the earliest contract termination date. This ten year period should be the basis for the amortization schedule because it is the life of the contract. Staff's proposed amortization period matches exactly the period of commitment by the parties to the agreement.

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[2] Exhibit No.___ (MLJ-1CT), page 12, lines 1-3.

The type of matching proposed by Staff is also consistent with the treatment of other amortizations approved by the Commission. For example, the approved Westcoast Pipeline Capacity regulatory deferrals in Dockets UE-082013 and UE-100503 (Adjustment 13.10, lines 31 and 32), amortize the regulatory liabilities over the lives of their respective underlying contracts. In the current case, PSE also used the 20 year contract life to amortize the Chelan PUD capacity reservation payment in Adjustment 13.09. There is no reason not to use a similar methodology for the Colstrip 1&2 (WECO) Coal Contract Prepayment.

Q. What are the impacts of Staff's adjustment related to this issue?

A. As shown on page 15 of Exhibit No. ___ (RCM-2), Staff's adjustment decreases electric rate base by $1,416,667 and increases operating expense by $500,000.

Q. Please continue with your next contested items under Adjustment 13.10.

A. All of the remaining regulatory assets on Lines 17 through 21 and the associated amortization expenses on Lines 38 through 42 relate to the costs of major maintenance of natural gas turbines under a long term service agreement ("LTSA") or a contract service agreement ("CSA").[3]

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[3] For major maintenance without contracts, PSE used the actual maintenance expense during the test year in the PCA as production O&M, which is classified as a fixed cost. Staff witness Alan Buckley addresses the ratemaking treatment of these fixed expenses in his testimony.

Q. Please describe the Company's proposal with respect to the major maintenance costs under a LTSA or CSA.

A. The Company includes in power costs the test year amortization expenses and average of monthly averages ("AMA") balances of unamortized deferred major maintenance costs under an LTSA or CSA. Under the Company's proposal, the pro forma amounts of return of and return on these contracts amounts equal the actual test year levels and will be classified as variable components of the PCA rate. On a prospective basis, the costs (amortization and return on the AMA balance) of new major maintenance events, as regulatory assets, will be added in the period that they occurred and will be amortized until the next major maintenance.

Q. Does Staff consider PSE's proposal consistent with the "deferral method" the Commission approved in principle in the 2009 general rate case?

A. Yes, in part. Staff considers the portion which defers and amortizes major maintenance costs under an LTSA or CSA as consistent with the deferral method the Commission accepted in principle in the last general rate case:

> All parties advocate that major plant maintenance should be handled using the "deferral method" though it appears the parties may have some different ideas about what this means in practice. While we accept in principle the use of the deferral methodology for major plant maintenance expenses, we have no need to decide its finer points here. This undoubtedly will be brought before the Commission in some future proceeding when such costs are incurred and it will then be ripe for decision.[4]

This deferral methodology, adopted by PSE under FASB Staff Position No. AUG AIR-1, spreads the expense of major maintenance over the maintenance interval or

[4] *WUTC v. Puget Sound Energy, Inc.,* Dockets UE-090704 and UG-090705, Order 11, ¶ 163 (April 2, 2010).

until the next major maintenance occurs, effectively normalizing the major expense impact.

Q. What parts of the Company proposal do you contest?

A. Staff objects to the Company's proposal to make an exception to the ratemaking treatment of production-related regulatory assets and liabilities that are recovered through the PCA. As explained by Mr. Story on page 34 of Exhibit No. (JHS-1T), the Company includes the test year amortization expense and AMA balances of the costs of major maintenance under LTSA or CSA. Including the expenses and balances of the deferred major maintenance costs at test year levels departs from the treatment and calculation as agreed in the PCA settlement approved by the Commission.

Q. What is the approved treatment and procedure related to regulatory assets and liabilities for ratemaking purposes under the PCA?

A. The amortization expenses and balances of regulatory assets and liabilities are adjusted to their rate year amortization amounts and AMA balances, and then production factored back consistent with the treatment of other power cost-related expenses and rate base.[5]

[5] *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-011570 and UG-011571, Twelfth Supplemental Order Appendix-Exhibit A to Settlement Stipulation at 4 (Settlement Terms For The Power Cost Adjustment Mechanism (PCA) (June 20, 2002).

Q. What is the appropriate treatment of the expense and rate base levels associated with costs of major maintenance under an LTSA or CSA?

A. They should be treated like all other power costs and production-related rate base items, *i.e.*, the rate year expenses and balances should be used for ratemaking purposes.

Q. What is the impact on the results of operations if these items are appropriately treated as you recommend?

A. The impacts, before production factoring, reduce rate base by $1,595,416 and decrease operating expense by $1,062,520. These compare with the Company's zero adjustment in both regards.

Q. Are there any other aspects of the Company's adjustment regarding the costs of major maintenance of natural gas turbines?

A. Yes. Staff objects to the proposal that new major maintenance items should be added as regulatory assets once completed. This implies that PSE has a blanket authority to add regulatory assets with variable treatment under the PCA. Staff believes that acceptance in principle of the deferral methodology does not mean automatic designation as regulatory asset of the in-between-rate case deferred costs of major maintenance under a LTSA or CSA. Like any other regulatory assets and liabilities, they should be first presented for consideration and approval by the Commission to be designated as such in a general rate case or similar proceeding. Outside of a rate case, the deferral methodology pursuant to FASB guidelines should continue to apply. The Company should continue to spread the costs of completed major maintenance under LTSA and CSA until the next maintenance occurs. Staff considers this as a finer point that needs to be clarified in this proceeding.

4. LSR Deferred Costs

Q. You stated earlier in your testimony that you propose two adjustments for which there are no Company counterparts. Please discuss the first adjustment related to LSR Deferred Costs.

A. The purpose of the Staff adjustment is to include the estimated rate year amortization expense and net rate base amount for deferred costs associated with PSE's Lower Snake River wind electric generation project. The costs of the project from the in-service date to the date rates become effective in this rate case are deferred under RCW 80.80.060(6), which allows cost deferral for renewable resources like LSR. LSR Phase 1 is expected to begin commercial operation in mid- February 2012 which, therefore, is the date costs will begin to be deferred.[6]

Q. Why does Staff recommend this adjustment in this proceeding?

A. Staff includes the estimated deferred costs of LSR Phase 1 to avoid further build-up of a regulatory asset than if the deferral occurs over the twenty-four month period otherwise allowed by RCW 80.80.060(6). The current general rate case proceeding provides the earliest opportunity for Commission consideration of the deferrals.

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[6] PSE Response to Staff Data Request 156

Staff calculated its adjustment based on estimates provided in PSE's Response to Staff Data Request 197. To the extent actual costs become available during this proceeding, they should be used by PSE in its compliance filing.

Q. What is the appropriate amortization period for the LSR project deferred costs?

A. Staff recommends a reasonable amortization period of four years from the date the rates in this docket become effective.

Q. Does Staff dispute any aspect of the estimated amounts used in the LSR adjustment provided by the Company?

A. Yes. Staff excluded the estimated property tax amount consistent with the proposed treatment of Staff witness Rick Applegate, as explained in his testimony regarding Adjustment 13.02-Lower Snake River and Adjustment 14.11- Property Tax.

Q. What are the impacts of Staff's LSR Deferred Costs adjustment?

A. The LSR adjustment increases electric operating expense by $5,616,072 and increases electric rate base by $12,682,422. These are shown on lines 23 and 44 of Adjustment 13.10.

5. Renewable Energy Credits "RECS" Adjustment

Q. Please discuss the next Staff proposed adjustment that has no Company counterpart.

A. Staff includes in this proceeding the estimated RECs available after the REC/Production Tax Credit offset pursuant to the Commission's Order in Docket No. UE-070725. Since it is unknown at this point if more REC sales will be generated after the REC/PTC offset, which is expected to occur at the end of 2011, Staff used only the estimated residual of realized RECs based on the latest compliance report filed with the Commission on November 30, 2011. Including the RECs now is consistent with the Commission's goal of providing additional benefits to the ratepayers.[7]

Mr. Story has not included any RECs as a regulatory liability, but stated that PSE will include the known and measurable AMA balance in electric rate base during the course of this proceeding as the REC amount becomes more certain.[8]

Q. What are the impacts of Staff's REC adjustment?

A. The REC adjustment decreases electric operating expense by $946,294 and decreases electric rate base by $2,767,909. These amounts are shown in lines 22 and 43 of Adjustment 13.10.

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[7] *In the Matter of the Amended Petition of Puget Sound Energy, Inc.,* Docket No. UE-070725, Order 6 (October 26, 2010) and *In the Matter of the Petition of Puget Sound Energy, Inc.* Docket No. UE-101581, *et al.*, Order 1, (October 26, 2010).
[8] Exhibit No. ___ (JHS-1T), page 37, lines 15-17.

6. Adjustment 13.11 – Production Adjustment

Q. Please discuss the Production Adjustment and describe the purpose of the adjustment.

A. This adjustment reflects the application of a production factor to complete the pro forming of production costs from the forward looking "rate year" level (May 2012 to April 2013) back to the calendar year historic "test year" amount. The adjustment is a necessary component when pro forma major production plant additions from outside the test year are included in rate base and the results of operations. The production property adjustment allows the matching of the relationship between future sales (measured by increased system load) to the production rate base.

The production factor is the ratio of test-period loads and the pro forma rate year loads. In determining net power costs, rate year levels of consumption are used. Likewise, the adjustment considers the associated power costs for the future rate year. Central to the adjustment is the assumption that the future rate year will have different levels of consumption than the normalized historic test period. The production factor is derived by taking future loads over test year normalized loads. The resulting production factor is then applied to the rate year production costs bringing the pro formed rate year costs, on a unit basis, back to the historic test year for proper matching and comparability of all costs used in the revenue requirement determination.

Production costs that are subject to the production factor are dependent on other power-related ratemaking adjustments. This adjustment is a fallout adjustment that is dependent on rate year power costs and related expenses and production rate base levels, which may be different from the final cost inputs determined by the Commission. Therefore, if power supply costs are recomputed, as with any other production associated adjustments, the production adjustment must also be recomputed.

Q. What is the impact of Staff's Production Adjustment?

A. Staff's proposed adjustment increases net operating income by $2,224,593 while reducing rate base by $49,421,747.

7. Adjustment 14.05 – Tax Benefit of Pro forma Interest

Q. Please describe Adjustment 14.05, Tax Benefit of Pro forma Interest

A. This adjustment, often referred to as "interest synchronization" or the "pro forma interest adjustment", adjusts the book interest expense to the amount reflected by the application of the weighted cost of debt to the pro forma rate base. The purpose of this adjustment is to synchronize the effect of interest expense on the computation of income taxes used for setting rates to rate base. The weighted cost of debt is applied to rate base to derive a pro forma interest expense. The derived amount is then used as a component in the computation of the regulatory income tax.

Q. Please describe the effect of your proposed pro forma interest adjustment and the difference between the Staff and Company's proposals.

A. As shown on page 21 of Exhibit no. ___ (RCM-2), Staff's adjustment increases electric net operating income by $54,026,842. The Company's adjustment on page 3 of Exhibit No. ___ (JHS-12) increases electric net operating income by $55,619,944. The difference between Staff and Company proposals is due solely to differences between Staff and PSE in the weighted cost of debt and electric rate base.

8. Adjustment 14.22 - Working Capital.

Q. Please explain the last contested adjustment in your list, Adjustment 14.22- Working Capital.

A. This adjustment reflects the difference between Staff and the Company in the level of allowance for investor supplied working capital that is added as an element of rate base. As shown under the column labeled "Actual Results of Operations", page 1 of Exhibit No. ___ (RCM-2), PSE has added an allowance for working capital of $204,952,589 to its electric rate base. Staff recommends two adjustments to this amount which Staff considers appropriate.

Q. Please describe the two adjustments to working capital recommended by Staff.

A. The first adjustment corrects a misclassification of two special deposit accounts. The correction is based on a Company response to Staff Data Request 91, so this item should not be contested. The second adjustment implements a recommendation by Mr. Smith related to federal income tax.

Both adjustments are portrayed in Staff's working capital Exhibit No. ___ (RCM-6).

Q. Please discuss Exhibit No. __ (RCM-6).

A. This exhibit shows a comparison of investor supplied working capital, as calculated by Staff and by the Company. The column labeled "Per Exh. JHS/MJS-3 PAGE 3.04" reflects the Company's calculation, while the column labeled "REVISED TOTAL AS ADJUSTED BY STAFF" shows the Staff's calculation, which incorporates the two adjustments under the column labeled "STAFF ADJUSTMENT AMA", also described in Footnotes 1 and 2 in the exhibit.

Q. What is the impact of the Staff adjustments?

A. With the adjustments, the electric working capital is reduced by $34,987,817. This is also reflected on page 39 of Exhibit No. __ (RCM-2).

9. Portrayal of Mr. Smith's Recommendations Related to Federal Income Tax

Q. Please describe how the recommended adjustments proposed by Mr. Smith are depicted in Staff's Electric Results of Operations.

A. Mr. Smith's recommendation to reduce electric rate base by $41,414,322 due to a change in tax accounting involving repairs and retirements deductions is shown as a rate base deduction in Adjustment 14.04-Federal Income Tax on page 20 of Exhibit No. __ (RCM-2). His recommendation to exclude a debit balance of approximately

$47.3 million for accrued federal income taxes payable is accounted for in Staff's working capital Exhibit No. ___ (RCM-6). For presentation purposes, Mr. Smith's recommendation to zero out current federal income tax expense is presented under a separate column on page 1 in Staff's Results of Operations Exhibit No.__ (RCM-2).

Q. Does this conclude your testimony?

A. Yes, it does.