EXHIBIT NO. EMM-5T
DOCKET NOS. UE-090704/UG-090705
2009 PSE GENERAL RATE CASE
WITNESS: ERIC M. MARKELL

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-090704** **Docket No. UG-090705**

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
ERIC M. MARKELL
ON BEHALF OF PUGET SOUND ENERGY, INC.

DECEMBER 17, 2009

PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

Q. Are you the same Eric M. Markell who provided prefiled direct testimony in this proceeding on May 8, 2009, on behalf of Puget Sound Energy, Inc. ("PSE" or "the Company")?

A. Yes. On May 8, 2009, I filed direct testimony, Exhibit No. EMM-1T, and three exhibits supporting such direct testimony, Exhibit No. EMM-2 through Exhibit No. EMM-4.

Q. Please summarize the purpose of your rebuttal testimony.

A. My testimony responds generally to the testimony submitted by the other parties to this case and presents an overview of PSE's rebuttal filing.

Q. What is PSE's reaction to the response testimonies submitted by the other parties?

A. PSE obviously disagrees with much of the response testimony and will offer specific reactions and counterpoints to the other parties' detailed adjustments and proposals.

Q. Could you describe PSE's reaction to the response testimony of Commission

Staff?

A. PSE finds in the testimony of Commission Staff, some common ground with respect to PSE's proposals that are agreeable as to the methodology proposed, but not numbers. Some of these generally agreeable items include major plant maintenance, federal tax issues, property and liability insurance and truing up rate base items to provide consistency of treatment for similar items in gas and electric. We also agree with adjustments to property insurance and certain wage adjustments when all known and measurable increases are included in the calculation. We also are close to agreement with respect to certain non-recurring Colstrip Generating Facility costs, but we offer an alternative amortization schedule for such costs to further reduce annual revenue requirements. Curiously, we find various Commission Staff witnesses seem to take inconsistent and opposing views on the treatment of similar forward-looking cost adjustment items. And, with respect to certain other Commission Staff positions that advocate the elimination of certain forward looking cost adjustments, we strenuously oppose such proposals because they advocate the overturning of long held Commission precedent and shift even greater financial risks to the Company. If adopted, such Commission Staff proposals would lead to a severe under-recovery of PSE's cost of service and worsen the already serious under-earning position of the Company. Mr. Story elaborates on the matter of forward-looking adjustments in his rebuttal testimony.

Finally, the proposed rate of return and capital structure of Commission Staff are unacceptable and unsupported. Mr. Gaines and Dr. Morin offer additional testimony and evidence in this regard.

Q. Does PSE have a general reaction to the response testimony of Public Counsel?

A. Public Counsel endorses positions that will not allow for the establishment of fair, just, reasonable and sufficient rates. As is the case with certain Commission Staff proposals, Public Counsel's proposed adjustments with respect to rate year operating costs stand long-held Commission precedent on its head. They are, in fact, a disservice to the energies of so many Company employees attempting to construct, maintain and manage a complex gas and electric system to reliably and cost effectively serve customers over the long term. Some of these proposals attempt to shift current costs of consuming energy to future generations of customers and to the providers of the capital who invest in the business.

Q. How is the Company attempting to balance its significant investment requirements and system maintenance needs with the challenges its customers are facing in the regional economy?

A. PSE is keenly aware of the economic challenges currently faced by its customers. Indeed, the Company works diligently to manage its changing cost structure for the long term and has provided ample evidence of those activities in this proceeding. Furthermore, the Company has been a leader in advocating for an increase in low-income bill assistance (Docket Nos. UE-072300 and UE-072301) and weatherization programs (Docket Nos. UE-072235, UG-072236, UE-091859 and UG-091860) for its least fortunate customers. Through its foundation grant activities and the generosity of its employees, the Company supports dozens of social service and community organizations aimed at improving the welfare of the communities we serve. We take pride in our leadership position in these activities and believe it is fundamental to the obligation we have as a regulated public service entity.

Q. Does the Company have a reaction to the positions of Commission Staff and Public Counsel with respect to their advocacy for new and more restrictive interpretations of forward looking cost adjustments?

A. Yes. The Company does recognize that the regulatory process is inherently a litigious process. Nevertheless, it is especially surprising that Commission Staff, who is obligated to balance the goals of supporting strong, stable utility industries with consumer protection measures, seems to disregard the fundamental forces that are imposing rapid and significant transformation upon the Company. The compliance environment, the physical transformation of the Company's asset base and expanding geographic footprint and its related financial and accounting characteristics are changing rapidly. The investment and operational cost demands facing the Company are significant and cannot be wished away, as Public Counsels' witnesses do, with vague illusions to technologically induced operational efficiencies. New federal regulatory requirements, the replacement of aging poles with new poles and old cast iron pipe with new plastic pipe, bring no efficiencies, no new customers and no new revenue, but such requirements and investments do bring increased costs that must be spread among current customers. Both Commission Staff and Public Counsel participate in and monitor the Company's Conservation Resource Advisory Group and Integrated Resource Plan processes, and accordingly, notwithstanding the implications of their testimony in this proceeding, are well aware of the need to recover the increased costs incurred by the Company.

Q. Is the magnitude of investment in the distribution system that Mr. Valdman describes commensurate with the depreciation cash flow in rates from the existing distribution system?

A. Not at all. Our present rate of annual investment in the distribution system and related capital facilities approximates $500 million per year. The annual depreciation related cash flow from the transmission and distribution system currently approximates $163 million per year and will approximate $170 million annually with the Company's rate request. Thus, the Company is investing approximately three times its internal cash flow to improve its distribution system and related facilities.

Q. Are the incremental depreciation, operating and carrying costs of such investments recovered from increased unit sales and margins?

A. No, they are not. Such investments are a key determinant of the under recovery of operating expense and the associated under earnings shown in Exhibit No. EMM-

6C, which is an updated calculation of the Company's regulated return on equity, authorized return on equity and resulting under earnings from year-end 2002 through the 12 months ended September 30, 2009. Something must give; either the rate of such investment must be reduced or rates increased frequently and sufficiently to provide adequately for the level of investment.

Q. Do you believe that the investment and expenditure activity for which the Company seeks rate relief in the case is consistent with state and national goals with respect to safe reliable gas and electric service?

A. I do. PSE believes that its customers—and the State of Washington—will be best served if all those who participate in the regulatory process find the vision to look beyond modest short-term rate impacts. It seems to me the public service obligation of all the parties to a proceeding like this is to work more effectively together to support the evolution of a vibrant, modern utility organization capable of addressing the ever increasing requirements placed on it by governmental policy and the energy service needs of the communities served. One must wonder if the efforts to recover the bona fide costs required to maintain a safe and reliable distribution and support system, plus obtain clean energy supplies, is constantly greeted with such antagonism by the Parties, how will compliance costs with emerging carbon policy be met? How might the costs to support a greater electrification of the transportation system be received? The Company constantly hears federal and state policy makers and energy policy activists call for a more technologically modern and responsive utility, but such an organization can only be built through the robust support of the state regulatory process.

Q. What is the response of the parties to PSE's investments to expand and rebuild its energy delivery system and supply portfolio?

A. In this proceeding some of the Commission Staff support the new energy resources that have been added to our supply portfolio. However, other parties, including some members of Commission Staff, offer no acknowledgement of the long-term customer benefits that will flow from the Company's investment and operating activities to expand the delivery system or to comply with ever more exacting legal requirements that are meant to ensure system security and reliability.

Q. Does Commission Staff challenge the prudence of any resource acquisitions?

A. No. Commission Staff supports the Company's acquisition of the new resources presented for the Commission's approval in this case. Commission Staff determined that the Company acted prudently in its decision to acquire these resources and properly documented its decision-making process. However, Commission Staff proposes removing the pro forma costs associated with purchasing Fredonia, instead substituting the test year lease cost for this facility. Additionally, they do not allow $8 million in capital additions to the Wild Horse Expansion facility even though these known and measurable costs are in service as of November 9, 2009. Finally, they remove other costs associated with new resources that have historically been allowed by the Commission.

Q. Do you agree with Public Counsel's testimony challenging the prudence of PSE's newly acquired resources?

A. No. As discussed in Mr. Roger Garratt's and Ms. Kimberly Harris's rebuttal testimony, proposals such as those offered by Public Counsel to deny in rates operating costs of the Mint Farm Generating Station which PSE acquired at a discount from both its original and replacement costs, should be rejected by the Commission. Public Counsel’s lose-lose proposal of disallowing the equity cost associated with Mint Farm but then proposing that the Company be forced to provide the output of this prudently acquired and cost effective plant to customers constitutes an affront to even-handed regulatory policy. As the Commission is aware, plant additions are lumpy and seldom are the early-year costs cheaper than short term alternatives. The life of the plant has to be used to determine the benefit to customers, not its first year of operations. Commission Staff has done its prudence review and does not question the timing or the methodology used to evaluate this plant.

Q. Could you comment on the matter of the frequency of regulatory filings?

A. Yes. Public Counsel has made an issue of the frequency of Company rate filings since 2002 although little attention is given by Public Counsel to the two 2009 gas rate decreases filed by the Company, nor the pending accounting petition to significantly moderate electric rates over the next several years. As demonstrated in PSE’s 2009 Integrated Resource Plan (Docket Nos. UE-080949 and UG-

080948), the Company is engaged in a multi-year restructuring of its electric supply portfolio involving numerous supply contracts and large assets and their related operating expenses. As Mr. Valdman has described in his prefiled direct testimony in this case, the Company is also engaged in a very significant investment program in its distribution system to meet customer, state and federal compliance requirements. All these activities come with greater costs not offset with "efficiencies" hypothesized by Commission Staff Witness Parvinen or Public Counsel Witness Dittmer. Consequently, PSE is in the midst of a series of regulatory filings that will be required to recover its actual costs and a fair and reasonable return on invested capital. These filings are likely to continue for several more years, although it is hoped that the rate of cost increase will be moderate. This work must be done and its associated costs recovered in rates. PSE has been plain spoken about its future need to rely heavily on the regulatory process to support these efforts. PSE has also shouldered the financial burden of financing these investments by stepping up to make the commitment to safe and reliable service with the expectation of even-handed regulatory treatment.

II. REVISED REQUEST FOR RELIEF

Q. Has the financial relief that is being requested by PSE changed since its initial filing of this case on May 8, 2009?

A. Yes. In September 2009, PSE made a supplemental filing in this case to update the amount of the gas and electric revenue increases it is requesting. The supplemental filing incorporated more current information about PSE's anticipated rate year (year ending March 2011) costs than the information that was available to the Company when it prepared its filing of May 8, 2009. That supplemental filing increased PSE's original request for an annual increase in electric retail revenues to approximately $153.6 million from approximately $148.1 million. A supplemental filing also increased PSE's original request for an annual increase in gas retail revenues million to approximately $30.2 million. from approximately $27.0

Q. Is PSE's request for relief in this rebuttal case the same as its request for relief in the September 2009 supplemental filing?

A. No. Although PSE does not agree with many of the positions set forth in the other parties' testimonies, the Company has accepted some of their revenue requirement adjustments in whole or in part. PSE is also proposing some additional updates and corrections based on information that has become available since it prepared its filings of May 2009 and September 2009

The net result of such adjustments is a reduction to approximately $113.3 million in PSE's request for an increase in electric retail revenues. If approved, this adjustment would represent an average 5.66% electric rate increase. PSE's rebuttal case also adjusts downward its gas revenue requirement by approximately $1.9 million to $28.3 million. This would represent an average 2.3% gas rate increase.

III. OVERVIEW OF PSE'S REBUTTAL TO VARIOUS SPECIFIC OBJECTIONS RAISED BY OTHER PARTIES

A. Financial Structure and Rate of Return

Q. What is PSE's response to the other parties' recommendations regarding capital structure and return on equity?

A. PSE's direct filing explained that the approved equity ratio in the Company's capital structure and its authorized return on this equity need to be raised to modestly higher levels to support the Company's financial recovery and its ability to meet the long-term interests of its customers. The requested financial relief will support PSE's investment in its distribution system, new power plants, and the cost of its growing maintenance and compliance activities. PSE proposes a weighted average cost of capital of 8.50%, comprised of an authorized return on equity of 10.80% on a capital structure that includes 48% equity. This equity ratio is below the 48.85% on which rates were set, on average, across the country in recent proceedings. The weighted equity return of 5.18% (e.g. 10.8% ROE multiplied by 48% equity ratio) is consistent with the average on which rates have been recently set of 5.07%. *See* Exhibit No. DEG-13. I also note the Company's requested 10.80% return on equity is very close to the 10.74% average authorized equity return from other jurisdictions included in materials relied upon by Commission Staff. *See* Exhibit No. DEG-11T, at page 16.

No party disputes PSE's need to replace aging components of the Company's electric and gas delivery systems, maintain a reliable and adequate energy supply by acquiring new electric generation resources and/or entering into risk management transactions to mitigate energy price volatility. Yet, Commission Staff and Public Counsel make proposals that would weaken the cash flow of PSE, erode its current credit metrics, compromise its risk management capabilities and compromise the financial condition of the Company.

Q. Would you please explain?

A. Commission Staff and Public Counsel propose that the Commission authorize much lower returns on equity than exist today or that PSE requests in this proceeding. They also propose equity ratios that are less than what actually exists – the very equity structure that supports the current credit standing and interest costs deployed to make the investments that provide the benefits customers already enjoy. At the same time, Commission Staff proposes to make shareholders assume significant new power cost risks by a proposal to filter hydro data and by eliminating known, measurable and reasonable forward-looking adjustments to test year operating costs. These include the increased operating costs known to be required in connection with the same resources Commission Staff finds to be prudently obtained by the Company.

Commission Staff and Public Counsel's proposed ratemaking would worsen the already significant under-earnings situation borne by the Company and would allow customers to utilize the benefits of the investments and operating expenditures without paying the costs of such investments.

The prefiled rebuttal testimonies of Mr. Donald Gaines, Dr. Roger Morin, Mr. Bertram Valdman and Mr. David Mills address these points in greater detail.

B. Cost Management/Deferred Investment and Expenses

Q. Has PSE acted responsibly to mitigate the cost pressures it faces?

A. Yes, it has. Despite the impression that the testimony of Public Counsel and Commission Staff may create in the record, PSE continually focuses on cost management. Many of these activities are described in response to Public Counsel Data Request No. 434, Exhibit No. JRD-8. As Mr. Valdman states in his prefiled direct and rebuttal testimony, PSE remains one of the lowest cost providers among investor-owned combined electric and gas utilities in the United States. *See* Exhibit No. BAV-3.

. Q. Please describe PSE's approach to cost management and cost control.

A. In addition to those cost control actions described in Exhibit No. JRD-8, PSE takes the long-term view with respect to overall cost management. Cost management over the long term is a key tenet of our long-term cost control strategy. For example, as Ms. Harris and Mr. Garratt describe in their prefiled direct testimony, PSE has been diligent in its commercial approach to acquiring new supply resources. PSE’s reputation for leadership in the systematic analysis of potential resource options, the acquisition of renewable energy and in implementing cost-effective energy efficiency measures is well established. PSE believes that it has demonstrated exceptional commercial skill with first-mover strategy and opportunistic resource acquisitions. Although it is not the topic of this proceeding, PSE has taken well-publicized steps to create options for its customers with respect to the potential development of a significant portion of the renewable resources it will require. Such control rights and optionality are valuable levers to help manage future renewable power costs.

Q. Has the Company taken any extraordinary measures to reduce its cost of service?

A. Yes it has. The Company has been at the forefront in the region of procuring its legally required renewable resources. The Company's procedures and methods to acquire such resources will enable it to have significant influence over the ultimate cost of such resources as the region and nation demand more and more renewable resources be acquired in ever-shorter time frames.

Q. Has the Company taken steps to monitor and participate in the emerging marketplace for renewable energy credits ("RECs")?

A. Yes, it has. The Company is keenly focused on maximizing the value of its renewable energy assets for its customers and has taken commercial steps to optimize the market value of its related surplus renewable energy credits. The significant amount of cash provided by the sale of such credits will serve to lower its cost of service for customers over the next several years.

Q. In what Commission proceeding is the disposition of such renewable energy credit proceeds being addressed?

A. The disposition of the proceeds related to the prospective sale of renewable energy credits will be addressed by the Commission in Docket No. UE-070725. A hearing has been set for March 2010. The Commission should reject requests by Public Counsel to address the disposition of REC proceeds in this proceeding.

Q. Has the Company taken any other steps to reduce costs through the sale of the intangible value of its portfolio of assets?

A. Yes, it has. The Company is also engaged in monitoring the slow emergence of a marketplace for the transacting of carbon attributes. Our neighbors in California are leading the development in the region of these markets. Although the Company's resources in carbon intangible assets is much smaller than its REC asset base, it has sold and continues to monitor the market for opportunities to sell its unneeded carbon financial instrument (CFIs") assets. Disposition of such proceeds will also be addressed in Docket No. UE-070725.

As importantly, the Company's activities in these commercial markets may also provide PSE important competitive advantages and future cost reduction opportunities as the framework of regional and national carbon reduction policies emerge. If carbon reduction policies require industries of all kinds to deploy and utilize renewable resources (or acquire their related carbon offsets) well beyond those levels now required by state and federal renewable portfolio standards ("RPS"), new markets will emerge.

Q. **Does the Company agree with Public Counsel's proposal that PSE "cut costs and defer activities that do not have longer term safety implications" (Dittmer at page 30, lines 19-22)?**

A. Safety is but one criterion for the Company's investment and operating activities. Obviously, the Company must operate a safe system. However, as Mr. Valdman describes in his prefiled direct and rebuttal testimony, the Company has many drivers it must contend with when making such decisions. We believe we have struck the right balance between long-term needs and short-term expediencies. Deferral of investment and maintenance usually results in greater long-term cost and may well result in compliance challenges and poorer service quality. As custodians for the region's critical infrastructure, we take the prudent, long view and reject arguments that advocate for the temporarily convenient actions of deferred investment and deferred system maintenance. It gives the Company no measure of satisfaction to seek price increases in a no growth and challenging economic climate. It is the less responsible course to postpone to someone else's watch those activities that should be accomplished and funded now. Postponement of action with respect to the region's critical infrastructure is not responsible public policy, but rather a formula for future problems. Further, it could potentially subject the Company to significant penalties for non-compliance with NERC mandatory reliability standards given FERC's expanded enforcement authority.

C. Historic Financial Returns/Underearning

Q. Could you summarize the likely effect on PSE's financial position of the other parties' proposals?

A. Taken as a whole, the positions advocated by the other parties, if adopted, would not allow PSE to recover the actual costs incurred to provide service to its customers or to have a reasonable opportunity to earn a fair return for its shareholders. In the filings of other parties, PSE finds no recognition of the fact that the Company continues to under-earn its authorized return, not merely by small amounts that one might reasonably expect, but by very large amounts, and not only from time to time, but regularly. As shown in Exhibit No. EMM-6C, from 2003 through 2009, the Company has continually under-earned its return on equity during this period. Such unrecovered costs to render service are not sustainable.

Exhibit No. EMM-7C summarizes a forecast of the Company's rate year return on regulated equity, authorized return on equity, and resulting under earnings. Such exhibit demonstrates that the Company is projected to earn only 6.0% on equity even if the level of rebuttal revenues requested by the Company are granted. Indeed, adoption of either Public Counsel's or Commission Staff's recommended rates significantly exacerbates PSE's already sizable and perpetual under-earnings. Commission Staff's recommendation, if pro formed into the Company's projected rate year financial results, would further reduce PSE's forecasted earned return on equity by approximately 190 basis points, and Public Counsel's recommendation would reduce PSE's forecasted earned return on equity by more than 250 basis points. Please see Exhibit No. EMM-7C for a calculation of these likely effects.

Commission Staff and Public Counsel also propose to reduce the current level of authorized return on capital well below the levels recently approved by utility commissions around the country and thus, the potential return PSE can earn. *See* Exhibit No. DEG-11, at page 16, lines 5 to 7. Dr. Morin discusses why these proposals are inappropriate. Mr. Donald Gaines explains in his rebuttal testimony how acceptance of these proposals in concert with others being made in this proceeding that shift additional risk to PSE could compromise the progress the Company has made to improve its creditworthiness.

D. <u>Known and Measurable Adjustments: Principles and Practice</u>

Q. What is the Company's reaction to the proposals of Commission Staff and Public Counsel with respect to changes to pro forma cost adjustments?

A. The Company believes such proposals are contrary to long established Commission precedent on these issues, and in some cases, contrary to Commission Staff's own testimony in prior cases.

Q. Please elaborate.

A. For example, Commission Staff witness Kathryn Breda proposes to remove from rate year revenue requirements the costs of the Fredonia generating plant coming on line prior to the rate year. Instead of using the ownership costs associated with this plant, Ms. Breda includes the test year pre-ownership lease payments for this machine. Although the difference between the Company's adjustment and Commission Staff's adjustment are relatively small in revenue requirement, the principles behind the calculations are far apart and very troubling. Contrary to Ms. Breda's testimony and proposals, Commission Staff witness Mr. Parvinen has previously recognized the need to make reasonable estimates of such costs to be incurred during a rate year, and accordingly, to make pro forma adjustments. Mr. Parvinen's cross-answering testimony in Docket No. UE-072300 is on point in this regard and is included in this proceeding as Exhibit No. JHS-21 for ease of reference. Mr. Parvinen's cited testimony in that docket refutes proposals of Commission Staff witnesses Mr. Parvinen, Ms. Breda and Public Counsel witness Mr. Dittmer, all of whom seek in this case to overturn Commission precedent with respect to such reasonable pro forming adjustments. Beginning on page 2 of Mr. Parvinen's referenced testimony in Docket No. UE-072300 *et al.*, he describes the Commission's practice of allowing specific pro forma rate base adjustments to reflect the addition of resource acquisition to the Company's resource supply portfolio. Commission precedent and practice in this regard should be respected and continued.

Q. Does Mr. Parvinen address the question of "offsetting factors" when advocating in this case for a new and narrow reading of allowable pro forma cost adjustments?

A. Yes, he does. Mr. Parvinen advocates judging operating decisions and cost matters, "when the whole picture, i.e. the company's entire operations, are reviewed."

Q. What is your reaction to that view?

A. I say exactly so. The Company's "whole picture" to use Mr. Parvinen's phrase is best assessed by its overall regulated operating results. Those results are dramatically portrayed in Exhibits Nos. EMM-6C and EMM-7C. The first schedule provides the historical operating results of the Company. The latter schedule depicts the operating results that PSE estimates it would produce in the rate year under Commission Staff and Public Counsel's proposed revenue requirements.

Q. Could you summarize those results?

A. As stated above, Exhibit No. EMM-6C shows that since 2003, the Company has continually under-earned its authorized return on equity. For the period from 2003 through 2009, the Company expects to have under-earned by more than $275 million. As shown in Exhibit No. EMM-7C, the Company forecasts it will under-earn in the rate year by approximately 4.80% or over $125 million including the impact of the reduced gas and electric revenue requirement set forth in the Company's rebuttal testimony. The continued and significant under-earnings forecasted by the Company, even if the Company's rebuttal revenue requirements are accepted by the Commission, clearly underscores the commitment the Company has made to its customers and communities. However, such level of commitment is not financially sustainable without reasonable regulatory support.

To be clear, the Commission Staff's proposed revenue requirement, if adopted, would push the Company's under-earnings in the rate year to almost 700 basis points and provide the Company a paltry 3.3% ROE, a return well below even "risk free" ten-year U.S. Treasury bill rates. Public Counsel's proposed revenue requirement would reduce the forecasted earned ROE during the rate year to only 2.18%.

As discussed in Mr. Gaines' rebuttal testimony, Staff and PC's proposed revenue requirements would weaken the Company's credit ratios. *See* Exhibit DEG-11HCT. Furthermore, a rate increase such as that recommended by Commission Staff or Public Counsel is designed to further increase the Company's exposure to under recovery of its actual costs. These proposed actions place in doubt the level of regulatory support for the Company's endeavors to maintain and operate a safe and reliable transmission and distribution system plus provide a reliable and adequate energy supply.

Q. Does Mr. Parvinen address the matter of regulatory lag?

A. Indeed, he does. Mr. Parvinen asserts that regulatory lag can be dismissed because in his words, "there is inherently a return on, or offset to, such expenditure immediately upon its being placed in service whether it is an efficiency improvement leading to reduced maintenance expense, fewer outages (reliability), growth in customers (revenues) or a controlled reduction in other operating expense".

Q. What is your reaction to such assertions?

A. They are overly simplistic and greatly misleading.

Q. Please explain.

A. As already noted, a great deal of capital invested in the distribution system is done for safety, compliance and reliability reasons. Such investments come with neither new customers nor new revenue. Moreover, replacement of decades old infrastructure that is substantially or entirely depreciated adds tremendous costs as the cost of the new, far more costly units of property replace the old unit of property that has little or no current revenue requirement due to its very low book value. Similarly, as Mr. Valdman explains, compliance costs are rising rapidly and bring neither customers nor revenue to pay for their costs. It has been a fundamental premise of rate regulation that incremental investment and operating costs be spread over all customers to the extent that incremental sales revenues do not provide sufficient revenue to recoup such incremental costs. PSE is in a period of substantial incremental cost growth and slow unit sales growth. Mr. Parvinen's assertion that, “regulatory lag, to the extent it exists, provides an incentive for the utility to manage its costs…so that it has an opportunity to earn its authorized return”, ignores fundamental regulatory principles of “just, fair and sufficient” rates and the plain facts presented by the Company in Exhibit Nos. EMM-6C and EMM-7C.

Q. Do you agree with proposals of Public Counsel and Staff that many of the Company's revenue requirement adjustments not be allowed because they will be offset by cost reduction and productivity efficiencies and/or are inappropriate pro forma adjustments to test year expenses?

A. No. Public Counsel offers unsubstantiated claims with respect to hypothetical cost reduction and productivity efficiencies. Both parties, Commission Staff and Public Counsel, allude to cost reductions and efficiencies as reasons for disregarding the Company’s reasonable adjustments to test year costs. For example, Mr. Parvinen (Exhibit No. MPP-1CT at page 3-4) proposes to eliminate from the Company’s combined gas and electric revenue requirements approximately $101 million of operating and power cost expenses in the rate year, excluding the Mint Farm deferral and rate of return differences. However, he offers no evidence that such enormous cost reductions can be achieved from any number of specific “efficiencies”. Nor does he, or other Commission Staff, provide evidence that the pro forma cost adjustments proposed by Commission Staff are reasonable, or supported, other than the quoting of a narrow definition of pro forma adjustment which definition the Commission has reasonably interpreted through multiple proceedings over the years.

Q. If adopted, what actions might the Company have to take to offset such proposed revenue reductions?

A. Such proposals imply, and would require if adopted, such actions as deferred maintenance on the Company's generating facilities and distribution system and layoffs of operating personnel. To illustrate, even after the Company has accepted some of Commission Staff's and Public Counsels adjustments the difference between the Commission Staff and the Company is still in excess of $65 million, ignoring the differences due to cost of capital and Mint Farm. With that magnitude of cost reductions, the Company would need to lay off approximately 580 employees, or approximately 22% of its existing workforce to achieve such a cost reduction. In aggregate, Commission Staff's hypothetical productivity adjustments and disallowed pro forma adjustments imply such consequences as reducing the 2009 Company's *entire* Operating and Maintenance budget by more than 13% from the 2009 budget level.

E. <u>Summary of Other Company Testimony</u>

Q. Please provide a summary of other key points raised in PSE's rebuttal testimony.

A. In addition to the points I addressed previously in my testimony, the following are a few of the key rebuttal points set forth in the testimony of PSE witnesses. :

- Mr. David Mills responds to several one-sided proposals by Commission Staff, the Industrial Customers of Northwest Utilities and Public Counsel, which seek to tilt the power cost baseline rate and power cost recovery so that PSE is even less likely to recover its power costs. One such proposal is hydro filtering, which artificially maximizes a low cost resource (hydropower) and lowers projected rate year power costs when setting rates. Dr. Dubin provides testimony that hydro filtering is unsound practice from a statistical perspective and specifically addresses the statistical error created in data by using one standard deviation to exclude "outlier" water years. Another proposal imposes an arbitrary cap on the monthly volume of the rate year gas for power hedges. Mr. Mills demonstrates that PSE's customers have generally *benefited* from the existing treatment of mark-to-market for gas hedges. PSE's rates have included a mark-to-market benefit (a reduction to power costs) of over $122 million associated with its rate year fixed-price gas for power contracts since the 2003 power cost only rate case. Additionally, Mr. Mills refutes claims by Public Counsel that PSE has consistently under-forecasted the volume of Off System Sales of power when setting its baseline power costs in past rate cases and thus will tend to over-recover actual power costs during the rate year period. Mr. Mills points out that the history of the PCA mechanism does not support Public Counsel's assertion that the Baseline Rates have been overstated. Power cost under-recoveries have totaled $6.8 ***million*** of actual allowed PCA mechanism costs of $6.9 ***billion*** over a six and a half year period. Indeed, PSE has under-recovered over $17 million of power costs in the first eleven months of the current PCA 8 period. Thus, the PCA appears to be working within reasonable fluctuations around actual power costs.

- Mr Jon Piliaris rebuts arguments by Commission Staff and Public Counsel that PSE's proposed Conservation Phase-In Adjustment should be rejected because it does not rigorously measure conservation savings. PSE and other utilities are under increasing pressure to increase conservation, yet when it comes to the recovery of costs associated with such conservation and lost revenues that result from conservation activities, Commission Staff and Public Counsel offer no support and reject attempts by PSE to seek recovery of lost margins directly resulting from its economic conservation measures for customers.

- Ms. Harris and Mr. Garratt refute Public Counsel's self serving evaluation of the Mint Farm purchase. They provide a recap of the robust and thorough evaluation of the purchase process and the Company's Board of Directors participation.

- Mr. Hunt explains how the Company has been a leader in offering employee benefits that meet the objective of maintaining a trained and dedicated work force by using cost effective benefit programs.

IV. CONCLUSION

Q. Please summarize PSE's rebuttal case.

A. PSE's proposals in this proceeding are crafted to fund PSE's essential operational and investment activities on behalf of its customers. These reflect a considered balancing of company, employee and customer interests. They are made knowing that even if approved as we request, the Company will continue to significantly under earn its fair and reasonable authorized return. Yet, we pursue the business plan we have outlined in this proceeding and elsewhere because it is the right thing to do as a public service entity.

PSE has carefully considered the positions set forth by other parties and accepted them in whole or with minor modifications whenever possible. The Company, however, simply does not agree that the remaining objections of the other parties are correct, reflect market and operational realities, or would serve the long-term interests of PSE's customers.

Notwithstanding the objections raised by the other parties to this proceeding, we urge the Commission to reject ill conceived proposals to abandon long established regulatory policy. We ask the Commission to give weight to the facts presented on the record and to demonstrate its clear support for the long term benefits the Company's customers and the region will reap from a robust electric and gas provider financially capable of navigating the challenging waters ahead.

In conclusion, we request the Commission support the Company's efforts on behalf of its customers and approve the relief the Company has requested in this proceeding and as modified in this rebuttal filing.

Q. Does that conclude your prefiled rebuttal testimony?

A. Yes.