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BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION,)	DOCKET NO. UE-090704
)	and UG-090705
Complainant,)	(Consolidated)
)	
vs.)	Volume VIII
)	Pages 629 to 808
PUGET SOUND ENERGY, INC.,)	
)	
Respondent.)	
)	

A hearing in the above matter was held on
January 21, 2009, from 9:30 a.m to 3:00 p.m., at 1300
South Evergreen Park Drive Southwest, Room 206, Olympia,
Washington, before Administrative Law Judge DENNIS MOSS
and CHAIRMAN JEFFREY D. GOLTZ and Commissioner PATRICK
J. OSHIE and Commissioner PHILIP B. JONES.

The parties were present as follows:

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Court Reporter

0630

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1 P R O C E E D I N G S

2 JUDGE MOSS: Good morning, everyone. We are
3 reconvened in our evidentiary proceedings in the matter
4 styled Washington Utilities and Transportation
5 Commission against Puget Sound Energy, Inc., Dockets
6 090704, and did I forget the UE, and UG-090705. For
7 anyone who's new in the room, my name is Dennis Moss,
8 I'm an Administrative Law Judge with the Commission, and
9 the Commissioners have designated me as the presiding
10 officer in this proceeding to assist them with the
11 hearing, and of course they are sitting, Chairman Goltz,
12 Commissioner Oshie, and Commissioner Jones.

13 And I believe we have first up this morning
14 Dr. Morin. Is there anything before we swear the
15 witness and proceed?

16 All right, Dr. Morin, if you will please rise
17 and raise your right hand.

18 (Witness ROGER A. MORIN was sworn.)

19 JUDGE MOSS: Thank you please be seated.

20

21 Whereupon,

22 ROGER A. MORIN,
23 having been first duly sworn, was called as a witness
24 herein and was examined and testified as follows:

25

0647

1 D I R E C T E X A M I N A T I O N

2 BY MS. CARSON:

3 Q. Dr. Morin, please state your name, your
4 title, and your business name for the court reporter.

5 A. Roger A. Morin, M-O-R-I-N. My title is
6 Emeritus Professor of Finance, Robinson College of
7 Business, Georgia State University, and Distinguished
8 Professor of Finance for Regulated Industry at the
9 National Center for the Study of Regulated Industry,
10 also Georgia State University, University Plaza, Atlanta
11 Georgia, 3003.

12 Q. Dr. Morin, do you have before you what have
13 been marked for identification as Exhibit Numbers RAM-1T
14 through RAM-20?

15 A. I do.

16 Q. Do these exhibits constitute your prefiled
17 direct and rebuttal testimony and related exhibits in
18 this proceeding?

19 A. They do.

20 Q. Were these exhibits prepared under your
21 supervision and direction?

22 A. Yes, they were.

23 Q. Do you have any corrections to any of your
24 exhibits at this time?

25 A. Not on the direct, no.

0648

1 Q. Do you have any corrections to your rebuttal?

2 A. Yes, I do.

3 Q. Could you tell us what those are?

4 A. Yes.

5 JUDGE MOSS: This is Exhibit 19T?

6 THE WITNESS: Correct.

7 JUDGE MOSS: All right, give us a minute to
8 get there.

9 All right, go ahead.

10 A. On page 30, lines 10 through 21 up to the
11 word as should be deleted because those -- this exact
12 same language was repeated earlier in the rebuttal and
13 it's redundant. So again line 10 to line 21 should be
14 deleted.

15 JUDGE MOSS: On page 30?

16 A. On page 30 up to the word as.

17 JUDGE MOSS: Okay.

18 A. These are all my corrections.

19 BY MS. CARSON:

20 Q. With that correction, are your prefiled
21 direct and rebuttal testimony and accompanying exhibits
22 true and correct to the best of your information and
23 belief?

24 A. Yes, they are.

25 MS. CARSON: Thank you.

0649

1 Your Honor, PSE offers Exhibits RAM-1T
2 through RAM-20 into evidence and offers Dr. Roger A.
3 Morin for cross-examination.

4 JUDGE MOSS: Thank you. We also have on our
5 preliminary exhibit list exhibits marked RAM-21 through
6 RAM-32 designated as cross-examination exhibits for this
7 witness, does the company have any objections?

8 MS. CARSON: No objections.

9 JUDGE MOSS: All right, then those will also
10 be admitted as marked, assuming there are no objections
11 from the other parties who are putting on cross as well.
12 All right, very good, apparently not.

13 All right, with that we are ready for
14 cross-examination, and I see that Staff has requested 10
15 minutes, so Mr. Cedarbaum, why don't you proceed.

16 MR. CEDARBAUM: Your Honor, with the
17 admission of Exhibits 21, 22, and 23 of Dr. Morin, we
18 have no questions.

19 JUDGE MOSS: All right.

20 MR. CEDARBAUM: I do just want to confirm
21 that Mr. Parcell is on the conference bridge. I've
22 heard people call in, but I'm not sure --

23 JUDGE MOSS: All right, Mr. Parcell, are you
24 on the conference bridge line?

25 MR. PARCELL: Yes, I am.

0650

1 JUDGE MOSS: All right, so he is available
2 for us. Thank you very much, we'll call on you when
3 needed.

4 All right, Mr. ffitch, you have also
5 indicated cross-examination for Dr. Morin in the range
6 of 90 minutes, please proceed.

7 MR. FFITCH: Thank you, Your Honor, good
8 morning, it will not be 90 minutes.

9

10 C R O S S - E X A M I N A T I O N

11 BY MR. FFITCH:

12 Q. Good morning, Dr. Morin.

13 A. Good morning, sir, good to see you again.

14 Q. Nice to see you again, on a personal level,
15 not on a professional level.

16 A. That remains to be seen.

17 JUDGE MOSS: Refreshing candor.

18 Q. Please if you could first turn to Public
19 Counsel cross Exhibit RAM-24.

20 A. I have it.

21 Q. And in this data request, Public Counsel
22 asked you a series of questions about changes in your
23 cost of capital methodology between your direct
24 testimony in this case and your testimony in previous
25 proceedings, correct?

0651

1 A. Yes, sir.

2 Q. And just in general in the various subparts
3 of the exhibit, you go through and explain the
4 differences and note the differences in various areas,
5 correct?

6 A. Yes, sir.

7 Q. And what I would like to do this morning is
8 just to discuss the updated cost of equity analysis
9 contained in your rebuttal testimony, and I really want
10 to focus primarily here on the historical risk premium
11 analysis. Now your historical risk premium analysis has
12 changed again since the direct testimony in this case,
13 correct?

14 A. That's correct, the world has changed
15 drastically in the last year or so, and some adjustments
16 had to be made.

17 Q. Okay. So if you could please turn to cross
18 Exhibit RAM-27. It's a response to Data Request 544 if
19 that helps.

20 A. I have it.

21 Q. All right. And in this data request,
22 particularly in part B, we asked you to explain the
23 changes that you had made in your historical risk
24 premium analysis in the updated testimony in your
25 rebuttal, correct?

0652

1 A. Correct.

2 Q. And what the answer says in part B is that
3 you changed the basis of the risk premium measurement
4 from A utility bonds to Baa or BBB utility bonds,
5 correct?

6 A. That is correct, that's because the average
7 bond rating in the electric utility industry is now Baa.

8 Q. And when we asked you in part C why you made
9 that change, you here state the answer that you've just
10 given on the witness stand, that the reason you give for
11 the change is that the yields on utility bonds are --
12 the average bond rating in the utility industry on the
13 electric side is Baa?

14 A. That's correct.

15 Q. Right.

16 A. And Puget Sound Energy or Puget Sound
17 electric's bond rating is also BBB, so that's the second
18 reason why you wouldn't want to compare apples with
19 apples.

20 Q. And as we've both been doing, Baa or BBB are
21 essentially similar or interchangeable terms for the
22 same type bond level, correct?

23 A. You are correct.

24 Q. How much higher in terms of basis points are
25 BBB bonds utility yields than A utility bond yields on

0653

1 average?

2 A. This morning they were 60 basis points
3 differential between bonds rated A and bonds rated BBB
4 according to Value Line Investment Reports.

5 Q. Now in your rebuttal testimony, you report
6 the results of your new historical risk premium analysis
7 using the BBB bond yields to be 10.64%?

8 A. Right.

9 Q. Now can I ask you to turn to the next cross
10 exhibit, which is RAM-28.

11 A. I have it.

12 Q. All right. Now in response A, B, C, which
13 are grouped together there on page 1 of the exhibit, you
14 provided the data to support the 10.64 calculation,
15 correct?

16 A. Correct.

17 Q. And there in the last line of that response
18 you state that that includes a 30 basis point increment
19 for flotation costs?

20 A. Correct.

21 Q. Now it's my understanding from your earlier
22 testimony in the case, Dr. Morin, that you are not
23 including flotation costs in your cost of capital
24 analysis, so is this another change in the methodology,
25 or is this an error?

0654

1 A. No, it's simply the way I've been doing it
2 for 30 years is always including flotation costs. The
3 updated recommendation, the 10.95%, includes flotation
4 costs, and there's a pretty good reason why one should
5 exclude it in this case in view of the nature of the
6 private ownership of the company that has changed. So
7 if you take the 10.95% and remove approximately 25 basis
8 points with flotation costs, you are down to 10.7% would
9 be an updated recommendation, which is close to the
10 company's requested 10.8 and about dead equal to the
11 average authorized return for vertically grid electric
12 utilities in this country.

13 Q. So I need to I guess understand clearly,
14 Dr. Morin, whether you are including flotation costs in
15 your final updated rebuttal analysis or you are not
16 including flotation costs?

17 A. It should not be included.

18 Q. So this 10.64% then is a mistake?

19 A. It's not a mistake. It includes flotation
20 costs. In this particular case there's a good reason to
21 remove it, so it would be 10.34 approximately.

22 Q. All right.

23 One more question about your update. The
24 response, the same response A, B, C in this cross
25 Exhibit RAM-28, indicates that the BBB bond yield that

0655

1 you used in your rebuttal was 6.24%, correct?

2 A. Correct.

3 Q. And that's an average yield for BBB rated
4 electricians you say?

5 A. That was the yield that was reported in the
6 Value Line investment report at the time of preparing
7 the update.

8 Q. All right.

9 A. That number is now 6.7, so it has increased
10 since.

11 Q. Are you aware, Dr. Morin, that according to
12 Mr. Gaines' response to discovery in this case, the most
13 recent long-term debt issued by Puget carried an
14 interest rate of 5.757%?

15 A. Yes, I'm aware of that.

16 Q. That's about 50 basis points below the
17 average cost of debt capital that you've been using here
18 for BBB rated electricians?

19 A. The benchmark in this historical risk premium
20 analysis is the average yield on utility bonds rated
21 Baa. It's a basket of bonds as opposed to one
22 particular issue with singular characteristics.

23 Q. But that's higher than the most recent
24 long-term debt issued by Puget, correct?

25 A. I don't know what it's yielding today, but at

0656

1 the time of issue yes, it was a lower coupon. But if I
2 was doing this today I would use 6.7 instead of 6.24
3 because that is the yield that's reported by Value Line
4 on the web site this morning.

5 Q. Please turn to page 54 of your rebuttal
6 testimony.

7 A. I have it.

8 MR. FFITCH: I'm sorry, Your Honor, I believe
9 that's Exhibit RAM-19.

10 JUDGE MOSS: 19T, that's correct.

11 BY MR. FFITCH:

12 Q. And there you state that in your updated CAPM
13 analysis you used a risk free rate of 4.5%, an average
14 beta of 0.74, and a market risk premium of 6.5%,
15 correct?

16 A. Where are you?

17 Q. Let me just make sure I've got you the right
18 reference there.

19 A. I'm on page 54 of Exhibit RAM-19T, and I see
20 on line 12 the risk free rate of 4.4%.

21 MR. FFITCH: May I have a moment to check
22 this reference, Your Honor?

23 BY MR. FFITCH:

24 Q. I think what occurred here is we've got
25 different printout versions with different pages. Can I

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1 have you turn to page 55, please, and at the bottom of
2 page 55 starting at line 19, again that indicates you
3 used a risk free rate of 4.5%?

4 A. Correct.

5 Q. An average beta of 0.74, and then when you
6 turn the page to 56 you can see the market risk premium
7 of 6.5, correct?

8 A. Yes, sir.

9 Q. And when I put those inputs together in the
10 CAPM formula, I get a result of 9.31%, correct?

11 A. Correct.

12 Q. You appear to have added 30 basis points of
13 flotation costs to that estimate as well?

14 A. That's correct. The numbers that you see on
15 page 56 in the grand summary are all adjusted for
16 flotation costs. So if you were to remove flotation
17 costs, the average would be approximately 25 basis
18 points lower, and the recommendation would be decreased
19 from 10.95 to 10.7.

20 Q. Is there any testimony in your rebuttal
21 regarding the removal of the flotation cost?

22 A. No, there is not. The reason I included
23 flotation cost is for consistency with all my past
24 testimony.

25 Q. So if we want these figures shown on page 56

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1 starting at line 10 in the summary to be on the same
2 basis as your direct testimony, we would subtract 30
3 basis points from each of these figures to reflect
4 removal of flotation costs?

5 A. Almost, not quite. For the first 3 you would
6 subtract 30 basis points. For the last 4 the exact
7 amount of basis points depends on the magnitude of the
8 dividend yield component of the DCF model. It's
9 approximately anywhere between 25 and 30 basis points.
10 I can give you the exact numbers if you wish.

11 MR. FFITCH: Your Honor, we would request
12 that Dr. Morin provide those numbers in a record
13 requisition.

14 JUDGE MOSS: All right, that's fine. When do
15 you want them?

16 THE WITNESS: I could provide those today.

17 JUDGE MOSS: All right, let's just do that
18 then.

19 MR. FFITCH: Thank you, I believe I'm just
20 about finished, Your Honor, if I may have a moment to
21 check.

22 Thank you, Dr. Morin.

23 That completes our questioning of the
24 witness, Your Honor.

25 THE WITNESS: Thank you, sir.

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1 JUDGE MOSS: All right, that completes the
2 designated cross-examination for Dr. Morin, but I know
3 there are questions from the Bench, so let's proceed
4 with those.

5 Commissioner Jones.

6

7 E X A M I N A T I O N

8 BY COMMISSIONER JONES:

9 Q. Good morning Dr. Morin.

10 A. Good morning, Commissioner, how are you.

11 Q. Appreciate you coming out here under your
12 circumstances.

13 A. It's always fun to come to the state of
14 Washington.

15 Q. I have several lines of questions. Some will
16 follow up on the flotation adjustment discussion that
17 Mr. ffitch was making, but let's start more broadly with
18 the I think you use the term unique ownership structure
19 of PSE in your testimony, do you not?

20 A. Yes.

21 Q. How familiar are you with Docket UE-072375,
22 the merger docket, and the nature of the testimony on
23 cost of capital and the ring fencing commitments?

24 A. Not very, just with the broad nature of it.

25 Q. But you are -- you do recognize that this is

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1 a unique owner, correct?

2 A. I do.

3 Q. Okay.

4 A. And hence the absence of flotation costs for
5 example.

6 Q. Right, I'll get to that in a minute.

7 A. Okay.

8 Q. I'm an admirer of yours, I've read your
9 textbook, which is obviously used by many commissions
10 throughout the country on regulatory finance.

11 A. You must have insomnia or something.

12 CHAIRMAN GOLTZ: It's more than that
13 actually.

14 COMMISSIONER JONES: Mr. Chairman, don't go
15 there.

16 BY COMMISSIONER JONES:

17 Q. I guess I'll throw you kind of a broad
18 question, could be a softball question as they say, but
19 there's nothing in your textbook on this new, quote,
20 breed of investors that some people call private equity,
21 some people call infrastructure investors, who raise
22 their capital in different ways than public markets.

23 A. That's in the next edition.

24 Q. That's in the next edition?

25 A. Yes. But you're right, there isn't any,

0661

1 because the vast majority of utilities are investor
2 owned utilities that have publicly traded common stock
3 and are exposed to flotation costs when they issue
4 equity, but that's gradually changing with the increased
5 prevalence of private equity owners.

6 Q. But I think academic folks like you are
7 somewhat entrepreneurial and would, you know, when a new
8 opportunity to look at a new class of investors would
9 come up, I would expect someone in the academic
10 community would examine that in some detail, but that
11 hasn't, not just you, but has that happened yet?

12 A. Not yet, but FERC, I'm sort of almost under
13 contract with FERC to write a paper on that.

14 Q. Okay.

15 A. What are the implications of private equity
16 ownership on risk return, flotation costs, utility rate
17 making, but nothing published yet.

18 Q. Okay.

19 Could you turn to page 17 of your direct
20 testimony, please, and I will use this as a start for
21 this discussion.

22 A. I have it.

23 Q. Okay. On lines 4 through 6, you are
24 discussing what is the required rate of return on equity
25 capital, and you -- could you just quote the second

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1 sentence there that begins with investors.

2 A. (Reading.)

3 Investors set return requirements
4 according to their perception of the
5 risks that are inherent in the
6 investment, recognizing the opportunity
7 costs of forgone investments in other
8 companies and the returns available from
9 other investments of comparable risk.

10 Q. So my question here, is PSE any longer traded
11 in public markets?

12 A. No.

13 Q. So my question to you is, how is the equity
14 price established for a privately held stock that is
15 held by pension funds, infrastructure investors?

16 Because I think this testimony frankly is not relevant
17 to this case, so could you just expound on that.

18 A. Whenever you have a privately owned utility
19 or a government owned utility with no publicly traded
20 common stock, you have to rely on comparables that are
21 publicly traded as proxies for this stand-alone private
22 equity type company, and that's what I do here. There
23 really is no other way of doing it. If you wanted to
24 attach a price for example for pension fund actuarial
25 purposes, what the investor would have to do is engage

0663

1 in a very extensive discounted cash flow exercise,
2 project the revenues and the costs and the margins and
3 the growth rates in the future and take the present
4 value of all of that using a risk adjusted discount rate
5 and come up with a price per share. That's what you
6 would have to do. This is what form evaluation experts
7 would do.

8 Q. So it gets to the issues, the different ways
9 of arriving at fair market value?

10 A. Correct.

11 Q. Has any of that evidence been presented in
12 this case either by you or Mr. Hill or Parcell?

13 A. No. We've all used proxies.

14 Q. Right. So that is what your recommendation
15 to the Commission is, this is the end of my broad line
16 of -- my line of inquiry on this broad question is that
17 the Commission should continue to rely on these, the
18 traditional DCF analysis, comparable earnings analysis
19 that incorporate historic risk premiums even though the
20 stock is not publicly traded any more, right?

21 A. Correct, the Commission should continue to
22 rely on proxies for PSE.

23 Q. So then the argument becomes over proxies,
24 and you and Mr. Hill and Mr. Parcell obviously differ on
25 many of the proxies, the historical growth rates, the

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1 future growth rates, et cetera, et cetera?

2 A. Well, Mr. Parcell and I, he uses my own
3 group, and our DCF numbers are almost identical, so.

4 Q. Do you have any recommendations for the
5 Commission on transparency? Because obviously with
6 public markets the Commission has access to a broad
7 variety of information, not just the proxies, but the
8 actual information on what the parent companies are
9 doing. And maybe you can't answer this question because
10 you were not in the merger case, but there is some issue
11 with getting information on what is going on above the
12 subsidiary, the regulated subsidiary level in terms of
13 leverage, debt, equity, how debt and equity are raised,
14 injected into the regulated sub, so any recommendations
15 on what the Commission should be looking at, what sort
16 of information we should be getting?

17 A. The Commission should be looking at very
18 closely the ring fencing provisions that are already in
19 place. We want to make sure that the rate payers of PSE
20 are insulated from any distress at the parent level,
21 which I think they are through the ring fencing
22 exercises. That would be my first caveat.

23 Q. Okay, let's move to flotation adjustments,
24 and this is on page 37 of your rebuttal testimony.
25 Well, it's in several places, I think it's on -- let's

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1 go to page 37 of your rebuttal testimony. And I must
2 say, Dr. Morin, I get confused here, because -- on this
3 flotation adjustment. So on lines 13 through 16, you
4 state that Mr. Hill disregards the fact, and then you
5 say I am not advocating a flotation cost adjustment.

6 A. Correct.

7 Q. And could you just read your quote from the
8 direct testimony that begins with although, could you
9 just read that for the record, please, although
10 flotation cost.

11 A. (Reading.)

12 Although flotation cost adjustments are
13 necessary for privately held subsidiary
14 utilities, I am not advocating flotation
15 cost adjustments for PSE in this
16 proceeding because of the unique
17 ownership structure of PSE. PSE's
18 ultimate parent, Puget Holdings LLC, is
19 owned by infrastructure investors,
20 predominantly pension funds. These
21 types of funds do not issue equity to
22 obtain funds and instead obtain funds
23 from participants to a pension plan that
24 must pay into such a plan. In obtaining
25 funds, these pension plans do not incur

0666

1 the types of costs that are normally
2 associated with flotation cost
3 allowance. Additionally, it is my
4 understanding that neither PSE nor any
5 affiliate of PSE has any current plans
6 to issue equity. In other words, it is
7 unlikely that any equity injected into
8 PSE for the foreseeable future will be
9 funded by any equity issuance by PSE or
10 any affiliate entity. For this reason,
11 I do not advocate a flotation cost
12 adjustment for PSE in this proceeding.

13 Q. Thank you. So this was confusing to me I
14 must admit in reading your direct and rebuttal and
15 trying to sort through, are you advocating for one or
16 not and if your analyses includes flotation cost
17 adjustments or not. Because one would assume that if
18 you're not advocating for a floatation cost adjustment,
19 you would not put it into your DCF, CAPM, and comparable
20 earnings analysis, but that's not the case.

21 A. Well, that's correct. As I've already
22 testified, if you look at the summary of my updated
23 recommendation, if you remove the flotation cost
24 adjustment, which one should do, the 10.95 becomes 10.7.
25 And I am not advocating a flotation cost in this

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1 particular case. Another option for the Commission to
2 consider if there were flotation costs in the future is
3 simply to expense them, pay as you go so to speak.
4 That's another policy that's done by some commissions
5 like Nevada for example.

6 Q. Right. But, Dr. Morin, just turn to page 54
7 for a minute.

8 A. Of the direct?

9 Q. No, of the rebuttal, and I think this is the
10 summary section.

11 A. Yes, I have it.

12 Q. And what does it say under section 4 there,
13 just the title?

14 Doesn't it say, I'll read it, it says updated
15 ROE recommendation of 10.95% for PSE.

16 A. Right.

17 Q. Doesn't that give the Commission a strong
18 indication that this is what you are advocating for in
19 your rebuttal testimony, 10.95%?

20 A. Well, if the Commission were to include
21 flotation costs, that would be my recommendation, as has
22 been the case in the past. It is not in this particular
23 case. The reason the flotation costs can still be
24 relevant even though there are no stock issues in the
25 future is to simply compensate the company for all the

0668

1 equity that was raised in the past and those flotation
2 costs associated with past issues. All the equity
3 that's already there has never been expensed.

4 Q. No, I'm familiar with that, okay. Well, I
5 think I'm as clear as could be, it's just more on the
6 structure of your testimony and the way you used it.

7 Could we turn to the cross Exhibit 22,
8 please.

9 A. I have it.

10 Q. Okay. Now since 2000 you have testified in
11 several proceedings before the UTC, and this just
12 summarizes your recommendations and where the Commission
13 authorized an ROE.

14 A. Correct.

15 Q. So the company obviously pays for your
16 services to develop these recommendations, and the last
17 recommendation I think was you advocated for what, what
18 was your ROE recommendation?

19 A. 11.25 in '06.

20 Q. Okay. And then what was the eventual
21 settlement that the Staff, well, the parties agreed to
22 and that was approved by the Commission?

23 A. In '06 it was 10.4. In '07 I recommended a
24 range of 10.8 to 11.2.

25 Q. Correct.

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1 A. The negotiated settlement was 10.15.

2 Q. All right. So the -- and maybe you can't
3 answer this, but I'm going to pose it anyway. What is
4 the Commission to make of this, that you develop these
5 -- and obviously it's good analysis and -- but the
6 methodologies that you use, you produce these higher
7 rates, and then the company settles for a lower rate.
8 And frankly with the last settlement it was not just the
9 company but the investor consortium that bought the
10 company had to sign off on that settlement ROE. So what
11 is the Commission to make of this in terms of basis
12 points, it's always a substantial reduction below your
13 recommendation?

14 A. Well, settlements of course are trade offs,
15 we'll give you this, we take that, there's lots of give
16 and take and compromises and so forth, so that's one
17 observation. The second one is I mean I'm recommending
18 10.7% here, and the -- I feel really, really, really
19 good about that recommendation, and not only because of
20 my own work but because I look around the country, and
21 the average authorized return right now for integrated
22 utilities is 10.6 if you look at orders in the last 12
23 months. If you look at the authorized return on average
24 for everybody regardless of when the return was
25 authorized, it's 10.7. I look at Mr. Parcell's top 10

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1 of his range, and it's pretty close to 10.7. I look at
2 his DCF estimates, it's close to 10.7. So there's a lot
3 of concordance and a lot of consensus if you wish
4 between what I do and what's going on in the industry
5 outside of Washington as well, so.

6 Q. Right.

7 A. So I would urge the Commission to look at
8 that.

9 Q. Okay, I take your point.

10 Let's move on to general economic conditions
11 now.

12 A. Okay.

13 Q. What have been the major changes in financial
14 markets since your last testimony in a Puget Sound case,
15 how would you describe it?

16 A. There's been a structural shift in risk
17 aversion. Investors have become a lot more risk averse,
18 and that was manifested in the explosion in yield
19 spreads that we saw between corporate bonds and treasury
20 securities. The rule of thumb in the old days, well, a
21 year and a half ago, was you could borrow money at 100,
22 120 basis points above treasuries. It shot up to 400.
23 It's gradually coming back to more normal circumstances,
24 but it's still a little bit high, so that's the one
25 change. The second change is investors have become

0671

1 extremely quality conscious, and you see that in the
2 data by looking at the yield spreads between Baa and A,
3 and they were up to 100, 150 basis points, and they're
4 still very high right now at 60 basis points.
5 Historically we used to say, well, you know, Baa over A,
6 20, 25, 30 basis points. It shot up to above 100 and
7 it's still at 60. So to me that suggests that investors
8 have become more discriminatory, more risk averse. And
9 that's why I make a huge recommendation to all of my
10 clients to try to strive for an A bond rating to be
11 insulated from this quality effect. So those are the
12 two changes that I would say --

13 Q. What about the policies of the Federal
14 Reserve?

15 A. Well, the Federal Reserve policies following
16 the financial crisis that began in October 2008 was
17 simply to jump start, try to help to jump start the
18 economy, and it was a massive shift towards quality.
19 Everybody sort of fled the corporate equities market and
20 the corporate debt market in favor of treasury
21 securities to the point where treasury securities were
22 yielding zero almost. So I think the Federal Reserve
23 responded very, very well to the financial crisis, and
24 it's one of the reasons why we've avoided an even more
25 disastrous result.

0672

1 Q. Would you agree with the statement that the
2 policies of the Federal Reserve are to keep interest
3 rates at 0.25%, at least the short-term rates at 0.25%
4 or in that range, quote, for the foreseeable future?

5 A. I would agree with that right now. The only
6 fly in the ointment right now is the specter of
7 inflation. And also with government borrowing trillions
8 of dollars, and that's going to raise interest rates,
9 there's going to be a crowding out effect, and most
10 economists and most financial services that I look at
11 are forecasting an increase in interest rates in
12 treasury bond yields from 4 1/2% to 5%, \$5 1/2%.

13 Q. I'll get to that in a minute when we talk
14 about CAPM, but generally if we take -- wouldn't you
15 agree with the statement that if we take the Federal
16 Reserve statements, the policies of the FOMC, at face
17 value, their intention is to keep interest rates at
18 extremely low levels for, quote, the foreseeable future?

19 A. I agree with that, because the economy is
20 still relatively soft.

21 Q. Okay. So now I'm going to get into CAPM
22 analysis and the three components of that a bit, because
23 I think you and Mr. Parcell are not that far apart. So
24 at least in your direct testimony, didn't you come in
25 with a rate of roughly 8.5%?

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1 A. Correct.

2 Q. And where was Mr. Parcell's end rate using
3 the CAPM?

4 A. I think he was using a risk free rate of 4%.
5 I don't recall, I can find it for you, but --

6 Q. No, that's okay.

7 A. Yeah, I was using 3.6% when I prepared the
8 direct. Again, remember earlier we discussed how the
9 Federal Reserve kept rates very, very low and the
10 quality and all of that, and that biased the whole CAPM
11 results.

12 Q. So the three components of the CAPM, it's a
13 fairly simple mathematical formula, are the risk free
14 rate, the beta, and the risk premium, correct?

15 A. Correct.

16 Q. Let's talk about the risk free rate. In your
17 rebuttal testimony, you call Mr. Parcell's number for
18 the risk free rate, quote, slightly stale, I think it's
19 4.2%.

20 A. Correct.

21 Q. Those are unusual words, why did you say
22 slightly stale, because I think --

23 A. Only because it's not up to date, that's all.
24 All the stuff I've been reading for the last 2 or 3
25 months indicates treasury yields of 4.5 and forecasts up

0674

1 to 5%, so I just thought it was a little out of date,
2 that's all. Nothing personal.

3 Q. But in terms of your recommendations, it's,
4 what is it, is it 4.5% in your rebuttal?

5 A. Yes, it is.

6 Q. Okay, so that's not -- 30 basis points is not
7 that far, is it?

8 A. Well, it's significant.

9 Q. It is, okay. What was the last rate that you
10 used in your last testimony in the last rate case before
11 us, do you happen to recall?

12 A. In the PSE case?

13 Q. Mm-hm.

14 A. 3.6.

15 Q. 3.6.

16 A. This was at the height of the crisis.

17 Q. In terms of the beta, you and Mr. Parcell
18 both use 0.76, don't you?

19 A. Correct.

20 Q. In terms of the risk premium, that's where I
21 see the major differences --

22 A. You're right.

23 Q. -- between you and Mr. Parcell; is that
24 correct?

25 A. You're right.

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1 Q. And Mr. Hill as well, I don't mean to ignore
2 Mr. Hill. And in your direct testimony I think you used
3 -- what was the risk premium that you used in your
4 direct testimony?

5 A. I think it was 7.1.

6 Q. And what did you use in your rebuttal
7 testimony?

8 A. 6.5.

9 Q. Okay. So as I understand the major
10 differences between you and Mr. Parcell, it gets into
11 some details we probably don't want to get into, but
12 it's total returns versus income and using a geometric
13 average verses an arithmetic average?

14 A. Yeah, the differences between us are rather
15 technical in nature, and one of them is when you're
16 using bond returns it's better to use the income
17 component of the bond returns because that's a better
18 measure of expected returns. The other difference we
19 don't need to get into, but the only correct way to
20 estimate the cost of capital is to use arithmetic
21 averages and not geometric averages, and I don't think
22 we want to get into that.

23 Q. What is your understanding of the
24 Commission's precedence, if you will, on using the
25 various methodologies in previous cases? Let's just

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1 talk about the PSE cases since you've been involved in
2 those, is it to give more weight to one particular
3 methodology?

4 A. My sense from reading past orders is there's
5 a slight preference for DCF.

6 Q. Why is that, can you cite an order and can
7 you provide a basis for that?

8 A. Just from a general reading of rate orders.
9 The Commission's never come out and said we are a DCF
10 Commission or we are a CAPM Commission, and nor should
11 the Commission do this, because you can back yourself
12 into a corner when circumstances change later. You
13 don't want to do that. So you have to be open to
14 receive all the information that's relevant and then
15 judge the adequacy and the relevance and the accuracy of
16 that information. But don't back yourself into a corner
17 and wave a flag, you know, I'm DCF or CAPM or whatever,
18 so I think this Commission has been pretty receptive to
19 a variety of methodologies.

20 Q. Given what you said before about the
21 financial markets and the huge changes over the past 18
22 months, is it do you think that we should give more
23 weight because of those changes to any particular
24 methodology? And I'm -- my specific question is on
25 CAPM, because as I understand that theory, that was

0677

1 developed as you well know two, three decades ago to try
2 to describe asset prices under various conditions for
3 specific sectors of industries.

4 A. Mm-hm.

5 Q. It seems to me to be maybe more relevant
6 today than DCF analysis where prices are going up and
7 down wildly, interest rates are moving, it's very
8 volatile.

9 A. Well, I think probably the reverse is true
10 right now. For example, both Mr. Hill and I agree that
11 less weight should be given to CAPM, and also
12 Mr. Parcell in his final range, the CAPM seems to occupy
13 a minor role and not a prominent role, and that's
14 because the key inputs to the CAPM are extremely
15 difficult to ascertain right now, particularly the
16 market risk premium. Following the financial crisis,
17 what is the market risk premium. It's probably very,
18 very high. You can't really find any numbers to put a
19 tag on it. The beta, the historical betas are
20 measurable over five year periods, and therefore they
21 don't really capture the disastrous performance of the
22 equity markets in the last 18 months, and hence the less
23 weight should be given to the CAPM. And I'm not saying
24 that because the DCF results are higher, I'm just saying
25 that for economic reasons. But in my recommendation I

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1 put CAPM, DCF, risk premium, like I've always done it,
2 but I think less weight should be placed on the CAPM for
3 those reasons and the ones I expound in my testimony as
4 well.

5 Q. You use some of those same principles though
6 about stock price volatility and interest rate
7 volatility over the last 18 months, doesn't that apply
8 to DCF analysis as well, meaning --

9 A. Yeah.

10 Q. I mean what's been the range in the DG, in
11 the Dow Jones utility index from the bottom until now,
12 what's the range?

13 A. 200 to 600, it's huge, it's gigantic, I
14 agree.

15 Q. And isn't it just a simple mathematical
16 equation that when the stock price goes down, the yield
17 goes up, when the stock price goes up, the yield goes
18 down?

19 A. That's correct.

20 Q. Assuming the dividend payout ratios remain
21 constant.

22 A. So to get some comfort on that, what I would
23 do if I was a Commissioner, and hope to be one day, I
24 would look at the graph of the Dow Jones utility index
25 and find out how stable it is. If I were to do that

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1 today, this morning as we speak, you would find that the
2 Dow Jones utility index average has been fairly stable
3 in the last few months. That would give me some comfort
4 as opposed to jumping up and down like it did a year and
5 a half ago. The other thing I would look at, I would
6 look at what we call the VIX, which is a measure of
7 volatility of the stock market index, and there is a VIX
8 also for the Dow Jones utility index, and I would see
9 where I am on the graphs versus history. And it turns
10 out that if you do that right now, we are sort of back
11 to normal. The good news about all the discussion we've
12 been having is that there's a reversion to more normal
13 conditions prior to October 2008 that we're seeing in
14 financial markets. The stock market's recovering,
15 interest rates are fairly stable, betas are steady
16 state, so I think that the worst is behind us in terms
17 of volatility and crisis conditions and uncertainty and
18 so forth.

19 Q. I hope you're right, but the challenge for
20 the Commission is we're peering into the future for the
21 rate year 2010 and trying to determine what the
22 financial conditions might be.

23 In terms of the yield spreads, back to this
24 departs from DCF for a minute, but isn't it true also,
25 you mentioned stability, that the spreads between an A

0680

1 rated utility bond and a long-term treasury bond have
2 come down to a lower level, that spread, than before the
3 crisis?

4 A. That's correct. Again we're back to normal,
5 if there is such a thing. It's still a little bit
6 higher than historical levels. The difference between A
7 and BBB bonds right now is still about 60 basis points.
8 Historically it's been 20, 30, but it's been staying at
9 a 50, 60 level for quite a while now, so I would find
10 some comfort to that in making a decision.

11 Q. And isn't it true that at least for publicly
12 listed stocks, and again PSE is not a publicly listed
13 stock so there's a question of relevance here, I
14 understand your argument on proxies, but because PSE is
15 not publicly traded, it is not subject to these swings
16 of prices, correct?

17 A. That's correct, it is not. But if it were
18 publicly traded, it would be.

19 Q. Isn't it true that certain comments can be
20 made by certain influential financial investors such as
21 Warren Buffet and Bill Gross at PIMCO that cause fairly
22 significant changes in stock prices?

23 A. Particularly Warren Buffet, when he decides
24 to go after railroads for example, there's a run up on
25 railroad stocks, sure.

0681

1 Q. Okay, so just to sum up, so your
2 recommendation to the Commission is to use all three
3 methodologies?

4 A. I --

5 Q. In looking at each of the, excuse me, in each
6 of the capital witnesses, but in spite of my prodding on
7 CAPM, you still think that we should afford it less
8 weight and not equal weight? I'm still having a problem
9 or issue understanding that right now.

10 A. I would give more weight to the DCF results,
11 and I say that not because the numbers are higher, but
12 because if you look at Parcell's results and my results
13 for DCF, they're nearly identical, and they're equal to
14 about the average authorized return in the U.S. and the
15 recently allowed returns for electrics in the U.S. as
16 well, 10.6, 10.7, so I would find that useful
17 information.

18 COMMISSIONER JONES: Okay, thank you, Judge.

19 THE WITNESS: Thank you, Commissioner.

20 JUDGE MOSS: Okay, I think that does it, does
21 that complete our questions from the Bench?

22 Chairman Goltz.

23 CHAIRMAN GOLTZ: No, with some trepidation to
24 venture into this.

25

0682

1 E X A M I N A T I O N

2 BY CHAIRMAN GOLTZ:

3 Q. Good morning, Dr. Morin, thank you for
4 joining us and helping sort this out.

5 A. Pleasure.

6 Q. I won't be as -- I will be much briefer than
7 Commissioner Jones. Looking at your direct testimony,
8 page 56 or starting at page 56.

9 A. Yes, I have it.

10 Q. You're talking about -- you're making the
11 point that in your view PSE is riskier than I suppose the
12 average utility?

13 A. Correct, slightly riskier.

14 Q. Slightly riskier. And that's due in part to
15 its I think you called it the ambitious capital spending
16 program.

17 A. It's what we call a construction risk. This
18 company has to raise \$1 Billion in the next 5 years
19 approximately.

20 Q. Okay. And is that basically, is that, I
21 didn't reread that this morning, but is that basically
22 the sole reason for your saying that PSE is riskier than
23 the average utility?

24 A. It's one of three reasons, but it's my major
25 reason. When a company has to appeal to capital markets

0683

1 to the tune of \$1 Billion in the next 5 years, the
2 company's at the mercy of a very, very fickle, you know,
3 capital market and investor environment, and we call
4 that construction risk. It has to raise the money come
5 hell or high water basically. The second distinguishing
6 feature of PSE versus the industry is the historical
7 test year versus a semi historical, semi forward, or a
8 complete forward test year, and that causes regulatory
9 lag, so it makes it very, very difficult for the company
10 to earn its allowed rate of return. And the third
11 factor is the company's chronic but diminishing
12 dependence on purchased power. So those are the three
13 reasons why I think this company's slightly riskier than
14 the average.

15 Q. So are the first and the third somewhat
16 related though?

17 A. Yes.

18 Q. I mean the more -- you're saying that the
19 more a utility relies on purchased power, all other
20 things being equal, that's makes it riskier?

21 A. Correct.

22 Q. And so --

23 A. But the construction will palliate that
24 somewhat over time.

25 Q. Right. So looking ahead when this

0684

1 construction boom is leveled off, at that point then in
2 your view PSE would be less risky than the normal
3 average shareholder utility?

4 A. I agree with that, it might even be upgraded.

5 Q. And so given that the -- I assume that one
6 invests in the -- since I don't own utility stock and
7 can't -- but I assume that one invests in utility stock
8 for the long haul, then wouldn't that sort of offset
9 your concern about the immediate riskiness because
10 there's a prospect of more stability in the future?

11 A. I don't think so. The company has to raise
12 money, lots of money, at unknown rates, and we don't
13 know what's going to happen to capital markets in the
14 next five years. They have to raise the money
15 regardless, and that's risky basically, that's the point
16 I'm trying to make. Internal financing will not
17 suffice, they have to go outside and issue bonds and get
18 some equity from outside sources, and that's a risky
19 proposition, and if that's tied with regulatory risk as
20 well, if the Commission awards a fair and reasonable
21 rate of return, that makes the company's financial
22 metrics acceptable and -- to investors, to bond rating
23 agencies to maintain support and even possibly upgrade
24 the bonds.

25 Q. But then you would also though agree though I

0685

1 believe you said that the light at the end of the tunnel
2 is a less risky utility?

3 A. Eventually if all goes well, yes.

4 Q. Right. And isn't that light at the end of
5 the tunnel, shouldn't that be in the minds of an
6 investor today?

7 A. It should be, but I think they're more
8 concerned with construction risk. If you read the
9 equity research reports on electric utilities, it's
10 construction, construction, construction everywhere.

11 Q. And on page 60 of your testimony, you talk
12 about regulatory lag making it difficult to earn a
13 reasonable rate of return, especially in an inflationary
14 environment, and I -- did I hear you correctly in
15 response to Commissioner Jones that there's some concern
16 about potential inflation, but we don't have that right
17 today?

18 A. Right now the inflation fears are not
19 serious. We're forecasting somewhere like 2.5%
20 inflation. So right now today the fears of inflation
21 are remote. But if the economy and when and if the
22 economy recovers, probably next year in a more robust
23 fashion, the specter of inflation will rear its ugly
24 head once more. And that of course, I mention the
25 record high trillion dollar deficits at the federal

0686

1 level, the company -- the government has to borrow money
2 crowding out private investors and therefore raising
3 interest rates, which is part of inflation. But right
4 now I agree with you that inflation is not a major fear
5 right now.

6 Q. So my last question is really to help me out
7 here with how we respond to what we've heard from
8 members of the public at the public hearings both this
9 week and earlier. Members of the public have no
10 trepidation venturing into this area I might add. And
11 they -- I took away kind of two points as to why Puget's
12 rate of return should be lowered, and that is that their
13 perception is, and this has been their perception, that
14 investments in utilities are low risk, kind of fixed,
15 guaranteed return. Perhaps something that they learned
16 from playing Monopoly when they were kids, I don't know.
17 And then also they see themselves when they personally
18 try to, you know, invest or even buy CD's, the interest
19 rate is next to nothing, and so they extrapolate that to
20 the larger corporate environment. So what's the
21 response to that when they make those two simple points
22 that I think are based in some, if they were to analyze
23 them more deeply there's economists that make that
24 point, those points as well, so what's the response?

25 A. Playing Monopoly for real is not quite the

0687

1 same as playing Monopoly for fun. But the response to
2 that is I always tell people that a utility is a
3 monopoly, but it's in perfect competition with everybody
4 else for inputs, including money, capital, and the
5 company has to compete with everybody else for investory
6 savings, and investors have become very selective, very
7 discriminatory, and very astute in their choice of
8 investments. And again perfect competition is such that
9 you have to pay the going rate, you have no choice. And
10 if it's 10.7%, so it is. But I do sympathize with your
11 point about the economy is a little tough right now, and
12 a lot of consumers are suffering and so forth, and it's
13 difficult to respond to that other than to say that a
14 utility must, come hell or high water, they've got to
15 produce electricity, safe, reliably, they must restore
16 an aging infrastructure and --

17 Q. It's actually come hell or low water.

18 A. Or low water, yeah. Well, it might be high.

19 And again it's tough when you have to
20 increase rates in this kind of environment, but there's
21 really no choice in the sense that there will be a pain
22 now for gain later. This company doesn't have any
23 choice about the CapX program to provide the
24 infrastructure, the service, the reliability, the
25 safety, and all of that. And in terms of regulatory

0688

1 impact, when the economy is booming, we don't give
2 utilities a bonus, all right. So when the economy is
3 not doing terribly well, why should we do the reverse
4 and inflict more pain, you know. But it's a tough
5 situation you guys have to deal with with customers and
6 struggling and having to raise rates, but my quick
7 answer to that would be immediate pain for much more
8 gain later.

9 CHAIRMAN GOLTZ: Thank you, I have nothing
10 further.

11 THE WITNESS: Thank you.

12 COMMISSIONER JONES: Judge Moss, I just have
13 a clarifying question, then we can -- if that's okay.

14 JUDGE MOSS: All right.

15

16 E X A M I N A T I O N

17 BY COMMISSIONER JONES:

18 Q. In response to Chairman Goltz, Dr. Morin, you
19 said because of this huge CapX need that the company
20 will need to raise equity and debt from outside sources.
21 What do you mean by raising equity from outside sources
22 for the new investor consortium?

23 A. Well, from their ownership, who in turn have
24 to raise the money. \$1 Billion over 5 years or so,
25 approximately half of that will come from debt issues,

0689

1 that's \$500 Million, actually more than that because
2 they have to refinance maturing issues as well, and the
3 other half presumably will come from equity, and that
4 equity will presumably come from the ownership, and who
5 knows where they'll get the money.

6 Q. So isn't it more appropriate to call that an
7 internal equity source?

8 A. Well, are you going to invest in something
9 where the returns are not there? The returns have to be
10 competitive too in order to invest.

11 Q. And where do those funds come from?

12 A. From the private ownership.

13 Q. And where do those funds come from?

14 A. From the savings, the pension savings or --

15 Q. Pensioners basically?

16 A. Yeah, right.

17 COMMISSIONER JONES: Thank you.

18 JUDGE MOSS: Okay, I believe that completes
19 our questions from the Bench, but I sense that
20 Mr. Cedarbaum may have some follow up here before we go
21 to the redirect.

22

23 C R O S S - E X A M I N A T I O N

24 BY MR. CEDARBAUM:

25 Q. Hello, Dr. Morin.

0690

1 A. How are you, good to see you again.

2 Q. One question, just a clarification on Exhibit
3 RAM-22 that you discussed with Commissioner Jones.

4 A. Yes.

5 Q. And if I -- I think the exchange between the
6 two of you happened under the assumption that the 10.4
7 ROE that was granted in the 2006 rate case was a settled
8 amount. Are you aware or can you accept subject to
9 check that that was a litigated amount?

10 A. Yes, that was litigated, right, I agree.

11 Q. And then you, on another subject, you
12 indicated that you feel good about your what I think we
13 know now to be a 10.7 ROE recommendation?

14 A. Yes.

15 Q. Because it's in line with other ROEs granted
16 around the country. You also testified that settlements
17 involve trade offs. Did you examine whether or not
18 those other ROEs granted around the country were the
19 result of settlements?

20 A. Approximately in my experience, I've done
21 what, 230 cases over the last 30 years, approximately a
22 third are settlements.

23 Q. And on that same subject, the Commission
24 recently issued orders for Avista and PacifiCorp in
25 which ROEs were set in those cases, and are you aware of

0691

1 those orders at all?

2 A. Yes, I am.

3 Q. Do you know what the ROE that the Commission
4 authorized in those two cases?

5 A. If my memory serves me right, it was either
6 10.1 or 10.2.

7 Q. So if you feel good about your 10.7 being in
8 the range of other commissions around the country,
9 should this Commission feel bad about being in the 10.1,
10 10.2 range?

11 A. I don't have an opinion on the Commission's
12 feelings.

13 Q. Well, do you think --

14 A. But all I'm saying is my recommendation seems
15 to be in line with the average authorized return for
16 integrated electric utilities. That's all I said.

17 Q. Are you being --

18 A. That reinforces my strong belief in my own
19 recommendation.

20 Q. Well, then why aren't you critical of this
21 Commission being outside the mainstream?

22 A. That's not the business I'm in. I don't
23 criticize commissions.

24 MR. CEDARBAUM: Thank you, those are all my
25 questions.

0692

1 A. I disagree with them, but I don't criticize
2 them.

3 MR. CEDARBAUM: Those are all my questions,
4 thank you.

5 JUDGE MOSS: Thank you.

6 Nothing further?

7 Then any redirect you may have. See how bold
8 you are in venturing into this area, Ms. Carson.

9 MS. CARSON: Just one question.

10

11 R E D I R E C T E X A M I N A T I O N

12 BY MS. CARSON:

13 Q. Dr. Morin, do you know if the recent ROE
14 decisions and the Commission orders for Avista and
15 PacifiCorp were from settlements or litigated cases?

16 A. I do not.

17 MR. CEDARBAUM: Your Honor, just to follow up
18 on that, to be fair, they were the result of
19 settlements, and I don't mind having that be part of the
20 record.

21 JUDGE MOSS: Well, the parties are free to
22 cite prior Commission orders which will clarify such
23 points as well, so we appreciate having that for the
24 record, Mr. Cedarbaum, thank you.

25 All right, well, with that, Dr. Morin, we

0693

1 appreciate you being here this morning, and I don't
2 think we're going to need you back, we're probably going
3 to finish our hearing today, but if we do need you back,
4 you'll be here for the duration today I imagine.

5 THE WITNESS: My exchanges today were well
6 worth my visit.

7 JUDGE MOSS: Thank you very much, and it
8 looks like you brought the sunshine with you as well, we
9 appreciate that. All right, with that you may step down
10 and subject to recall as I indicated.

11 Now on our schedule we have Mr. Gaines next,
12 but I think we probably should go ahead with Mr. Parcell
13 for whom no cross has been indicated, but I know
14 Commissioner Jones at least has some questions, so let's
15 -- we have Mr. Parcell on the telephone.

16 Mr. Parcell, let me ask you at your end of
17 the line, please, if you would please rise and raise
18 your right hand, we'll go through the oath.

19 THE WITNESS: Okay.

20 (Witness DAVID C. PARCELL was sworn.)

21 JUDGE MOSS: Thank you very much, you may
22 seat yourself wherever you are.

23 Do we want to just stipulate the evidence in,
24 Mr. Cedarbaum?

25 MR. CEDARBAUM: Unless Mr. Parcell corrects

0694

1 me, I don't believe there are any corrections he needs
2 to make on the record, so I would -- stipulation seems
3 better to me.

4 MS. CARSON: No problem with the company.

5 JUDGE MOSS: Okay, that seems agreeable with
6 everyone, so we won't go through the formalities of
7 brief direct examination, Mr. Parcell, and we will go
8 directly to questions from the Bench and Commissioner
9 Jones.

10

11 Whereupon,

12

DAVID C. PARCELL,

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

15

16

E X A M I N A T I O N

17

BY COMMISSIONER JONES:

18

Q. Good morning, Mr. Parcell, this is

19

Commissioner Jones.

20

A. Good morning.

21

Q. You had the benefit of listening to the

22

previous conversation with Dr. Morin, did you not?

23

A. I did, yes.

24

Q. So if you want to incorporate any comments

25

based on that in answers to my questions, please feel

0695

1 free to do that.

2 So if you could turn to page 44 of your
3 testimony.

4 A. 44, yes.

5 Q. Labeled DCP-1T.

6 A. I have that.

7 Q. And this is ROE recommendation, this is a
8 summary of your recommendations using the three
9 methodologies that you do, correct?

10 A. Correct.

11 Q. And you use three, discounted cash flow,
12 CAPM, and comparable earnings, correct?

13 A. That I do, yes.

14 Q. How does your analysis in terms of
15 methodologies employed differ from Dr. Morin's in terms
16 of he uses something called empirical CAPM, doesn't he?

17 A. He does.

18 Q. Okay. And does he use a comparable earnings
19 methodology as well?

20 A. Not directly, no.

21 Q. Okay, well, let's move to I think on page 44
22 your overall recommendation is 10.0%, correct?

23 A. That's correct, the mid point on my range.

24 Q. And then at some point here, I think it's in
25 -- is it in this section or elsewhere you state

0696

1 something to the effect that the Commission in the past
2 has placed the heaviest reliance on DSF analysis?

3 A. DCF, correct.

4 Q. What is the basis for that assertion?

5 A. Well, it's been my general perception from
6 being in several cases there over the last few years,
7 but I could give you one example which I have in my hand
8 right now. It's the Commission's decision in a Puget
9 case, Docket Numbers UG-040640, I believe that's the
10 electrical portion. And on page 29, paragraph 73 where
11 you make your conclusion as to the cost of equity:

12 In summary, we focus on the DCF analyses
13 presented by Dr. Wilson and Mr. Hill as
14 the most substantial and reliable
15 evidence of PSE's cost of equity at this
16 time.

17 And in that case which you specific adopted
18 the DCF recommendation of Staff witness Dr. Wilson, so
19 that's a case where there were several methods --

20 Q. Okay.

21 A. -- proposed for you or by witnesses for your
22 consideration, which your recommendations focused on DCF
23 results only.

24 Q. Thank you for that reference. I do recall
25 that now. I thought you might be referring to a

0697

1 previous case before my time at the Commission that
2 dealt with a telecom company ROE but --

3 A. No, that's not the case.

4 Q. Okay.

5 On line 20 of that --

6 A. Of page 44, yes, okay.

7 Q. Yeah, page 44, you say that the Commission
8 should place more emphasis on the lower end of your DCF
9 recommendation?

10 A. Yes.

11 Q. And why should we -- what do you mean by
12 lower end, is it 9.5 to 10.0 or 9.5 to 10, the current
13 ROE is what based --

14 A. Well, here's what I'm trying to say on page
15 44 there. My DCF results as shown on page 44, line 13,
16 was a range of 9.6% to 11.3%, and I said in my view at
17 this time the proper DCF range should be at the bottom
18 portion, and the reason for that, this was touched upon
19 by -- (inaudible) -- the circumstances of the financial
20 markets in the last couple years are such that DCF
21 results currently show lower cost of equity than
22 historically and -- I'm sorry, CAPM's are lower and
23 DCF's are higher. And the reason that -- is the same.
24 The so called flight, the quality of flight to safety
25 has driven or did drive the risk free rate, which is a

0698

1 component of the CAPM, down to historical levels, and
2 that has the -- had the impact of lowering CAPM costs.
3 At the same time this flight to quality has driven down
4 the stock prices, which has driven up dividend yields,
5 so the DCF is pushed higher with these results, not just
6 -- it's not just true for the yields when you have a
7 growth rates present, there's a future growth rate.
8 You're finding the projections of growth are from a base
9 that's a recession. And this may be a growth rate in
10 the next 5 years, but it's not a sustainable growth
11 rate. So what I'm saying is that since the CAPM --
12 since the CAPM is lower by -- (inaudible) -- it gets
13 higher. You can't just ignore the CAPM and accept the
14 DCF at face value because the same factors that make one
15 low make the other one high. So based upon that, I
16 propose that the lower portion, the lower end portion of
17 my DCF range be appropriate.

18 Q. And again, what do you mean by lower end,
19 you're just throwing that out for the discretion of the
20 Commission, it could be 9.6, 9.8, 10.1, the current
21 rate, it could be anywhere in that range?

22 A. It could be, but I'm willing to propose 10.0.

23 Q. Turning to page 45 of your testimony, the
24 next page, this gets into the CAPM analysis, as I
25 understand your testimony, it is that you recommend that

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1 we use the CAPM as a check only. Just as you stated,
2 when the DCF analysis produces a lower result, the CAPM
3 results because of the risk free rate and the way it's
4 calculated will produce a higher result, correct?

5 A. That is correct.

6 Q. And then you cite two factors for the CAPM.
7 One, the relatively low yields on treasury bonds, and
8 then two, the lower risk premium, so let's take those up
9 each separately.

10 A. Okay.

11 Q. Do you expect the relatively low yields on
12 treasury bonds to continue for the foreseeable future?

13 A. Probably not. I mean they've gone up some
14 already, but in December for example of '09, the yield
15 -- the average yield on 20 year treasury bonds was 4.4%.
16 Over the last 3 months it was about 4.25% roughly. I
17 would anticipate over time that they would eventually
18 edge back up, but they've already edged up some. My
19 schedule DCP-4, page 4, which shows monthly figures, and
20 I only show as much as 10 year treasuries here.

21 Q. Right.

22 A. As you can see, they were down to like 2.42%
23 in December of '08 and 2.52% a year ago this time,
24 January of '09. So by October of '09 they were 3.39, I
25 happen to know that they were about 3.6 at this point in

0700

1 time at least in December. So they have moved up some
2 over the past several months as they -- as the count
3 marks move back to what we used to consider as normal.

4 Q. So, Dr. Parcell, if you had done this
5 analysis using CAPM in December of '08 using a 2.4
6 treasury rate, the CAPM rate would be even lower,
7 correct?

8 A. Well, it would have except for the fact that
9 in December of '08 I would not have had access to the
10 returns through the year 2008, which were pretty
11 miserable for us. So the market returns in '08 were
12 lower, and that pulled down the risk premium when you --
13 and I would not have access to that in December of '08
14 whereas I would have in February of '09.

15 Q. You and Dr. Morin differ in his rebuttal
16 testimony and in your responsive testimony on the risk
17 premium, correct? I think he advocates 6.5%, and you
18 advocate 5.6%, correct?

19 A. That's correct.

20 Q. Do you stand by that testimony, is there
21 anything that you heard this morning or based on market
22 conditions in the last 3 months that would cause you to
23 change your --

24 A. I basically use three factors in my risk
25 premium development, he uses one. One of those is

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1 geometric returns and arithmetic returns and one is the
2 difference between returns on equity and treasury bonds,
3 so. And I firmly believe you really should consider
4 both geometric and arithmetic because investors consider
5 both. For example, if you get a mutual fund report for
6 a funds you own or one you're going to buy, the FCC
7 requires them to show you returns on a geometric basis.
8 So investors see these and they presumably consider
9 those, so I don't -- I can not accept that investors
10 would not at least consider geometric returns in
11 conjunction with arithmetics. I use both, he only uses
12 one.

13 Q. Dr. Parcell, I understand your cite of our
14 previous orders on placing a heavier reliance on DCF
15 analysis, but if there were no reliance on your
16 understanding there were no reliance and we had a choice
17 today based on the financial market conditions for the
18 last 18 months, the state of the economy, the business
19 cycle, inflation rates as you understand them, and we
20 were essentially at tabula rasa, we could just create
21 based on the recent past a reliance on one methodology,
22 would your recommendation on CAPM and DCF and comparable
23 earnings be the same, i.e. to use CAPM as a check only
24 and place heavier reliance on DCF, or should we afford
25 more reliance on CAPM in this financial environment?

0702

1 A. Well, I can answer that question in an
2 indirect sense. I'm filing other testimonies as we
3 speak or recently have filed in other electric cases,
4 and those are like Arizona for example I'm testifying in
5 a case involving UN Gas and Electric, and there there's
6 no precedent per se for primary reliance on DCF. But my
7 approach there is the same approach as in this case, I'm
8 using DCF earnings as the primary factors in my
9 recommendation and CAPM as a check. Normally I would
10 use all three, its's just if you have three methods and
11 one of them is a lot different than the others, you have
12 to have some check is there something about this method
13 right now that makes you want to give it less weight,
14 then I think the answer's yes. But again I have to cite
15 the factors that make the CAPM lower also makes DCF
16 higher, so if that is a check in my view, it's also a
17 reason for considering the lower end DCF results. So I
18 hope that's responsive to your question.

19 Q. Yes, it is, thank you.

20 My last line of questioning to you is on the
21 capital structure recommendations. Could you turn to
22 page 26, 27 of your -- let's start with 26 of your
23 testimony.

24 A. 26?

25 Q. 26.

0703

1 A. Yes. By the way, if you're on the phone like
2 this, if someone chimes in on the chat line or whatever
3 it's called, the beeping drowns out all the
4 conversation, so you asked me a question and a beep came
5 in, and I missed part of it. At least I think I did.

6 Q. And there you are I think disputing
7 Mr. Gaines' recommendation for 48% common equity ratio
8 and recommending a 45% common equity ratio, correct?

9 A. That is correct.

10 Q. And then you get down into lines 20 and 21,
11 this is what I wanted to explore a bit, where you're
12 talking about a relatively, well, higher than your
13 recommendation on common equity ratio. You state:

14 These decisions regarding PSE's capital
15 structure are not necessarily consistent
16 with the interests of rate payers.

17 So can you opine on that in a summary
18 fashion, what do you mean by that?

19 A. I'm saying that if you use an equity ratio
20 that's higher than it needs to be, that results in a
21 higher cost of capital and also higher revenue
22 requirement. That is because the higher cost of capital
23 is the fact that the return on equity component has to
24 be bumped up for taxes. So there are some benefits for
25 the company having a higher equity ratio, but they're

0704

1 not always the benefits of customers, and there needs to
2 be some balance there.

3 Q. And then you go on to say, you talk about the
4 owners' new management and capital structure with the
5 holding companies above the regulated utility, PSE,
6 correct?

7 A. Correct.

8 Q. And you heard my exchange with Dr. Morin on
9 this point, and could you just explain for the
10 Commission why we should be concerned about leverage in
11 the parent companies, the capital structure above the
12 regulated utility, and what sorts of evidence should we
13 be looking at and why?

14 A. Okay, that's a convoluted question, I will
15 try to give you a briefly concise answer. But the
16 objective of the cost of capital analysis is to
17 recognize the capital cost of business, and one of the
18 capital costs is the cost of common equity. And when
19 you determine a cost of equity in a regulatory setting,
20 let's just say hypothetically it's a 10.0% cost of
21 equity, you're saying that the company's shareholders,
22 stockholders, should have the opportunity to earn a 10%
23 return on the value of their investment, the equity
24 investment. If the money coming into the utility
25 reflects a combination of debt and equity, what that

0705

1 really means is because of leverage at a higher level
2 that is a parent or ultimate parent. The effective
3 return is to be much higher then because of so called
4 double leverage. And there's nothing -- in the case of
5 utility holding companies, you can actually measure the
6 impact of double leverage because you would see what the
7 parent's capital structure is, but that's not true here.
8 And I referred this morning to the ultimate owners of
9 PSE are probably largely or partly pension funds. Well,
10 pension funds invest their dollars in a combination of
11 debt equities, and this combination of debt and equity
12 put into any utility or viewed from that perspective
13 it's you can have a situation where a higher return is
14 ultimately comes out of there. But again, the key
15 factor is debt one level down for the pensions is where
16 the debt is raised by the consortium, and this debt
17 issues its leverage, and because that's leveraged, the
18 ultimate return that you grant could be considerably
19 higher than what you intend it to be.

20 Q. So in the next paragraph you say that:

21 The equity ratio following the
22 completion of the merger may give the
23 appearance of a capital structure
24 manipulation by PSE's parent company.

25 So is that what you're referring to is that

0706

1 because the Commission does not have all the information
2 necessarily or visibility over what the parent companies
3 may be doing with leverage that we should be somewhat
4 conservative in the capital structure and there could be
5 an appearance issue if the Commission were to grant 48%
6 or a higher equity ratio?

7 A. That's largely it, but I mean you have a
8 situation here where this company has a history of
9 having a low actual equity ratio, and this Commission
10 over time has approved equity ratios in a hypothetical
11 sense that -- I have a chart on that if you go back to
12 the 2002 case, the Commission used a 40% equity ratio
13 for this company, which is hypothetically a settled
14 number, and that exceeded the actual equity ratio of the
15 company, so I determined that to be the Commission was
16 giving the company an incentive to raise equity ratio.
17 And over time the approved equity ratios have gone up.
18 In the '04 case you used a 43% equity ratio. In the '06
19 case used a 44. And by the way, every case along the
20 line from 2000 --

21 JUDGE MOSS: Mr. Parcell, sorry to interrupt,
22 this is Judge Moss, you started your sentence from 2000
23 and you got cut off by somebody coming on the bridge
24 line.

25 THE WITNESS: That's right, that's what I was

0707

1 saying a while ago with the phone line goes dead when
2 the beep goes on.

3 JUDGE MOSS: Right, so if you could start
4 right there at 2000.

5 A. In a 2002 case, which is UE-011570, the
6 company requested a 45% equity ratio and the Commission
7 actually approved a settlement with 40.0%. In the '04
8 case, UE-040640, again the company requested a 45%
9 equity ratio, and a decision was made on 43.0%. The '06
10 case, UE-060266, again the company requested a 45%
11 equity ratio, and the Commission decision was 44%. And
12 by the way, all the way along the line here the
13 company's actual equity ratios were less than both the
14 requested and approved. And the point being the history
15 of the company asking for 45% equity ratio was actually
16 less. And suddenly after the consortium takes it over,
17 we have a requested jumping from 48%. And I understand
18 there's an appearance, there could have been an
19 appearance factor there. You know, why after all these
20 years of the company wanting 45%, why now because of a
21 new owner is the request jumping from 45% to 48%. And
22 I'm not casting stones to anyone, I'm just saying
23 there's a potential of an appearance thing here because
24 of the one factor changed is the ownership, and suddenly
25 the perception of the proper common equity ratio has

0708

1 gone up. That's what I meant by an appearance thing.
2 But your question also alluded to the fact that it's not
3 quite as transparent, and that's also a factor, so it's
4 really those two things I'm trying to convey on page 27.

5 COMMISSIONER JONES: Thank you, Dr. Parcell,
6 that's the extent of my questions.

7 THE WITNESS: Thank you.

8 JUDGE MOSS: Anything from counsel?

9 Oh, I'm sorry, Commissioner Oshie.

10

11 E X A M I N A T I O N

12 BY COMMISSIONER OSHIE:

13 Q. Mr. Parcell, this is Commissioner Oshie just
14 following up on your response to Commissioner Jones'
15 last question. Does your answer imply that the
16 investors in Puget right now are satisfied with the
17 return that it's earning, its overall rate of return
18 earned if they're investing more capital and more equity
19 into the company?

20 A. I'm not sure you can make that direct
21 finding. Obviously I think you get to go a little bit
22 further. I think to answer that question properly, you
23 would have to say, well, before they decided to purchase
24 the company, what were the prospects this company would
25 earn, you look at the capital structure, authorized

0709

1 returns, and then the decision made to purchase the
2 company at that point in time would have reflected some
3 kind of an acceptance. Once the decision was made to
4 purchase the company, I think they're committed to go
5 ahead and put capital into construction and provide
6 services, et cetera. So I think the real question is
7 what was the indication 2 years ago as opposed to 2010.

8 COMMISSIONER OSHIE: Okay.

9 A. I think your point is proper, just time frame
10 would be, in my view, would be more in terms of the
11 premerger time frame as opposed to current time frame.

12 JUDGE MOSS: Chairman Goltz.

13 CHAIRMAN GOLTZ: Yes, thank you.

14

15 E X A M I N A T I O N

16 BY CHAIRMAN GOLTZ:

17 Q. Mr. Parcell, this is Jeff Goltz, a couple of
18 questions, I'll be fairly brief. You had said in
19 response to Commissioner Jones that current economic
20 factors bias CAPM maybe a little bit lower and the DCF a
21 little bit higher, so you can't ignore CAPM without
22 adjusting perhaps the DCF analysis a little bit?

23 A. That's correct.

24 Q. And just sort of at a higher level, what
25 would be an economic situation in your opinion where

0710

1 that would be reversed, where one -- where CAPM would
2 overstate it and DCF would understate it, what would be
3 -- are there sort of factors where that -- the biases
4 would be reversed?

5 A. If you have a circumstance where there was a
6 perceived temporary phenomenon that drove interest,
7 government interest rates up above what was perceived to
8 be normal levels, that could create a circumstance where
9 the CAPM would be overstated.

10 Q. And that's because the risk free rate would
11 be sort of unusually or abnormally high?

12 A. That is correct.

13 Q. So is that based --

14 A. And all --

15 Q. Go ahead.

16 A. And another consideration but this is less so
17 because betas are basically based on 5 years of data,
18 but if you have a situation where utilities
19 substantially outperform the market over a period of
20 time such that their betas were higher. A higher beta
21 normally implies greater risk, but a situation could
22 occur where a better performing utility could create a
23 higher beta, which would be misleading. Those are
24 circumstances where the CAPM could overstate.

25 Q. Okay.

0711

1 And then just so I would like to ask you the
2 same question I asked Dr. Morin about the how risky
3 Puget Sound Energy is as it embarks upon or is in the
4 middle of this construction phase. Did you hear that,
5 Dr. Morin's response to my questions?

6 A. Yes, sir.

7 Q. And is -- what's your view on sort of the
8 impact of this construction endeavor on the riskiness or
9 the risk to investors of PSE?

10 A. Well, I don't regard PSE as being
11 substantially different from other utilities. We have a
12 situation where the electric utilities from like 1985
13 until 2000, maybe 2005, where there was very little
14 growth in investment because they were not building
15 power plants, and there was no capital being raised, and
16 what plants were being built were being funded by
17 internally generated funds, that is retained earnings.
18 And we have another growth cycle for utilities like that
19 where many, many, if not most utilities are actually
20 planning or building power plants, including here in the
21 East nuclear power plants, but that's a situation where
22 most utilities are doing this. So if you use a proxy,
23 new companies also in a growth mode, that growth is
24 reflected in your DCF and CAPM analyses. So in that
25 regard, PSE should not be considered different from

0712

1 proxy companies in general.

2 Q. And what about the -- my question about sort
3 of long term that a utility reliant on its own
4 generating facilities is less risky than a utility
5 that's been just relying on contracts?

6 A. Well, there's some kind of a happy medium in
7 between where perhaps, you know, too much growth makes
8 the company risky and no growth at all makes the company
9 risky, you know. To give an analogy, almost 10 years
10 ago when Pacific Power Company and Nevada Power Company
11 merged to form the New Pacific resources, part of their
12 merger application was to divest all their generation
13 assets. And in fact they actually had contracts to sell
14 the first round when the Western energy crisis hit. And
15 so instead of having a company who was potentially
16 deemed to be low risk because they were selling their
17 capacity, it was realized that perhaps the most valuable
18 thing they had was their generating capacity, so the
19 legislature passed a law to actually prevent them from
20 selling their generating capacity. So, you know,
21 perceptions changed over a 2 year period as to what the
22 risk was of having your own capacity. So I think it was
23 some kind of a fairly large happy medium of having your
24 own capacity and having your growth through your own
25 purchases, your own capacity, is useful within certain

0713

1 limits but probably not 100%.

2 Q. And my last question is the same as my last
3 question to Dr. Morin, at the public hearings we heard
4 some very thoughtful comments from folks about how much
5 they thought Puget Sound Energy should be able to earn,
6 what its ROE should be, and I think if you were to say
7 put your number in front of them of 10.0, they would say
8 that's high. So what's our -- what would be your
9 response to those people who believe that because these
10 are tough economic times, people are earning less in
11 their personal lives, and because Puget or utilities in
12 general are less risky than other investments, why
13 shouldn't the ROE be substantially lower than even 10%?

14 A. Okay. Well, actually in an indirect way I
15 addressed that in the first part of my testimony where I
16 said, you know, what's changed in terms of capital costs
17 since the last case, and one of the factors I mentioned
18 was the fact that alternative investments are having
19 lower returns now in Puget's business or not as much
20 money as prior years. If a customer wants to go to a --
21 if I can get a CD that gets 2%, he or she has done very
22 well. Having said all that, as a cost of capital
23 witness like I am, Dr. Morin is, Mr. Hill is, I view it
24 as our job is to look at the financial models, financial
25 markets, and do our analyses based on what we see there.

0714

1 What you're asking me is more of a what I perceive to be
2 a policy factor, a policy factor decision that's
3 something that a commission has the luxury of taking
4 into consideration that a witness does not.

5 Q. So you're punting?

6 A. I'm saying that I'm not --

7 Q. I'm sorry, could you slow down a little bit,
8 I'm having trouble following you.

9 A. What I'm saying is that I am comfortable with
10 my 10.0% cost recommendation from a technical, economic,
11 and financial perspective. If from a policy or real
12 world perspective you or some other commission determine
13 that something lower is appropriate at this point in
14 time, that's a different reason that you can consider
15 that I can not or should not consider. That's what I'm
16 saying.

17 Q. I understand, thank you.

18 A. It's my job to give you a financial economic
19 perspective, and it's your job to make a decision based
20 upon all factors, including economic and financial, but
21 not limited to that.

22 Q. I understand, thank you, I have nothing
23 further.

24 THE WITNESS: Thank you.

25 JUDGE MOSS: All right, I believe that now

0715

1 does complete the questions from the Bench.

2 Mr. Cedarbaum, do you have anything?

3 MR. CEDARBAUM: No, I don't.

4 JUDGE MOSS: All right, thank you very much,
5 Mr. Parcell, we appreciate having your testimony today.
6 That apparently completes our examination, and I imagine
7 you may wish to continue listening in.

8 THE WITNESS: I will stay on the line, yes.

9 JUDGE MOSS: But we will release you subject
10 to recall if needed.

11 And also we'll take our recess right now.
12 We'll just try for a 5 minute break then and everybody
13 try to be back at about 10 after or, I can't see that
14 clock, a quarter after.

15 CHAIRMAN GOLTZ: Actually that clock is slow.

16 JUDGE MOSS: So let's say a quarter after
17 by our far more accurate wrist time pieces, 5 minutes.

18 (Brief recess.)

19 JUDGE MOSS: All right, let's be back on the
20 record. Counsel has just reminded me, Mr. Cedarbaum I
21 should say that, has just reminded me that he did
22 circulate this morning two supplemental exhibits for
23 Mr. Story, to which I understand there is no objection.
24 I'm going to mark those as JHS-33 and JHS-34, and they
25 will be admitted with those numbers. I will craft

0716

1 appropriate descriptions in the exhibit list responsive
2 to data requests. There won't be any questions with
3 regard to them, so I haven't circulated those yet.

4 I asked Mr. Hill to take the stand, and we
5 have some brief questions from the Bench. Can we
6 stipulate his exhibits and so forth in?

7 MS. CARSON: Yes, Your Honor.

8 MR. FFITCH: Your Honor, we do have three
9 minor corrections for Mr. Hill to make.

10 JUDGE MOSS: All right, fine, well, let's
11 just go ahead and we'll stipulate the exhibits in,
12 that's SGH-1THC through SGH-16, and with that I will
13 swear the witness, and we can have the corrections, and
14 then we'll have the questions, all right.

15 (Witness STEPHEN G. HILL was sworn.)

16 JUDGE MOSS: Thank you, please be seated.

17 Mr. ffitch, go ahead.

18

19 Whereupon,

20

STEPHEN G. HILL,

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

23

24

25

0717

1 D I R E C T E X A M I N A T I O N

2 BY MR. FFITCH:

3 Q. Good morning, Mr. Hill. Could you please
4 turn to your direct testimony in this case, Exhibit
5 SGH-1HCT.

6 A. I have it.

7 Q. And do you have any changes or corrections to
8 that exhibit?

9 A. I have three typographical changes. The
10 first is on page 1. E-mail address is incorrect. It
11 should be hillassociates@gmail.com. I'm not sure
12 Compuserve is even still in existence, prehistoric
13 Internet provider.

14 Next is page 14, and at line 2 beginning with
15 the word that and ending with the word cash should be
16 struck.

17 JUDGE MOSS: This is line 3?

18 THE WITNESS: Line 2 in my version, line 2
19 begins with the word corporate.

20 JUDGE MOSS: Okay.

21 A. And after the word change at is the word
22 strike from that that all the way over to cash, and that
23 sentence makes a whole lot more sense.

24 All right, and the next one I'm going to have
25 to blame on Bill Gates, I think we should depose him.

0718

1 Page 22, when the spreadsheets was transferred and
2 embedded in the document, the dates changed at the
3 bottom of that graph. I think the easiest way to do
4 this would just be to strike those dates below the graph
5 and underneath the title write December 3rd to August
6 '09, December '03 to August '09. Those are monthly
7 priced yields between those months.

8 JUDGE MOSS: Thank you.

9 A. That's all I have.

10 JUDGE MOSS: All right.

11 MR. FFITCH: Your Honor, I just have one
12 other matter just in an excess of caution. We've
13 already talked with the company about this. Page 5 of
14 Exhibit SGH-5 contains highly confidential material,
15 page 5 of Exhibit SGH-5, so Mr. Hill's Exhibit 5, page 5
16 of that should have been marked in blue paper. There is
17 highly confidential information on that page. We have
18 requested and the Commission's records center has
19 withdrawn that from the web site. We've advised the
20 company, we are advising all parties via E-mail today,
21 we are going to refile the exhibit correctly.

22 JUDGE MOSS: All right. And if there are any
23 questions concerning that page today, we are all on
24 alert, so thank you very much.

25 All right, with that I believe we're ready

0719

1 for our questions from the Bench, Commissioner Jones.

2

3 E X A M I N A T I O N

4 BY COMMISSIONER JONES:

5 Q. Good morning, Mr. Hill.

6 A. Good morning, sir.

7 Q. My first question I think, I think you heard
8 all the exchanges that the Bench had with the other two
9 witnesses this morning on the methodologies, did you
10 not?

11 A. Yes, I did.

12 Q. So is your understanding that the Commission
13 gives more reliance to a DCF analysis than a CAPM or
14 comparable earnings or not?

15 A. I would agree with that. I think
16 historically that's been the case. Over the past four
17 or five years it's not been so clear. The Commission
18 has said we used to rely on this, but you mentioned a
19 telecom case a number of years ago where there was a
20 case where cost of capital was the only issue, and I
21 believe it was GTE Northwest, and the Commission had a
22 clear preference for the DCF.

23 Q. But my broader question is, what is your
24 recommendation in your testimony on the use, the
25 Commission's use of those -- I'll wait for the beep.

0720

1 What is your recommendation on the
2 Commission's general use of those three methodologies?
3 Should we assign equal weight? And weave into your
4 answer recent market conditions obviously with
5 volatility.

6 A. Right.

7 Q. The VIX index on stock prices on utility
8 stocks.

9 A. Right. The recent volatility in the market
10 and events of the fall of 2008 made cost of capital
11 analysis very difficult, but it was basically like a
12 giant rock thrown in the pond. It disturbed things
13 violently for a while, and now things have calmed back
14 down. So the indicators swung pretty widely, but I'm
15 not really sure that people's long-term return
16 expectations really changed all that much, and
17 ultimately we're back to a place where they were before
18 the crisis.

19 Now to your direct question, I believe that
20 DCF is probably the most reliable of all the
21 methodologies. I've always thought that. But I've
22 always also used the CAPM and other methodologies to
23 supplement that, and I think the Commission should do so
24 as well. I'm not really a fan of a simple average of
25 all the methodologies. I believe one of the problems

0721

1 with both the CAPM and risk premium is that they can be,
2 for lack of a better word, they can be gamed, and I'm a
3 little less -- a little more reluctant that is to put a
4 lot of weight on those methodologies. I understand what
5 you said about the CAPM and I agree with you about
6 theoretical support for that model. It's a very elegant
7 model and it's used in all business schools and firms do
8 use it, you know, so it's valuable. But each one of
9 inputs except for the risk free rate is controversial,
10 beta, you know, there's wide swings in beta, the R
11 squares are very low, market risk premium, you've talked
12 about that already.

13 Q. Could you turn to page 62. I think this is
14 the summation part of your testimony, of your testimony
15 before you comment on the company's cost of capital
16 testimony.

17 A. I'm there.

18 Q. And just so I understand your overall
19 recommendation, you use four different methodologies and
20 come up with a range of 9.25% to 9.75%?

21 A. Yes, sir.

22 Q. And you end up at 9.50%, correct?

23 A. Correct.

24 Q. And then you throw in the cap structure that
25 you recommend a 43% common equity and the overall cost

0722

1 of capital recommendation is 7.73%, correct?

2 A. Correct.

3 Q. I just want to hone in on this interest
4 coverage issue a bit. Are you entirely satisfied with
5 that rate of return at 7.73%, that there would be
6 adequate cash flow to cover the interest needs, if you
7 will, the interest expense of the regulated utility,
8 PSE?

9 A. Yes. As I say there on page 62, over the
10 past 5 years the interest coverage has been lower than
11 what I'm recommending here. The pretax interest
12 coverage that results from my recommendation is 2.72
13 times, and over the past 5 years the average for the
14 company has been lower, so my recommendation actually
15 gives the company an opportunity to improve its pretax
16 interest coverage.

17 Q. My last question, if you could turn to page
18 16.

19 A. 60 or 16?

20 Q. 1-6, 16 of your testimony. And, Dr. Hill, I
21 don't intend to get into the ring fencing discussion in
22 the merger case, so you can be satisfied that that's --
23 this Commissioner at least is beyond that now. What I'm
24 talking about here is on lines 23 and 24, and this
25 relates to Commissioner Oshie's question that you

0723

1 probably heard. And there you make the point that
2 investors bought Puget with an in place allowed ROE of
3 10.1%. It should really be 10.15%, correct?

4 A. Yes.

5 Q. And then you make the point if that wasn't a
6 sufficient return for investors, cost of equity, et
7 cetera, the transaction would not have been consummated.
8 It did proceed. So could you just elaborate briefly on
9 that point. I think I understand it, but get into the
10 investors' expectations of return on common equity based
11 on a transaction of this --

12 A. All right, well, the investors that are
13 involved in this transaction are savvy. They know
14 what's going on. They know that the moneys that flow
15 from rate payers to Puget Sound Energy are the moneys
16 that will eventually come to them. There are no other
17 moneys available. And if they thought that the rate of
18 return that was being allowed, 10.1%, would not provide
19 them with the return that they required, then they
20 wouldn't have gone through with the purchase. They
21 would have gone, hey, wait a minute, we don't think we
22 can live with that. It's that simple.

23 Q. And as I recall, the two proceedings were
24 done relatively in parallel, correct?

25 A. Yes, they were.

0724

1 Q. The merger proceeding of course was teed up
2 in early '08 with testimony; you were involved in that?

3 A. Yes.

4 Q. And then the rate case was teed up I think
5 roughly about the same time. The rate case settled,
6 Commission approved it before our order on the merger
7 case, correct?

8 A. Right, the settlement occurred before the
9 hearing on the merger settlement and our Public
10 Counsel's cross-examination of that whole thing. So 2
11 or 3 months before the merger case was heard I think the
12 settlement happened. Maybe it wasn't that long, maybe
13 it was just a month, but it was before the merger case
14 took place.

15 Q. And I guess one more question before I let
16 you go. I think what page did you have the, oh, could
17 you turn to page 24 of your testimony. This deals with
18 the bond yield spreads.

19 A. Yes.

20 Q. Now just summarize again your point here that
21 the -- as I understand this graph, it is that, as you
22 said earlier, things have stabilized. We had this big
23 turmoil, things have stabilized, but isn't the point of
24 this graph that, you know, right now, January 2010,
25 well, this graph only goes until September, does it not?

0725

1 A. That's correct.

2 Q. So what are the -- but your point here is
3 that bond yield spreads have actually gotten more narrow
4 than pre-crisis?

5 A. Yes, that's correct, that's what this shows.
6 This shows that prior to the crisis in August the
7 spreads were about 250 basis points. And then after
8 Lehman failed, you see they widened extremely wide until
9 the widest point was probably November of 2008. And
10 then as we've gone past that point, the investors have
11 gotten a little more -- a little less nervous, and
12 they're requiring lower and lower yields. Treasury
13 bonds have resumed their position prior to the crisis,
14 and the yield spreads are actually, now, are actually
15 below what they were pre-crisis is what it shows.

16 Q. So this shows investor returns are lower than
17 they were before the crisis and in general that the bond
18 markets have -- and I think Dr. Morin supported that
19 point too?

20 A. Yes.

21 Q. They've gone a long way towards
22 stabilization?

23 A. They calmed down, yes.

24 COMMISSIONER JONES: Okay, thank you.

25

E X A M I N A T I O N

1

2 BY CHAIRMAN GOLTZ:

3 Q. Mr. Hill, just one question, and that is if
4 you could respond to my questions I asked the other
5 witnesses about the relative riskiness of Puget Sound
6 Energy compared with other utilities based on their
7 capital construction requirements.

8 A. Well, two points about that. First of all
9 the objective indicators in the marketplace are that
10 Puget is not more risky, but less. I believe as we
11 discussed with Dr. Morin, he said the average BBB bond
12 rating bond yields are around 6.1% or something.
13 Puget's most recent bond issue was 5.75%. That tells us
14 investors are -- need a lower return from their
15 investment in a bond of Puget Sound Energy than the
16 average BBB rated company. So that's an objective
17 measure that actually Puget Sound Energy's risk is
18 lower, not higher. I used a sample of BBB rated
19 companies in my analysis to estimate the cost of equity,
20 so that effectively assumes the risk is about the same.

21 Now with regard to the specifics of
22 construction risk, we heard Mr. Markell say yesterday or
23 the day before that subsequent to the merger Puget is
24 not concerned about raising the money for their
25 construction. That was part of the merger. There are

0727

1 debt vehicles in place at Puget Energy that were put in
2 place in order to meet the company's 5 year capital
3 requirements. So their concern now is refunding their
4 own debt at the Puget Sound Energy level as it comes
5 due. And Mr. Markell voiced some concern about being
6 able to access the capital markets and that sort of
7 thing, which is of course a concern, but now that the
8 capital markets have settled back down should not be a
9 problem for Puget.

10 CHAIRMAN GOLTZ: Okay, thank you.

11 JUDGE MOSS: All right, I believe that
12 completes the questions from Bench. Anything from
13 counsel?

14 All right, thank you very much, Mr. Hill, we
15 appreciate you being here today, and we'll release you
16 subject to recall if needed.

17 THE WITNESS: Thank you.

18 JUDGE MOSS: We are going to have to break
19 about 5 minutes before the hour in order for some other
20 business to be undertaken, but we might be able to get
21 Mr. Gaines up and off in that period since we only have
22 30 minutes of cross designated for him and counsel have
23 proved adept at shortening their estimated times.

24 MR. CEDARBAUM: And, Your Honor, I have
25 shortened mine to --

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1 JUDGE MOSS: To zero.

2 MR. CEDARBAUM: -- zero.

3 JUDGE MOSS: Boy, I'm good.

4 Thank you.

5 (Witness DONALD E. GAINES was sworn.)

6 JUDGE MOSS: Thank you, please be seated.

7

8 Whereupon,

9 DONALD E. GAINES,

10 having been first duly sworn, was called as a witness

11 herein and was examined and testified as follows:

12

13 D I R E C T E X A M I N A T I O N

14 BY MS. CARSON:

15 Q. Mr. Gaines, please state your name and title

16 and spell your name for the court reporter.

17 A. My name is Donald E. Gaines, last name is

18 spelled G-A-I-N-E-S, my title is Vice President of

19 Finance and Treasurer of Puget Sound Energy.

20 Q. Mr. Gaines, do you have before you what have

21 been marked for identification as Exhibit Numbers DEG-1T

22 through DEG-20?

23 A. Yes, I do.

24 Q. Do these exhibits constitute your prefiled

25 direct, supplemental, and rebuttal testimony and related

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1 exhibits in this proceeding?

2 A. They do.

3 Q. Were these exhibits prepared under your
4 supervision and direction?

5 A. Yes.

6 Q. Do you have any corrections to any of your
7 exhibits at this time?

8 A. I have two minor corrections to my original
9 testimony, but they are not items that affect the
10 revenue requirement in this case. I would like to go
11 through them. They are both in my Exhibit DEG-1T, and
12 if you would turn to page 17 in DEG-1T. There's
13 basically an addition error on line 4. The number that
14 reads 1.05 should read 1.15.

15 And then if we go to page 32 of that same
16 exhibit, there was a transposition of the commercial
17 paper ratings on lines 13 and 14. My testimony as
18 written reads PSE's commercial paper rating was
19 increased from a 2 to a 3, and it should be reversed, it
20 should read from a 3 to a 2.

21 Q. Thank you, Mr. Gaines. With those
22 corrections, are your prefiled direct, supplemental, and
23 rebuttal testimony and accompanying exhibits true and
24 correct to the best of your information and belief?

25 A. Yes, they are.

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1 MS. CARSON: Thank you.

2 Your Honor, PSE offers Exhibits DEG-1T
3 through DEG-20 into evidence and offers Mr. Donald E.
4 Gaines for cross-examination.

5 JUDGE MOSS: Okay, hearing no objection,
6 those will be admitted as marked.

7 We also have Exhibits DEG-21 through 30,
8 which are Public Counsel cross-examination exhibits, any
9 objection to any of those?

10 MS. CARSON: No objection, Your Honor. There
11 are two that have been supplemented I just wanted to
12 note, DEG-24 and DEG-26, and we have provided those.

13 JUDGE MOSS: All right, thank you, those will
14 be admitted as marked.

15 And with that, Mr. ffitch, you can go ahead.

16 MR. FFITCH: Thank you, Your Honor.

17

18 C R O S S - E X A M I N A T I O N

19 BY MR. FFITCH:

20 Q. Good morning, Mr. Gaines.

21 A. Hi, Mr. ffitch.

22 Q. This will be quite brief. Please refer to
23 cross exhibit I believe it's DEG-29 if I have the
24 initials correct, response to Staff Data Request 225.
25 Do you have that?

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1 A. I do, yes.

2 Q. And in that data request, Staff asked you a
3 question regarding the difference between what Puget had
4 projected for its debt cost and what its current actual
5 debt costs are; do you recall that?

6 A. The question actually dealt with how the most
7 recent debt issue compared with what's being used, what
8 the projected costs are, so we're comparing two
9 different times periods, the current period or the then
10 current period to the March period and the September
11 period of 2010 when we have planned funding.

12 Q. All right. And you here are discussing a
13 recent debt issue on cost rate of 5.757%, correct?

14 A. Well, that was in the question. What I was
15 talking about here is it's unfair to use that picking
16 that point in time for a period of time that's not
17 known, it's unfair was my point. That was my answer.

18 Q. All right. But you characterize that number
19 in your response as the lowest rate Puget has ever
20 achieved on 30 year debt, correct?

21 A. I think yes, but with a slight correction,
22 Mr. ffitich. We said it's the lowest rate that we
23 believe is the lowest rate we've received. We didn't go
24 back and do an exhaustive study, but in my 10 plus years
25 of being the Treasurer and certainly looking back on the

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1 history, I do not recall and I've never seen a rate on
2 30 year money that was lower than that.

3 MR. FFITCH: Thank you, those are all my
4 questions.

5 Thank you Your Honor.

6 JUDGE MOSS: Thank you very much.

7 Anything from counsel, or no, I guess I
8 should ask about the Bench first in the typical course
9 of proceeding here.

10 All right, nothing from the Bench.

11 MS. CARSON: Your Honor, we were hoping to
12 use Mr. Gaines to clarify the issue that came up in
13 Mr. Markell's testimony about the stub dividends, and I
14 think we told the Bench that we would clarify that
15 issue.

16 JUDGE MOSS: All right.

17 MS. CARSON: Would it be acceptable for
18 Mr. Gaines to clarify that now?

19 JUDGE MOSS: Let's clarify that issue.

20

21 D I R E C T E X A M I N A T I O N

22 BY MS. CARSON:

23 Q. Mr. Gaines, do you have before you Exhibit
24 EMM-9?

25 A. Yes, I do.

0733

1 Q. And looking at page 2 of that, part B, you
2 can see a table showing regular dividend, stub dividend,
3 and post merger stub dividend?

4 A. Yes.

5 Q. Were you able to hear the testimony of
6 Mr. Markell on this subject?

7 A. Yes, I was. Although I was not in the
8 courtroom, I was dialed in through the conference bridge
9 line, so I did hear the testimony. And it seemed to me
10 that he was perhaps confusing some of his responses to
11 the questions and perhaps answering questions that
12 weren't asked maybe or other questions when answering,
13 so I think there was some confusion left perhaps in the
14 record on what these components were. I think there was
15 confusion as to the fact that somehow the company had
16 doubled its dividend, which isn't the case at all.

17 Q. Could you clarify the dividends paid?

18 A. I will, yes. Previous, prior to the merger
19 for the recent periods, the company's quarterly dividend
20 was 25 cents per share. We had about 130 million shares
21 of common stock outstanding. That resulted in a
22 dividend of roughly \$32 Million a quarter. When you see
23 in the table that you pointed me to, part B, page 2 of
24 this exhibit, the regular dividend as mentioned here is
25 \$32.4 Million, and that's roughly the -- that's the

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1 number that's roughly in line with my \$30 Million that I
2 just paraphrased here. At the time -- and I think the
3 confusion dealt with the dates and the names of the
4 various dates used in declaring and recording dividends.

5 There's three dates that really matter when
6 you're setting a dividend policy. The first date is the
7 declaration date, the second date is the record date,
8 and the third date is the payment date. So what happens
9 is a board of directors will, in general now, will
10 declare a dividend on a date as of a record date that
11 maybe is a few days hence, so they'll say maybe January
12 4th that starting on January 20th we'll pay a dividend
13 of 20 cents a share for shareholders on record as of
14 January 22nd. That dividend will be paid on February
15 15th in our case. That quarterly dividend, if you will,
16 covers the period from the prior record date to that
17 January 22nd record date. So that's what that first
18 dividend date, the regular dividend from 2008, it
19 covered a period between record dates, and that was a
20 quarterly period, so it was a quarterly dividend.

21 I think there's always confusion that the
22 payment of the dividend corresponds with the payment
23 date, it doesn't. It actually corresponds with the
24 record date, which was prior. So when the company was
25 acquired, the commitment to existing shareholders was

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1 that they would be entitled to their regularly quarterly
2 dividends, and then they would be entitled to a dividend
3 to cover them up to the period in which time their stock
4 was purchased at \$30 a share. So we have the normal
5 dividend, not knowing what has been proposed to the
6 board, declared a regular dividend for the quarter that
7 ended March 22nd, 2009, and that would be payable on
8 February 15th, and that turned out to be after the date
9 of the merger.

10 And then there was a period of time that
11 spanned from January 21st through the February 6th, so
12 that would be probably 16 days or so, so there was a
13 dividend of basically 16/90, you know, going 16 days
14 over 90 days in a quarter, that was declared, and that
15 was the stub period dividend.

16 So the regular dividend of \$32,400,000 was
17 paid to the prior shareholders. The dividend, the stub
18 dividend was paid to the prior shareholders, that was
19 the \$5.8 Million. And then also in a board meeting the
20 board declared a dividend up from Puget Sound Energy up
21 to Puget Energy up to Equico of the \$30.4 Million. And
22 I think what happens is when we -- when you just look at
23 these quarters, you go, oh, gee, you know, we went from
24 \$32 Million to \$68 Million, that's a doubling. Well,
25 there's sort of some stub period dividends that confuse

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1 things. The company also has a lot more equity now.
2 Remember the consortium put in over \$300 Million of
3 equity at the time they announced the merger. They
4 invested another \$800 Million of equity at the time that
5 the merger closed. So when you look at the dividends
6 paid as a percent of the equity outstanding, that
7 percentage hasn't really changed from before and after.

8 MS. CARSON: Thank you.

9 JUDGE MOSS: Any questions from the Bench?

10 Commissioner Jones.

11

12 E X A M I N A T I O N

13 BY COMMISSIONER JONES:

14 Q. I just have a short question, Mr. Gaines.

15 Good morning.

16 A. Good morning.

17 Q. I think your -- I didn't realize this, but
18 there's cross -- it's your Exhibit 21, is it not, the
19 presentation to S&P, ratings agency business update
20 dated August 21st, 2009, in which -- do you recall that
21 exhibit?

22 A. I think it's 22, DEG-22.

23 Q. Okay. Was this prepared under your
24 direction?

25 A. Yes, it was.

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1 Q. Just a few questions about this. Did you
2 participate in that meeting with Mr. Markell?

3 A. I did, yes.

4 Q. Who were the people from PSE who were in that
5 meeting?

6 A. I believe there were three. I might be
7 wrong, but I recall there being Mr. Markell, myself, and
8 then Durga Doraisamy, who is our Director of Investor
9 Relations, who still has that role working with the new
10 investors.

11 Q. Okay. And there was a specific, I don't mean
12 to get into confidential information here, but there was
13 a bullet entitled regulation.

14 A. Can you point me to the page at least so I
15 can refresh my memory.

16 Q. I think it was on page 34 of that
17 presentation. That would be starting on page 38 in the
18 upper right-hand corners.

19 A. Yes, I have that page, and I can probably
20 answer this without getting into the confidential items.

21 Q. Right. I would just like to confirm that
22 this was a presentation made by PSE to S&P, that this
23 was part of the materials that were presented?

24 A. Yes, it was, and it was also sent to Moody's
25 in the interest of full disclosure, although we did not

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1 discuss it with Moody's.

2 COMMISSIONER JONES: Okay, thank you, that's
3 all I have.

4 JUDGE MOSS: All right, anything further?

5 Apparently not. All right, Mr. Gaines, we
6 appreciate you being here this morning and giving your
7 testimony.

8 I think we'll go ahead and take our recess,
9 and the Commissioners are free to go at this time, but
10 just as we get near the end here let me say that we have
11 the next witness for whom we have cross-examination
12 indicated I believe is Mr. Nightingale, and then we have
13 after that Mills, Odom, and that's it.

14 MR. CEDARBAUM: I believe Mr. Ffitch can
15 confirm that there is no cross-examination for --

16 MR. FFITCH: Your Honor, we have no cross for
17 Mr. Nightingale, and we've advised Staff of that.

18 JUDGE MOSS: All right, so the next witness I
19 guess will be Mr. Mills followed by Mr. Odom, and that,
20 subject to the Bench having some interest in examining
21 another witness, that will bring us to a conclusion this
22 afternoon, but for now we will be in recess until 1:15
23 by the wall clock.

24 (Luncheon recess taken at 11:50 a.m.)

25

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1 A F T E R N O O N S E S S I O N

2 (1:15 p.m.)

3 JUDGE MOSS: Good afternoon, everyone. We're
4 reconvened after the luncheon recess, and I believe
5 subject to correction that we're ready for Mr. Mills.

6 MS. CARSON: Correct.

7 (Witness DAVID E. MILLS was sworn.)

8 JUDGE MOSS: Thank you please be seated.

9

10 Whereupon,

11 DAVID E. MILLS,

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

14

15 D I R E C T E X A M I N A T I O N

16 BY MS. CARSON:

17 Q. Mr. Mills, please state your name and title
18 and spell your name for the court reporter.

19 A. My name is David Mills, last name is
20 M-I-L-L-S, I'm the Director of Energy Supply and
21 Planning for Puget Sound Energy.

22 Q. Mr. Mills, do you have before you what have
23 been marked for identification as Exhibit Numbers
24 DEM-1CT through DEM-17C?

25 A. I do.

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1 Q. Do these exhibits constitute your prefiled
2 direct, supplemental, and rebuttal testimony and related
3 exhibits in this proceeding?

4 A. They do.

5 Q. Were these exhibits prepared under your
6 supervision and direction?

7 A. Yes, they were.

8 Q. Do you have any corrections to any of your
9 exhibits at this time?

10 A. No, I do not.

11 Q. Are your prefiled direct, supplemental, and
12 rebuttal testimony and accompanying exhibits true and
13 correct to the best of your information and belief?

14 A. Yes, they are.

15 MS. CARSON: Thank you.

16 Your Honor, PSE offers Exhibits DEM-1CT
17 through DEM-17C into evidence and offers Mr. David E.
18 Mills for cross-examination.

19 JUDGE MOSS: And hearing no objection, those
20 will be admitted as marked.

21 We also have exhibits for cross-examination
22 designated for identification as DEM-18C through DEM-33,
23 is there any objection to any of these?

24 MS. CARSON: No objection.

25 JUDGE MOSS: All right, there being no

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1 objection to those, then we will admit them also as
2 marked.

3 Mr. Cedarbaum, did you have some cross for
4 Mr. Mills?

5 MR. CEDARBAUM: I do have just a few
6 questions, Your Honor.

7 Should I proceed?

8 JUDGE MOSS: Proceed, please, yes.

9

10 C R O S S - E X A M I N A T I O N

11 BY MR. CEDARBAUM:

12 Q. Good afternoon, Mr. Mills.

13 A. Good afternoon, Mr. Cedarbaum.

14 Q. If you could just turn to your Exhibit
15 DEM-15, it's a one-page exhibit. Let me know when you
16 have it.

17 A. I have it.

18 Q. And this is a summary of production O&M; is
19 that correct?

20 A. That's correct.

21 Q. On the left-hand side of the page there's a
22 column listing all the resources; is that correct?

23 A. Right.

24 Q. And so this page is a summary of O&M, company
25 proposed O&M adjustments for the resources listed on the

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1 page?

2 A. That is correct.

3 Q. Is it correct that the adjustment proposed by
4 the company for the Colstrip 1 and 2 and 3 and 4 units
5 are based on budgeted figures?

6 A. I will have to refer that question to
7 Mr. Odom to testify on the production O&M aspects.

8 Q. Would that be true for all of the resources
9 listed on this page?

10 A. Yes, it is.

11 MR. CEDARBAUM: Then, Your Honor, I guess
12 I'll just defer those questions to Mr. Odom.

13 JUDGE MOSS: All right.

14 MR. CEDARBAUM: Those are all my questions.

15 JUDGE MOSS: All right, thank you very much.

16 That will bring us then on my list the next
17 is Public Counsel, Mr. Ffitch.

18 MR. FFITCH: Your Honor, with the Bench's
19 permission, we are willing to let ICNU go first, and
20 that may cover some areas that we were going to touch on
21 and we could be more efficient.

22 JUDGE MOSS: That's fine, go ahead, Mr. Van
23 Cleve.

24

25

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1 C R O S S - E X A M I N A T I O N

2 BY MR. VAN CLEVE:

3 Q. Good afternoon, Mr. Mills.

4 A. Good afternoon, Mr. Van Cleve.

5 Q. Does PSE use the AURORA model to determine
6 the power costs that it includes in rates?

7 A. Yes, we do.

8 Q. And --

9 A. The AURORA model, cost - not in models
10 adjustment.

11 Q. And there's a, the forward gas prices,
12 there's a 90 day average that's an input to the model?

13 A. That's correct, it's a 3 month moving average
14 of daily forward prices.

15 Q. And I think you alluded to the I believe it's
16 called the cost - not in AURORA Excel Workbook, can you
17 tell us what that is?

18 A. The not models or the cost - not in AURORA
19 are intended to capture the costs that AURORA is not
20 capable of catching. AURORA is a production cost model
21 that dispatches units and takes that 3 month gas price
22 and creates a power price and then dispatches units
23 across the WTC as well as the Puget system to calculate
24 those power costs. There's a number of other costs, as
25 an example transmission costs, that are not able to be

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1 captured in AURORA, those are the types of other costs
2 captured in the not model.

3 JUDGE MOSS: Mr. Mills, our court reporter is
4 really excellent, but if you could moderate your pace of
5 speech a little bit, I think it would help.

6 THE WITNESS: I will, Your Honor.

7 JUDGE MOSS: Thank you.

8 BY MR. VAN CLEVE:

9 Q. In this case the company is proposing to make
10 a not in AURORA adjustment for short-term gas purchases
11 of \$45 Million; is that correct?

12 A. I believe the dollar amount you're referring
13 to is for the mark to market component of the short-term
14 gas purchases.

15 Q. And what does that mean?

16 A. And I will try to go slow. Keep in mind that
17 AURORA is nothing more than a forecasting tool, again a
18 production cost model, takes a forward look, a 90 day
19 look at gas prices and then produces all of the dispatch
20 logic and outputs accordingly. Because of Puget's
21 hedging program, at the time we run the model to produce
22 these end results, we've already entered into a number
23 of financial or physical natural gas hedges. So the
24 first thing that the mark to market captures on a model
25 basis is the difference between what those hedges, the

0745

1 actual hedge price and volumes were versus what the
2 inputs into AURORA were.

3 So for example we've had a, in the last 18
4 months, we've had an unprecedented run up and then run
5 back down in natural gas prices. Puget's hedging
6 program, which has been in place since 2004, modified in
7 2007 to add an additional 18 months of tenure, has not
8 been changed at all. In fact we did extend the hedging
9 program to deal with these types of variabilities.
10 Unfortunately what we have in this situation in this, in
11 what is being captured in that \$45 Million, is a
12 situation where the company has been hedging on a
13 regular basis per our programmatic strategy against a
14 scenario in the market where the market has dropped off
15 precipitously.

16 Q. Did the company have a programmatic hedging
17 strategy in place before 2004?

18 A. That's a definitional issue. I think that
19 some of the experts in the business would say yes, it
20 was a programmatic. 2004 is just after I arrived at the
21 company. We had an exposure based dollar cost average
22 approach to remove volatility from the portfolio. I
23 think some of the more advanced hedging strategies and
24 academics that go around it would say that the model
25 that we have now, which was adopted in 2004, is a fully

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1 blown programmatic with some fundamental adjustments,
2 fundamental meaning that the trading floor can make
3 adjustments to accelerate or decelerate the hedges based
4 upon market conditions.

5 Q. Is the time frame that you hedge for 18
6 months?

7 A. No, that was revised in 2007 to 3 years.

8 Q. And the gas volumes and hedges that are
9 included in the \$45 Million mark to market adjustment,
10 are those solely related to gas used to run Puget's
11 generating facilities?

12 A. It is gas for power generation.

13 Q. Does the AURORA model project the expected
14 generation of PSE's gas fired resources?

15 A. Yes, it does, but it does it in a very static
16 manner. Again you're feeding it this 90 day average of
17 daily forward power or gas prices. From that it
18 dispatches the regions in the company's assets to back
19 into what is a market heat rate. Again that's just a
20 forecast, and then what happens is then reality. And as
21 we all know from planning a power system, anything but
22 what the plan is what happens.

23 Q. Now Mr. Buckley and Mr. Schoenbeck are
24 proposing an adjustment to the \$45 Million mark to
25 market adjustment, right?

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1 A. Yes, that's my understanding.

2 Q. And it's based on their view that the hedges
3 that the company put in place exceed the gas need that's
4 shown in AURORA; is that right?

5 A. That is their premise, but again we don't use
6 the AURORA model to actually model or to actually manage
7 the portfolio on a day-to-day basis.

8 Q. Do you have their testimony, it's Exhibit
9 JT-1CT?

10 A. I believe I do.

11 Q. If you could refer to page 21 of the joint
12 testimony.

13 A. I'm there.

14 Q. And the table that starts at line 10 on page
15 21, that's a comparison of the gas needs shown by AURORA
16 and the financial hedges that the company's put in
17 place, correct?

18 A. That is my understanding.

19 Q. And are the numbers in that table accurate?

20 A. I didn't prepare this table.

21 Q. Well, did you review them to determine
22 whether they were accurate?

23 A. I did, yes. My -- I did review them, but
24 it's been quite some time.

25 Q. So you don't know whether they're accurate or

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1 not?

2 A. Down to the decatherm a day, no, I'm not.
3 I'm willing to agree that when we did review this the
4 first time, the absolute percent numbers seemed to be
5 about appropriate relative to AURORA.

6 But I must say that we don't dispatch nor do
7 we purchase gas based upon what AURORA tells us to
8 manage the portfolio towards. We run a very robust
9 management system that is fed daily updated gas and
10 power prices as well as updated unit outages and
11 transmission constraints across our system. That would
12 include such things as lower than normal hydro
13 conditions, temperature excursions away from normal
14 temperature, which is what AURORA forecasts against.
15 And so what this tells me is that the actual market heat
16 rate has been quite a bit higher than what was modeled
17 in AURORA. And given what we've seen going on with
18 commodity prices, that fits with my understanding of
19 where the last 18, 20 months have been. So it doesn't
20 surprise me that on an actual running and managing the
21 portfolio basis that we purchased more gas for power
22 than what was modeled in AURORA.

23 Q. Now Public Counsel has raised the point in
24 this case that the company's actual wholesale power
25 sales are significantly above what's assumed in rates;

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1 is that right?

2 A. They have raised that.

3 Q. And does the company use the AURORA model
4 dispatch of its resources to determine the wholesale
5 sales that are put into rates?

6 A. For the assumption for what is put into
7 rates, that's correct.

8 Q. So you use the AURORA dispatch of the
9 resources to determine the wholesale sales in the market
10 but not for the gas use; is that right?

11 A. I'm sorry, I don't understand the question.

12 Q. Well, I'm trying to determine whether it's
13 consistent to use the AURORA model to determine the
14 wholesale sales that you're putting into rates but not
15 the gas volumes?

16 A. We do use the gas volumes from AURORA to put
17 into rates.

18 Q. Well, but you're putting the hedges in as an
19 adjustment, correct?

20 A. We're putting the price difference between
21 the 3 month moving average and the actual transaction
22 cost of some of those gas hedges as a not model
23 adjustment from mark to market.

24 Q. Well, aren't the volumes of the financial
25 hedges, which I pointed out in the joint parties'

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1 testimony in that table, aren't those in rates too?

2 A. Yes, they are.

3 Q. So you're using what AURORA says about the
4 company's -- the dispatch of the company's resources to
5 determine the market sales but not to determine the cost
6 of the gas?

7 A. The cost of the gas is fed in through the 3
8 month moving average. It's just a -- it's a static cost
9 for the gas. But I will also point out that we also use
10 AURORA to forecast the market purchases, and in looking
11 at the -- looking at the off system or the market sales
12 is fairly, well, is one sided, and to get a better look
13 at the dynamics of this portfolio, you also need to look
14 at the difference in the market purchases. And if you
15 net out over the last 6 rate periods the sum of what was
16 projected versus actual for both the off system sales
17 and the purchases, what you see is about an \$80 to \$83
18 Million increase in purchase costs. So you have to look
19 at, in my opinion, you have to look at both the market
20 purchases, which is a cost to the company, as well as
21 the off system sales.

22 Q. Okay. Do you use the gas that you've hedged
23 to generate power that you use to make wholesale power
24 sales?

25 A. As in addition to serving our customer load,

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1 yes. The number one priority of the portfolio is to
2 meet load reliably. Where there are economic conditions
3 that generally avail themselves to the company on a
4 shorter term basis, we run resources and make off system
5 sales. But again, AURORA is simply a snapshot in time
6 look forward to a rate period, and as we are -- in
7 actually operating the portfolio, we're using a
8 different risk system that again is updated with more
9 real time market price information, hydro information,
10 weather, transmission, so on and so forth.

11 Q. So is one of the reasons that you're using
12 more gas than AURORA says that you should be using is
13 that you're making more wholesale sales than is --

14 A. No, that's not true. One of the reasons is
15 the market heat rate in the actual running of the
16 portfolio is higher than what was assumed in AURORA.

17 Q. Doesn't that result in more sales?

18 A. Depending on other conditions, but to look at
19 just gas fired generation in light of what we had, and
20 this is now going to be the fourth of the last 9 years
21 that will be below, significantly below normal with
22 respect to hydro generation, so you can't just line of
23 sight say pull out gas fired generation, say oh, there's
24 more gas used so you guys must be making off system
25 sales, when in fact a lot of this gas used was to offset

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1 a sub par or below normal hydro situation or could be
2 used to clear transmission congestion or to firm
3 renewable resources.

4 Q. But the fact is that gas use and wholesale
5 sales are what you're proposing is greater than what
6 AURORA shows; is that right?

7 A. Restate the question.

8 Q. Yes.

9 The company's proposal is to use more gas
10 volumes and, well, not the company's proposal, in
11 actuality for the test year you expect higher gas
12 volumes and more wholesale sales than what's reflected
13 in the AURORA results?

14 A. And we also expect more market purchases.

15 Q. And you're showing through your mark to
16 market adjustments those higher gas volumes in rates,
17 correct?

18 A. You're showing the difference between the
19 transaction executed price of those gas purchases versus
20 the 3 month moving average that was fed into AURORA at
21 the volume of transactions that were entered into prior
22 to the actual AURORA run. Because what AURORA does is
23 it takes -- what our system does is AURORA will run, and
24 using Commissioner Jones' comment, AURORA is a tabula
25 rasa, it's a blank slate. We feed all this information

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1 into it. It doesn't even know at that point what hedges
2 we've entered into. So we feed it this 90 day moving
3 average price for gas, and it generates everything else.
4 At that point because of our hedging strategy that's
5 been in place for several years, we've already entered
6 into a number of gas hedges to manage the portfolio, and
7 so the first calculation you have to make is are those
8 hedges above or below the gas price assumed that you fed
9 into AURORA. That could be a credit or a cost depending
10 on if you're upside or downside of the price in AURORA.
11 The second component, AURORA then assumes that all
12 remaining gas for power will be purchased at that 90 day
13 moving average price. So there's a two-step component
14 to the gas aspect of this.

15 Q. But both the gas and the volumes are higher
16 than what AURORA says, right?

17 A. In actuality?

18 Q. Yes.

19 A. Again, given the hydro situation that we've
20 had, given unit outages that we've had on our system,
21 that does not surprise me.

22 Q. Can you refer to page 19 of your rebuttal
23 testimony.

24 A. What's the exhibit number on that?

25 Q. It's DEM-12CT.

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1 A. Which page?

2 Q. 19.

3 A. I'm there.

4 Q. If you can refer to line 9, one of your
5 arguments against the adjustment proposed by Mr. Buckley
6 and Mr. Schoenbeck is that, "customers have benefited
7 from gas for power hedging", correct?

8 A. That is the argument here, yes.

9 Q. And Table 3, this purports to show what that
10 benefit is?

11 A. That's correct.

12 Q. And there's two columns. One's labeled
13 short-term contracts, can you define what a short-term
14 contract is?

15 A. Those would be the contracts 3 years and less
16 that are entered into by the trading floor.

17 Q. And the column long-term contracts, how do
18 you define that?

19 A. I would assume those are long-term fixed
20 price gas contracts.

21 Q. And which resources do these long-term
22 contracts relate to generating resources?

23 A. I believe that it would be Tenaska and
24 Encogen.

25 Q. So according to this Table 3, practically all

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1 of the benefit that you're alleging from the gas hedging
2 strategy comes from the long-term contracts; is that
3 correct?

4 A. Up until the 2007 GRC when those contracts
5 rolled off.

6 Q. So are there any long-term contracts in place
7 now?

8 A. Not that are subject to mark to market
9 calculation. But I guess my point in the testimony is
10 if you combine the short-term and long-term, yes, you do
11 get this fairly lofty customer benefit. But even if you
12 just look at the short-term contracts over the course
13 of, well, since the 2003 PCORC, you see that it's, you
14 know, it's a half million dollar difference.

15 Q. Now if we were to put a new line in this
16 table for the current rate case, would it show under the
17 short-term column \$45 Million as a cost?

18 A. On a planning basis, yes.

19 Q. And under the long-term column would be zero?

20 A. I believe it would be zero.

21 Q. So the average cost or benefit has been a
22 cost of a half million dollars since 2003, but in this
23 case it's a \$45 Million adjustment for the short-term
24 contracts; is that right?

25 A. Given the gas prices that are in AURORA right

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1 now versus the hedges that have been executed for this
2 time period, that would be correct.

3 Q. I would like you to take a look at a few of
4 the cross-examination exhibits that we provided, and
5 we'll start with the first one, which is Exhibit DEM-21.

6 A. I'm there.

7 Q. Is this the workpaper that supports the
8 calculations in Table 3 in your rebuttal testimony?

9 A. Yes, it is.

10 Q. In footnote number 2 there, does that list
11 out the contracts that are included in the long-term
12 column?

13 A. That's correct.

14 Q. And do you know what specific resources that
15 these contracts relate to?

16 A. I believe it's Tenaska and Encogen, but there
17 may be some ability to move some of this gas to other
18 gas fire generation, but I believe it's Tenaska and
19 Encogen.

20 Q. Is each contract tied to a specific resource
21 like for instance the Aquila contract, the first one?

22 A. Yes, but I couldn't tell you which exact
23 resource.

24 Q. And the first two contracts identified there,
25 Aquila and CanWest, those started in 1993 and 1991; is

0757

1 that correct?

2 A. Respectfully that's -- respectably that's
3 correct.

4 Q. And we've established that all of the benefit
5 that you referred to is related to these long-term
6 contracts, and what you said in your testimony was that
7 customers had benefited from the gas for power hedging
8 which became much improved in 2004 and is now a
9 programmatic hedging strategy, so given that, I'm
10 wondering whether it's really appropriate to attribute
11 the benefits from contracts which go back to 1991 as a
12 benefit to your gas for power hedging strategy?

13 A. Again going back to the definition and the
14 way that the mark to market is calculated, it looks at
15 all existing hedges regardless of the transaction or the
16 execution date. It's looking at the delivery schedule
17 volume timing against that original contract price and
18 comparing that price to what the AURORA input, again the
19 90 day gas price, what the AURORA input is, and in this
20 case, those were some very low priced contracts. So it
21 would make sense that, I mean from an accounting or a
22 true up perspective, that they're treated consistently,
23 which is the logic I just explained and what is shown
24 here, that they would capture that mark to market
25 benefit.

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1 Q. But what I'm asking, is it really appropriate
2 to attribute the benefit to your hedging strategy for a
3 contract that was signed back in 1991?

4 It says at your testimony at line 10 on page
5 19 that the customers have benefitted from gas for power
6 hedging, and when you look at the table, all the benefit
7 comes from these long-term contracts. Now was your
8 contract back in 1991 part of your gas for power hedging
9 strategy?

10 A. It was not part of the existing hedging
11 strategy.

12 Q. Can you look at Exhibit DEM-23C.

13 A. I'm there.

14 Q. Page 1 is the first page of the minutes from
15 the March 19th Energy Management Committee meeting,
16 correct?

17 A. That's correct.

18 Q. And you were an attendee of that meeting?

19 A. I was.

20 Q. And I will just tell you that page 2 is page
21 number 65 of the attachments to the first document. I
22 think there were 70 pages of attachments for the meeting
23 minutes. Is this a position statement that shows your
24 gas hedging at that point?

25 A. This shows a couple things. It shows the

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1 existing gas hedges at that point, and it shows the gas
2 remaining to be hedged per the position report that was
3 generated most likely the previous day by our risk
4 system, not by AURORA.

5 Q. Do you typically leave a portion of your
6 projected gas need unhedged?

7 A. For what time period?

8 Q. Well, let's say for the 6 quarters going out
9 that this reflects?

10 A. Yes, we do. The nature of the company's
11 hedging strategy has us starting at the 3 year mark, 3
12 years out mark, starting the hedging at that point and
13 taking a little bite of the apple so to say every
14 quarter, every month, so naturally you would expect to
15 see a larger exposure out in that 3 year time frame,
16 that exposure shortening or tightening up as you get
17 closer to delivery. And given the confidential nature
18 of the hedging strategy, that's probably about as far as
19 I can explain the strategy.

20 Q. Can you refer to Exhibit DEM-24C.

21 A. I'm there.

22 Q. This is one of your workpapers?

23 A. That's correct.

24 Q. And is this the workpaper that shows the
25 calculation of the \$45 Million mark to market

0760

1 adjustment?

2 A. Yes, it does under the column labeled 8-13-09
3 update.

4 Q. And if you look at that column, the second
5 and third numbers, those are gas prices; is that right?

6 A. Second and third numbers, give me a point of
7 reference.

8 Q. Under the 8-13 update column.

9 A. Oh, that's correct.

10 Q. And the first price is the average hedged
11 price for gas?

12 A. That's correct, an average for the volumes
13 shown.

14 Q. And the second price is the AURORA gas price?

15 A. As of the 8-13 date.

16 Q. Can you refer to DEM-25C.

17 A. With a magnifying glass, I'm there.

18 Q. Is this a list of the actual transactions
19 that are the -- make up the mark to market adjustment?

20 A. Yes, it is.

21 Q. If you can refer, I just have one more line
22 of questioning back on Exhibit DEM-21, which is the
23 workpaper behind Table Number 3.

24 A. I'm there.

25 Q. If you look at the second page and the

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1 following pages, they go through and show how the
2 benefit was calculated for each rate proceeding referred
3 to in the table, correct?

4 A. That's correct.

5 Q. And for example on 2003, the entire benefit
6 is related to the Encogen contract, right?

7 A. That is correct.

8 MR. VAN CLEVE: That's all I have, Your
9 Honor.

10 JUDGE MOSS: Thank you, Mr. Van Cleve.

11 Mr. Ffitch.

12 MR. FFITCH: Thank you, Your Honor.

13

14 C R O S S - E X A M I N A T I O N

15 BY MR. FFITCH:

16 Q. Good afternoon, Mr. Mills.

17 A. Good afternoon, Mr. Ffitch.

18 Q. Go back to mark to market for a moment. Is
19 it true that Puget Sound Energy's not able to predict
20 with certainty the actual gas mark to market amount for
21 the rate year or for the months after the rate year?

22 A. Are you asking me if the AURORA model
23 prediction of mark to market will be similar to what's
24 actually experienced?

25 Q. However Puget predicts the actual gas mark to

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1 market amount.

2 A. We predict the rate period mark to market
3 amount using the AURORA model in the manner I described
4 to Mr. Van Cleve. The actual mark to market won't be
5 known until after the contract, after the transactions
6 have settled and delivered against the actual market
7 price.

8 Q. So you're not able to predict it with
9 certainty?

10 A. That is correct.

11 Q. And so isn't it the case that Public
12 Counsel's proposal to reset the gas mark to market
13 amount in the baseline power charges to zero after the
14 rate period doesn't necessarily mean that Puget Sound
15 Energy will overrecover with certainty or underrecover
16 with certainty its gas power supply costs?

17 MS. CARSON: Object to the form of the
18 question.

19 JUDGE MOSS: Did you understand the question,
20 Mr. Mills?

21 THE WITNESS: No. Could you restate the
22 question.

23 BY MR. FFITCH:

24 Q. Isn't it the case then that Public Counsel's
25 proposal to reset the gas mark to market amount to zero

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1 for the period after the rate year period --

2 A. Could you direct me somewhere for that
3 specific proposal?

4 Q. This is in Mr. Norwood's testimony. You
5 responded to it in your own rebuttal. For example, at
6 page 50 of your rebuttal you're specifically taking
7 issue with his proposal.

8 A. Go ahead with your question again. I
9 apologize, there was a number of proposals made on this
10 aspect, and I just wanted to make sure I had the right
11 one. So if you could restate your question, I will try
12 to answer it.

13 Q. All right, well, I'm summarizing the proposal
14 in the question, which is that the gas mark to market
15 amount embedded in Puget's baseline power charges would
16 be reset to zero after the rate, after the rate year
17 period in this case.

18 A. You're asking me if that's their proposal?

19 Q. No, we can all read our testimony and see
20 what our proposal is, but --

21 A. I'm still not tracking, sir.

22 Q. All right, we'll move on.

23 A. No, you're free to try again, I'm just --

24 Q. We'll move on.

25 Can you turn to page 47 of your rebuttal

0764

1 testimony, please.

2 A. I'm there.

3 Q. And on this page you have presented Table 6
4 entitled Puget Sound Energy Actual Market Transactions
5 versus Projected, correct?

6 A. That's correct.

7 Q. And this table shows that over the last 6
8 cases, the actual level of off system sale megawatts was
9 more than 10 times Puget's forecasted level used for
10 setting fuel rates, correct?

11 A. You're looking at the average line at the
12 bottom of the table?

13 Q. Yes.

14 A. That is correct.

15 Q. And in your testimony you explain that PSE
16 makes off system sales when it has more generation than
17 needed to meet its native load, correct?

18 A. That's correct, but if you'll notice in the
19 part -- upper part of Table 6 that summarizes the market
20 purchases, we also see a significant -- I'm sorry, just
21 to the left of the column we were looking at, if you see
22 the increase in market purchases, we've also had a
23 significant increase in market purchases.

24 Q. Right, and we'll get to that.

25 A. Okay.

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1 Q. Normally when you make off system sales, you
2 derive a profit because the price obtained for the power
3 is less than the cost to generate the power, correct?

4 A. Under the theory of economic dispatch, that
5 is correct.

6 Q. And those profits from those off system sales
7 then serve as a credit to the baseline power costs paid
8 by rate payers?

9 A. I believe they flow through the PCA.

10 Q. So that's a yes?

11 A. That's a yes.

12 Q. So if Puget's rate year power cost forecast
13 was adjusted to include a higher level of off system
14 sales to reflect the actual historical sales levels on
15 Table 6, baseline power charges to the retail customers
16 would be lower, wouldn't it?

17 A. Could you restate that again, please.

18 Q. If Puget's rate year power cost forecast was
19 adjusted to include a higher level of off system sales
20 to reflect the levels shown on Table 6, the baseline
21 power charges to your retail customers would be lower?

22 A. Arithmetically that's correct, but I'm not
23 sure, given the way we are all using the AURORA model
24 for rate making purposes, I'm not sure of the efficacy
25 of extracting one component of AURORA that is currently

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1 modeling the off system sales and replacing it with some
2 proxy for off system sales. It seems at some point we
3 really have to challenge the way we're using the model,
4 and right now it seems like the model is working. If
5 you look at, again you're stating that these flow
6 through the PCA, if you look at the performance of the
7 PCA over the last 6 1/2 years, the sum total of power
8 costs over that time frame were \$6.9 Billion, and I
9 believe the cumulative underrecovery has been \$6.8
10 Million. So I think that if the assertion was correct
11 that the company is making the off system sales and
12 deriving a lot of profit that you would see significant
13 overrecoveries in the PCA, which I just don't -- we just
14 don't see.

15 Q. Well, part of this nature of this proceeding
16 is that people are raising questions or challenging the
17 application and results of AURORA, isn't that true? I
18 mean if we just accept AURORA and accept Puget's use of
19 AURORA, then we have no issues in this case and we move
20 on, but various parties are in fact raising questions,
21 are they not, as we're just doing in this line of
22 questioning?

23 A. Correct, as we do every proceeding.

24 Q. Well, now let's take a look at the market
25 purchases which you've just referred to also, staying

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1 here with Table 6. In each of the last 6 cases, the
2 company's forecast of market purchases was significantly
3 lower than the actual level of market purchases during
4 the forecast period, correct?

5 A. The projected were lower than the actual,
6 that's correct.

7 Q. And in fact the actual level was more than
8 double the forecasted level of market purchases as used
9 for setting fuel rates, right?

10 A. That's correct, but given that we're in the
11 weeds here in market purchases and market sales, AURORA
12 models a perfect world. AURORA models a scenario where
13 you can dispatch a unit for the hour that you need it or
14 for the hour that you can make an off system sale. The
15 real marketplace doesn't work that way at all. These
16 units have run times built into them, there are
17 non-financial, non-economic constraints or issues that
18 we have to deal with real time on the power system such
19 as work around transmission congestion issues that
20 conceivably could have us making out of market sales to
21 clear congestion or making an out of the market purchase
22 to clear congestion. So I guess the point that I want
23 to point out is that, and that's why I was pushing back
24 on you a little bit on AURORA, is that right now we seem
25 to use AURORA as kind of a clean ivory tower approach to

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1 model the rate side of how these portfolios are going to
2 be operated, but we all know that in reality stream
3 flows are going to be higher or lower, temperatures are
4 going to be higher or lower, gas prices are going to be
5 anything but the 90 day forecast that we plugged into
6 AURORA.

7 Q. Well, we're down here in the weeds, but the
8 weeds have an effect on the dollars, don't they,
9 Mr. Mills?

10 A. Agreed.

11 Q. In your testimony you state that Puget makes
12 market purchases when it's more economical to purchase
13 energy than it is to produce energy from its own
14 generating units, right?

15 A. That's correct.

16 Q. And so if Puget's rate year forecast was
17 adjusted to include a higher level of market purchases
18 at the actual level shown in Table 6, the baseline power
19 charges to retail customers would be expected to be
20 lower, correct?

21 A. That is correct.

22 Q. Now if we turn to page 48, the next page of
23 your rebuttal testimony, starting at line 19 I believe,
24 you criticize or take issue with Mr. Norwood's
25 assumption that Puget's off system sales would recover

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1 an average profit margin of \$2 a megawatt hour during
2 the rate year, correct, you disagree with him?

3 A. I disagreed, I don't believe that I
4 criticized.

5 Q. Okay, I've heard that somewhere before this
6 week, it's the reassertion of civility in the hearing
7 process.

8 Could you please turn to Public Counsel cross
9 Exhibit DEM-19, that's a response to DR 571; do you have
10 that?

11 A. I do.

12 Q. And there Public Counsel asked Puget to
13 provide the actual profits recorded from off system
14 sales, correct?

15 A. That's correct.

16 Q. And PSE responded, and I quote:

17 PSE does not track and therefore is
18 unable to provide an estimate of the
19 margin for off system sales which are
20 also referred to as sales to other
21 utilities.

22 That was your response, correct?

23 A. That's correct. We're not able to track each
24 individual electron that might have been sold as opposed
25 to consumed on our system. Because technically from an

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1 economics or finance perspective, to calculate the
2 margin you need to know the all end cost, the marginal,
3 well, actually the all end cost of the product that was
4 sold. And our portfolio is so diverse in terms of the
5 assets that are involved that Mid Columbia hydro on one
6 aspect, combined cycle combustion turbines on the other
7 aspect, and for two reasons. One is electrons flow like
8 water. I mean I can tell -- I can tell you I'm going to
9 sell you a product at Mid-C, I might even tell you I can
10 generate it off Mid-C, but in reality the electrons
11 could come from anywhere on the system. So that's one
12 aspect. We don't have the capability, the second
13 aspect, we don't have the capability to track each
14 individual unit's electrons and determine whether they
15 flow to load, to an off system sale, or to clear
16 transmission congestion. We are able to track total off
17 system sales, and that's what we recorded here.

18 Q. All right. And so instead we simply have to
19 rely on the AURORA output for the power cost
20 calculations; that's the company's position, right?

21 A. The company in this proceeding went down the
22 path of assuming all of -- all of the mandates that were
23 put in force in prior proceedings in terms of the
24 mechanisms. An example, the 90 day hydro filter or the
25 90 day gas price forecast, 50 year hydro forecast,

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1 historically. This is the way we've treated both off
2 system sales, off system purchases. It's also
3 historically the way we've treated mark to market.

4 It's interesting that in a less gas -- in a
5 less volatile gas market as we've had, well, there's
6 always been a lot of volatility but it's been most
7 noticeable in the last 20 months, but prior to that time
8 frame, there hasn't been a lot of concern or energy
9 focused on the mark to market aspect of the actual
10 portfolio, and now we have a situation where I mentioned
11 earlier of this unprecedented run up and now run down in
12 gas prices, it's attracting a lot of attention, but I
13 think what's ironic to me is that no one has -- no one
14 has challenged the company or engaged the company on our
15 hedging strategies. And so this hedging strategy that's
16 been in place conceptually since 2004, augmented in
17 2007, and now because of what's going on with the market
18 it's become kind of a front and center item.

19 So I guess what I'm saying is it would be
20 better if we all had perfect knowledge and foresight
21 about what these markets were going to do, but we don't,
22 so we all do the best we can do. We use the AURORA
23 model, we have the hedging program that's been in place
24 for years, being more knowledgeable about all of those
25 aspects and how they interplay would be most useful. I

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1 think that was the takeaway for me in this period.

2 Q. Just one other area, Mr. Mills. You do not
3 criticize but take issue with Mr. Norwood's proposal
4 that a gas trigger mechanism be implemented to require
5 Puget to file information to reduce its baseline power
6 charges any time the natural gas costs drop by 15%; you
7 disagree with that proposal, right?

8 A. I disagree with it on the premise that there
9 is no -- there doesn't appear to be a balancing
10 mechanism on the other side. If only gas prices rose
11 15%, that there would be a balancing or a counterpoint
12 for the company to do the same thing that Mr. Norwood
13 was proposing on the downward move side of the equation.

14 Q. And don't you also in your rebuttal testimony
15 object that it would require significant effort for
16 Puget to rerun AURORA should the gas trigger mechanism
17 require such a filing?

18 A. It is a significant amount of work, and it's
19 a significant amount of work for everybody in this room.
20 All entities sitting here would likely want to run
21 independently their version of AURORA, and I believe it
22 was in the '07 PCORC we had lengthy discussions about
23 how cumbersome running that model is for everybody.
24 That was the basis of my comment there.

25 Q. All right. Isn't it true that in this

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1 proceeding, Mr. Mills, Puget Sound Energy is asking the
2 Commission to allow it to update its power, baseline
3 power cost forecast for an increased gas cost of 1%?

4 A. Can you point me to something that references
5 that?

6 Q. Pages 56 and 57 of your rebuttal. It's
7 correct that on those pages you're recommending the
8 Commission ask PSE to allow update of the power costs to
9 reflect that gas prices have increased from \$5.97 to
10 \$6.02 for every mmbtu?

11 A. That's correct as of that date, which was I
12 believe the gas price on December 4, again the 90 day or
13 the 3 month average \$5.59.

14 Q. All right. Would you accept that that's a
15 less than 1% increase in the forecasted price of gas?

16 A. Versus the \$6.02?

17 Q. Right, from \$5.97 to \$6.02?

18 A. Yes.

19 Q. So in this instance Puget believes that the
20 effort required to rerun AURORA for that size of an
21 increase is a justified activity?

22 A. I think what we were opening up here was the
23 possibility or the, yeah, the possibility for the
24 Commission to order us to update it, which again from I
25 believe it was both the '06 and the 2007 PCORC was an

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1 issue that we discussed at length in terms of making
2 sure there was an updated power cost run as close to
3 prior to putting rates in place as possible.

4 MR. FFITCH: Okay, I don't have any further
5 questions. Thank you, Mr. Mills.

6 THE WITNESS: Thank you.

7 JUDGE MOSS: Thank you, Mr. ffitch.

8 Questions from the Bench?

9

10 E X A M I N A T I O N

11 BY COMMISSIONER OSHIE:

12 Q. Mr. Mills, excuse me just for a second, I
13 have to make a little note from just that last bit of
14 cross, not to hold you in suspense or anything.

15 A. I just wonder what you're drawing.

16 Q. Don't worry, it's only about your testimony.

17 I just -- I'm trying to get in my head at
18 least the relationship between this \$45 Million
19 adjustment and what the Staff and others have
20 recommended as far as if I understand it right a
21 tracker, which the company objects to. But I want to,
22 you know, what's the relationship between those hedging
23 costs that are at issue and the PCA? You know, my
24 understanding, or at a least as simple as it is with the
25 PCA, is that you've got -- you have a gas need, you fill

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1 it, and after -- and you have a hedging program that is,
2 you know, reflected in the cost of the natural gas,
3 because -- whether it be a long-term contract type of
4 hedge or whether it be an index kind of hedge, and so
5 all those costs gets rolled in as far as the cost of the
6 resource needed to run your power plants. And so when I
7 think of it in that way, I think of it as just it's --
8 it should be reflected in the PCA, and either the PCA --
9 you're either within the band or without, and those are
10 the costs that are -- essentially without making it, you
11 know, too simple, it's a cost of doing business,
12 obtaining fuel, and I'm trying to understand why it
13 should be separated out for a specific adjustment when
14 in my mind it should all be captured within that one
15 adjustment mechanism?

16 A. So the -- a number of the proposals that came
17 forth on power costs in this proceeding were quite --
18 were very interesting and very well put together, but I
19 go back to the comment about how the PCA has been
20 operating and functioning over time. And if you look at
21 the 6 1/2 or 7 year time period, it's been a \$6.8
22 Million underrecovery. The calendar year 2009 will not
23 be pretty, it will be an underrecovery to the company
24 significantly more than that. If you recall from the
25 way the current PCA is structured is the company is, you

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1 know, basically on the hook for the first \$20 Million
2 either way. In the '06 GRC, we proposed a revision to
3 the PCA. This is a long way to answer, but I'm getting
4 -- hopefully getting to your question. And what we
5 invited folks to do was we would entertain taking a
6 fresh look at the PCA. And the PCA mechanism itself is
7 the place to have this dialogue, because the way the
8 portfolio is modeled in AURORA currently with the not
9 models adjustment against our current PCA appears to be
10 working. And I can't say that this last year with gas
11 prices has been an outlier, but I hope we don't see it
12 again.

13 Q. And isn't that really the purpose of the PCA
14 and other mechanisms like it, to really spread the risk
15 involved with any particular period?

16 A. That's correct, but at what point do you say
17 that this is an outlier event to the extent that it is
18 intended to flow through the PCA, that this type of
19 event was what the PCA was intended to do.

20 Q. Well, I guess when the PCA was created, I
21 just assumed in my own simple way that what it was
22 designed to do was to cover the power costs of the
23 company, and no matter where derived, so that it could
24 meet its load. And if those power costs that were
25 actually incurred exceeded those that were built into

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1 rates, then that's what the PCA was meant to edge, if
2 you will, for the company and for the rate payers,
3 whether it be the California incident, for want of a
4 better word, when the market melted down and prices were
5 very high, wasn't that the precursor to the interest of
6 all our companies in some type of hedging mechanism like
7 the PCA or Avista's ERM?

8 A. That was -- that is our understanding of a
9 PCA mechanism as well.

10 Q. And wasn't that kind of a one-time event,
11 Mr. Mills, I'll let you answer, just wasn't that a
12 one-time event?

13 A. The California energy crisis?

14 Q. Yeah. I mean it could happen again, but had
15 it happened prior to that?

16 A. Not to that extent.

17 Q. Has it happened since?

18 A. No.

19 Q. Okay.

20 I'm sorry to interrupt, go ahead and answer,
21 I didn't mean to interrupt you.

22 A. I think the description of a PCA mechanism,
23 the company has assumed it's exactly as you describe it.
24 It's for events that happen from this day forward. And
25 these gas hedges have already been executed. We've

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1 already entered into these for our program, hedging
2 program. And we have assumed that to come forth with
3 the most accurate cost possible, rather than just not
4 paying attention to them and assuming in the, you know,
5 in the market that we incurred -- encountered over the
6 last 18 months, we would have blindly gone through and
7 said okay, well, these gas prices, AURORA, I don't have
8 the exact numbers, but AURORA would say they were \$4 a
9 decatherm when really my traders are out buying \$7 or \$8
10 gas because that's what the market was and nobody in
11 this room knew that it wouldn't actually go to \$14. So
12 we kept hedging away, nobody asked any questions about
13 the hedging program. So our assumption was that to come
14 in here with the cleanest and most accurate set of power
15 costs to set rates from would include what was an
16 actually incurred cost. And unfortunately that actually
17 incurred cost was at a market level that was above
18 because of the tenure, the length of the hedging program
19 was above where the current gas market or the 90 day gas
20 market had moved out to.

21 Q. And isn't that always the case though? I
22 mean if you're involved in a hedging program, isn't it
23 always the situation that these hedges go out to the
24 future, and so you hedge gas at the price that you think
25 that -- well, what you're doing is hedging against

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1 market volatility, so the hedge is in fact an executory
2 agreement that it will happen sometime in the future,
3 and at that point because you don't know what the gas
4 price will be, I guess theoretically it could be just as
5 high as it could be as low?

6 A. Exactly, and we've had that situation in
7 these filings, just that example where we're talking
8 nearly the inverse of this discussion that we're having
9 now where we've locked in with a mark to market credit
10 assumed in power costs.

11 Q. And how was that -- I guess that would be
12 another question that I have. I'm assuming that the
13 credits that were outlined in your testimony, and I know
14 Mr. Van Cleve questioned you at some length about that
15 and the nature of them and whether or not for example
16 the one of the contracts that went back to '91 would be
17 fairly called, I think that was his issue if I haven't
18 misinterpreted it, to be fairly called a hedge because
19 of the long length of that agreement. But my question
20 really is those issues were being raised is how were
21 those, if you will, benefits flowed through? I assume
22 they were flowed through the PCA.

23 A. They were.

24 Q. All right, well, I'm not sure I'm really
25 clear, Mr. Mills, but I'm not sure it can be improved.

0780

1 A. I apologize that I can't make it any more
2 clear.

3 Q. Well, you know, I guess I can think of it
4 very simply again and say, well, what's good for the
5 goose is good for the gander, to use an old legal term,
6 but anyway, we'll -- I'm sure, you know, it's going to
7 be a significant topic of discussion for all of us as we
8 go forward.

9 How -- are you the witness to talk about the
10 Mint Farm and the capacity of the natural gas contracts
11 to serve that facility?

12 A. Probably not.

13 COMMISSIONER OSHIE: Oh, okay. Well, that's
14 good for you I guess. All right, well, thank you,
15 Mr. Mills.

16 THE WITNESS: Thank you.

17 JUDGE MOSS: Nothing further?

18 All right, anything in the way of redirect?

19 MS. CARSON: No, Your Honor.

20 JUDGE MOSS: Okay, thank you very much. With
21 that then, Mr. Mills, we can release you from the stand
22 subject to recall if needed.

23 And given the company's apparent reluctance
24 to help us train the next generation of staff witnesses,
25 it seems that we have come to the end of those witnesses

0781

1 for whom cross-examination has been identified; is that
2 correct?

3 MS. CARSON: Mr. Odom is here.

4 JUDGE MOSS: Oh, we have Mr. Odom left, do we
5 still have cross-examination for Mr. Odom,
6 Mr. Cedarbaum?

7 MR. CEDARBAUM: Yes.

8 JUDGE MOSS: All right, actually we have one
9 more witness and that's it? All right, let's have
10 Mr. Odom then.

11 (Witness LOUIS E. ODOM was sworn.)

12 JUDGE MOSS: Please be seated.

13

14 Whereupon,

15 LOUIS E. ODOM,

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

18

19 D I R E C T E X A M I N A T I O N

20 BY MS. CARSON:

21 Q. Mr. Odom, please state your name and title
22 and spell your name for the court reporter.

23 A. Louis Edward Odom Junior, Odom, O-D-O-M, I am
24 the Director of Thermal and Wind Resources at Puget
25 Sound Energy.

0782

1 Q. Mr. Odom, do you have before you what have
2 been marked for identification as Exhibit Numbers
3 LEO-1CT through LEO-15?

4 A. I do.

5 Q. Do these exhibits constitute your prefiled
6 direct, supplemental, and rebuttal testimony and related
7 exhibits in this proceeding?

8 A. They do.

9 Q. Were these exhibits prepared under your
10 direction and control?

11 A. They were.

12 Q. Do you have any corrections to any of your
13 exhibits at this time?

14 A. I do.

15 One minor technical correction on LEO-1CT,
16 page 3, line 2, this is the megawatt capacity for
17 Hopkins Ridge, and that number should be corrected to
18 149.4 versus .6. And that is all.

19 Q. With that correction, are your prefiled
20 direct, supplemental, and rebuttal testimony and
21 accompanying exhibits true and correct to the best of
22 your information and belief?

23 A. They are.

24 MS. CARSON: Thank you.

25 Your Honor, PSE offers Exhibits LEO-1CT

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1 through LEO-15 into evidence and offers Mr. Louis E.
2 Odom for cross-examination.

3 JUDGE MOSS: Thank you. We also have -- oh,
4 hearing no objection, those will be admitted as marked.

5 We also have identified Exhibit LEO-16, which
6 is a PSE response to Staff Data Request 260, any
7 objection to that?

8 MS. CARSON: No, Your Honor.

9 JUDGE MOSS: Then we will also admit that as
10 marked.

11 And, Mr. Cedarbaum, I believe you are the
12 only one who has designated cross, so we'll turn to you.

13

14 C R O S S - E X A M I N A T I O N

15 BY MR. CEDARBAUM:

16 Q. Good afternoon, Mr. Odom.

17 A. Good afternoon.

18 Q. Were you in the hearing room when Mr. Mills
19 testified?

20 A. I was.

21 Q. He deferred some of my questions to you on
22 Exhibit DEM-15, so if we could start there. Do you have
23 that?

24 A. I do not.

25 One second, I do have that exhibit.

0784

1 Q. I don't have detailed questions about it, but
2 I think I established with him that this is a summary of
3 the company's rebuttal production O&M adjustments by
4 generation facility; is that right?

5 A. That appears to be correct.

6 Q. Is it correct that the company's proposed
7 adjustments for both Colstrip 1 and 2 and Colstrip 3 and
8 4 use budget amounts for the O&M piece?

9 A. That is correct.

10 Q. Is it also correct that if we move down a
11 column to what's shown as Freddy 1?

12 A. That is correct.

13 Q. And then moving just now back up the column,
14 the Upper Baker and Baker licensing and then Snoqualmie
15 1-2 including licensing, do those adjustments also use
16 budget numbers?

17 A. I'm sorry, those particular units are out of
18 my area of responsibility, and I am Director of Thermal
19 and Wind Resources, so I will defer back.

20 MS. CARSON: Your Honor, we --

21 Q. To whom?

22 MS. CARSON: Well, we made available Kim Lane
23 to provide -- who provided testimony on the hydro
24 facilities Baker and Snoqualmie. Mike Jones I believe
25 was a witness for Colstrip. So we've had both of those

0785

1 available for questioning and were told there was no
2 cross-examination for them.

3 MR. CEDARBAUM: Well, this was an exhibit of
4 Mr. Mills which I thought I could ask him questions
5 about, but that apparently wasn't correct, so I've been
6 referred to Mr. Odom. Now apparently I've been referred
7 to witnesses who are no longer available. I mean I
8 don't know that I need to recall those witnesses just
9 for that purpose, but I would like to get established
10 for the record whether the answer to my question is yes
11 or no.

12 JUDGE MOSS: Can we do that through a Bench
13 request?

14 MR. CEDARBAUM: I think so if, you know --

15 JUDGE MOSS: Or do we have either of those
16 witnesses available today?

17 MS. CARSON: They're not here in the
18 Commission room. They might be available by phone.

19 MR. CEDARBAUM: Perhaps then a Bench request
20 would work.

21 JUDGE MOSS: Do you want to prepare something
22 or try to do it now orally or --

23 MR. CEDARBAUM: I guess the Bench request
24 would be referring to Exhibit DEM-18, please confirm or
25 deny whether or not the proposed adjustments for the

0786

1 Upper Baker and Baker licensing and Snoqualmie 1-2
2 including licensing O&M adjustments use budgeted
3 figures.

4 JUDGE MOSS: All right, we'll call that Bench
5 Request 6.

6 Do you have that in mind?

7 MS. CARSON: Yes, we do.

8 JUDGE MOSS: All right.

9 Mr. Cedarbaum.

10 BY MR. CEDARBAUM:

11 Q. Mr. Odom, now -- and I should say I will be
12 coming back to Exhibit DEM-18C, which was part of
13 Mr. Mills' cross-examination exhibits, but apparently
14 you're the one to talk about those as well.

15 A. Just to be clear, is that DEM-15?

16 Q. 18. I just want to make sure you have that
17 with you when we get back to it.

18 A. Okay, fine.

19 Q. But referring to your rebuttal testimony,
20 which is LEO-13C, on page 1 starting at the bottom and
21 then to the top of page 2, you say:

22 Staff proposes that the company apply an
23 accounting methodology it calls the
24 deferral method "for major maintenance
25 events".

0787

1 Do you see that?

2 A. I do.

3 Q. Isn't it correct that the deferral method
4 that you attribute to Staff is the same method that
5 Puget Sound Energy uses for accounting and financial
6 reporting purposes?

7 MS. CARSON: Could you repeat the question.

8 Q. With respect to your, again on page 1 at the
9 bottom, you attribute to Staff an accounting methodology
10 that Staff calls the deferral method for major
11 maintenance events, and my question is, isn't it correct
12 that that deferral method that you attribute to Staff is
13 the same method that the company uses for both
14 accounting and financial reporting purposes?

15 A. Mr. Cedarbaum, I'm Director of Thermal and
16 Wind Resources, and to the extent that we talk about
17 deferral in my rebuttal testimony, we are referring to
18 the deferral method allowed under the airline accounting
19 industry, airline industry accounting for major
20 maintenance and the deferral allowed under there.

21 Q. And isn't that the deferral method that Staff
22 is referencing?

23 A. I assume that's correct.

24 Q. And that's the deferral method that the
25 company uses for accounting and financial reporting

0788

1 purposes?

2 A. Again, I apologize, I'm not -- I would have
3 to defer to Mr. Story for company accounting and
4 deferral practices.

5 Q. Well, if you could refer, or accept subject
6 to check perhaps might be the quickest way to do it,
7 that in Mr. Story's response to Staff Data Request 209,
8 which is Exhibit JAS-29, he states in Part A:

9 Puget Sound Energy has fully adopted the
10 AICPA Audit and Accounting Guide for
11 Airlines for all of its O&M major
12 maintenance.

13 Is that correct?

14 A. That is our proposal.

15 Q. That's the deferral method that we're
16 discussing?

17 A. That is correct.

18 Q. And that Staff was discussing?

19 A. That is correct. We were all discussing the
20 same accounting principle here.

21 Q. Then why in your testimony did you attribute
22 this accounting methodology that you placed in quotes to
23 Staff as the deferral method? Isn't the implication
24 there that Staff is proposing something new or
25 different?

0789

1 A. That was not the intent. We did as quoted in
2 the rebuttal testimony, yes, we did review the
3 testimony, and Staff proposes that the company apply an
4 accounting methodology that it calls the deferral method
5 of major maintenance events. There's no question that
6 we are proposing that we also use the deferral method as
7 allowed under the airline industry accounting
8 guidelines, so to that end I would say we're both
9 proposing the same thing.

10 Q. And both proposing a continuation of the same
11 thing?

12 A. Both proposing that we use the deferral
13 method for accounting for major maintenance, that is
14 correct.

15 Q. And I take it though with respect to that
16 deferral method, you have a -- you take issue with the
17 amortization periods the Staff proposes for capitalizing
18 and amortizing major maintenance; is that right?

19 A. We did. We felt that a more appropriate
20 amortization period was what is outlined in the
21 guidelines, which is that it's amortized over the period
22 until such time as you have that major maintenance event
23 occur again, which could be over a period of 2 to 3
24 years on some of our combined cycle facilities, on our
25 simple cycle facilities, no less, excuse me, no more

0790

1 than 10 years, but could be pulled forward based on how
2 many hours we actually run the machine and based on OEM
3 recommendations.

4 Q. Well, on page 2 of your testimony, your
5 rebuttal testimony, at lines 1 to 3, excuse me, lines 12
6 to 13, you state that the deferral methodology is
7 appropriate on condition, and you refer to the
8 amortization periods for major maintenance being
9 modified; is that right?

10 A. Just to be clear, we are in agreement with
11 the deferral methodology accounting for major
12 maintenance, and we do believe that the proper treatment
13 of that is to amortize that over the period until you
14 come to that next major maintenance event. If we simply
15 just say it's 10 years or 5 years, that's not taking
16 into account that that major maintenance event could be
17 occurring sooner, so this really tracks we believe the
18 airline industry guidelines.

19 Q. Okay, let me ask, do you have Ms. Breda's
20 testimony with you?

21 A. I do not believe so.

22 Q. Okay, well I would like to --

23 JUDGE MOSS: That could be provided,
24 Mr. Cedarbaum.

25 Q. If you could look at Exhibit KHB-4C.

0791

1 A. Okay.

2 Q. And this is an exhibit of hers entitled major
3 maintenance activities under long-term service
4 contracts; do you see that?

5 A. I do.

6 Q. And at the bottom of the page, there's a note
7 where she refers to her example being based on dollars
8 provided in a Mills workpaper; do you see that?

9 A. DEM-WPC, yes.

10 Q. So if we can turn now to Exhibit DEM-18.

11 A. Okay.

12 Q. This is the workpaper of Mr. Mills that
13 Ms. Breda references in her testimony, is that right, in
14 her exhibit?

15 A. I believe that is correct.

16 Q. And if we can just -- and this is a
17 confidential exhibit, so try to maintain that
18 confidentiality with these questions, but I just want to
19 ask you a couple clarifying questions so we can see how
20 the exhibit works. If you can turn to what's shown in
21 the upper right-hand corner as page 7. Let me know when
22 you're there.

23 A. Okay.

24 Q. And again this is a confidential document, so
25 unless you know that I'm asking you a question that

0792

1 doesn't ask for confidential information, we should try
2 not to go there, but this is a -- this page refers, I
3 think this is probably not confidential, this page
4 refers to the facility Frederickson 1; is that right?

5 A. Yes, that is one of our simple cycle
6 facilities.

7 Q. And if we look at the right-hand side of the
8 page, is it correct that on the sixth line down on the
9 extreme right-hand side there's a date; is that right?

10 A. There's a date, that is correct.

11 Q. And is that date according to this workpaper
12 the date for the next major maintenance for this
13 facility?

14 A. According to this paper, that is correct.

15 Q. And then if we look back to the left side of
16 the page, about a third up from the bottom there's a
17 line called last maintenance date, and there's a date
18 there as well; is that correct?

19 A. That is correct.

20 Q. And that's how all of these pages work with
21 respect to each of these facilities? For example page 8
22 concerns Frederickson 2, and the dates that I've
23 discussed involve according to this workpaper the next
24 major maintenance date and the last maintenance date?

25 A. Yes. And just to be clear, this particular

0793

1 work tool, maintenance tool, reflected the simple cycle
2 facilities that had been set up on a 10 year maintenance
3 cycle, which we are currently dispatching more, which
4 pursuant to the OEM recommendations would require that
5 we perform maintenance sooner than when this was
6 developed. Also I would like to point out that for the
7 combined cycle facilities that the maintenance period is
8 less than 120 months, so I just wanted to make that
9 clarification. For example on page 23 you would see
10 that the maintenance periods are covering, you know,
11 from July 10th, November 13th, July 17th, September 20.

12 Q. Okay, I think I'm finished asking you
13 questions on this exhibit.

14 A. Okay.

15 Q. Mr. Odom, if you could turn back again to the
16 cross-examination exhibit of Mr. Story, which is JHS-29,
17 I would like to return to this discussion of major
18 maintenance accounting. Earlier you stated that the
19 Staff and the company are proposing the same treatment
20 in accordance with the airline guide; do you recall
21 that?

22 A. I do.

23 Q. This data request response indicates in part
24 A that the company also has plans for setting up a
25 regulatory asset, is that right, with respect to major

0794

1 maintenance facilities?

2 I'm sorry, I may have drawn you to the wrong

3 -- I'm -- do you have any exhibits -- this is actually

4 your cross-examination Exhibit 16, apologize for that.

5 My question is --

6 A. Excuse me, which one is 16?

7 Q. It's the company's response to Staff Data

8 Request 260.

9 A. 260, okay, thank you, I have that.

10 Q. Part D of the response indicates that the

11 company intends to establish a regulatory asset for

12 major maintenance and then file an accounting petition

13 for approval of those deferred costs, and that last

14 paragraph describes the process that the company intends

15 to take on major maintenance costs; is that right?

16 A. Yes. Let me clarify that. So in the past

17 there's -- from an accounting perspective they just took

18 a 10 year average on how this was accounted for in the

19 past. Going forward as we incur major maintenance, we

20 would look to what the actual time period is between the

21 major maintenance cycles, and then we would actually

22 petition for how that is actually set up for a deferral

23 and amortization going forward.

24 Q. Okay, but that process is not provided for

25 under the airline guide, is that right, it's provided

0795

1 for under FASB 71?

2 A. No, I --

3 Q. Or setting up regulatory asset I mean.

4 A. Well, I would have to defer to Mr. Story on
5 the accounting principles and guidelines. We would
6 treat -- the goal is to treat our simple cycle
7 facilities much in the same way that we treat our
8 combined cycle facilities. And when a major maintenance
9 event occurs that that would be amortized until the next
10 major maintenance event is scheduled. And we can do
11 this based on what our capacity runs are, we can use our
12 major maintenance tool that we have developed, so we're
13 looking to treat this the same as we do our combined
14 cycle facilities.

15 Q. But I guess what I'm getting back to is when
16 I first started to question you, I think we agreed or
17 you agreed that the company and Staff were proposing a
18 deferral methodology, same deferral methodology under
19 the airline guide?

20 A. That is correct.

21 Q. And your response to Staff Data Request 260
22 discusses the establishment of a regulatory asset. So
23 my question is the process of establishing a regulatory
24 asset is not covered by the airline guide; is that
25 correct?

0796

1 A. That is correct.

2 Q. Do you know whether or not it's covered by
3 FASB 71?

4 A. I would need to defer to Mr. Story on that.

5 Q. I just had a couple I think what are
6 clarifying questions. Page 16 of your testimony, your
7 rebuttal testimony, you have a discussion about the
8 Hopkins Ridge Infill project and the Vestas contract,
9 and later on in your testimony you have a similar
10 discussion with respect to Wild Horse?

11 A. Yes.

12 Q. And is it correct that the dispute between
13 Staff and the company on the Vestas contract issue
14 involves the escalation provisions of the contracts?

15 A. That is a component of it. There's also
16 other provisions for balance of plant which would
17 require additional maintenance. With these facilities,
18 as you know, we have added wind turbines at both Hopkins
19 Ridge and Wild Horse that would require additional
20 maintenance on a go forward basis as well as the
21 escalation that you pointed out, that is correct.

22 Q. Is your understanding correct that Staff
23 included the actual cost as specified by the Vestas
24 contract in its adjustments?

25 A. If I understand the Staff's worksheets

0797

1 correctly, they do include the current what is known,
2 but they do not include the knowable, foreseeable, or
3 reasonable costs that we anticipate going forward.

4 Q. You mean portions involving the escalation
5 clause?

6 A. That is correct.

7 Q. And that escalation clause is tied to
8 inflation rate criteria that you discuss in your
9 testimony?

10 A. That is correct.

11 MR. CEDARBAUM: Thank you, Mr. Odom, those
12 are all my questions.

13 THE WITNESS: Thank you.

14 JUDGE MOSS: Anything from the Bench?

15 Apparently not.

16 Any redirect?

17 MS. CARSON: No.

18 Mr. Story is available if there are questions
19 about the accounting for the major maintenance. He's
20 the one with more knowledge about that.

21 MR. CEDARBAUM: Your Honor, I don't have any
22 questions for him, and I don't -- I don't have any
23 questions for him, so I don't think it's necessary.

24 JUDGE MOSS: Okay, fine.

25 All right then, unless there are other

0798

1 questions for other witnesses from the Bench.

2 Commissioner Jones.

3 COMMISSIONER JONES: Just Commissioner Oshie
4 was ready to ask a question of Mr. Mills I think on Mint
5 Farm and related to gas transport capacity, but who -- I
6 guess he's not the appropriate witness, I don't know who
7 would be.

8 MS. CARSON: That would be Mr. Riding.

9 JUDGE MOSS: Is he with us?

10 MS. CARSON: He is not with us. He had no
11 cross-examination, and we understood there were no
12 questions for him.

13 COMMISSIONER JONES: I thought it was
14 Mr. Mills, so maybe we could submit this.

15 JUDGE MOSS: Well, if we need to, we can
16 submit a Bench request after the hearing.

17 All right.

18 MR. FFITCH: Your Honor.

19 JUDGE MOSS: Yes, sir, Mr. ffitch.

20 MR. FFITCH: Just for information,
21 Mr. Norwood is on the phone, and he's available if there
22 are questions. We also have an errata sheet to submit
23 for him.

24 JUDGE MOSS: Okay, well, we'll take care of
25 that. Apparently there are no questions from the Bench

0799

1 for other witnesses. We have reached the end of the
2 list of witnesses for whom cross-examination was
3 designated. Unless there is some reason for me to ask
4 the Commissioners to stay, I know there will be a number
5 of housekeeping matters we have to take up, but we can
6 do that without them having to sit through it, is it
7 anybody's pleasure to have them remain?

8 Apparently not, so the Commissioners are free
9 to stay or go as they choose.

10 The first matter I want to take up is the
11 fact that we have 20 some odd witnesses who did not join
12 us on the witness stand, and as to them there is a
13 considerable volume of prefiled testimony and exhibits,
14 and it would be my fervent hope that we can simply
15 stipulate all that in without any discussion. But if
16 there is objection to anything that's been prefiled that
17 would otherwise become an exhibit in the record, tell me
18 now.

19 MR. CEDARBAUM: Staff has no objection to
20 that. The only two areas on that is that Staff was
21 going to make a couple of typo corrections if witnesses
22 had taken the stand, so I can -- should I present those
23 through an errata sheet?

24 JUDGE MOSS: You can just present an errata
25 on that type of thing, Mr. Cedarbaum, that will be fine.

0800

1 MR. CEDARBAUM: And then the other -- the
2 other issue is that given the Commission's prior order
3 in this case and the motion to strike and granting, I
4 think Staff's assumption is that all of the related
5 testimony that was subject to the motion will be
6 stricken, because some of it's in the testimony that's
7 being offered kind of within this bulk offering.

8 JUDGE MOSS: Well, do you mean are we going
9 to physically remove it from the documents that are on
10 the electronic records system? That wasn't my intention
11 to do that. I mean it's not part of the evidence in the
12 record, in that sense it is struck. We won't be hearing
13 about it on brief, so in that sense it's not part of our
14 record. But if you're asking me is it going to be
15 physically eliminated from what's been prefiled?

16 MR. CEDARBAUM: I guess I was just trying --
17 asking -- I was just trying to confirm that testimony
18 and exhibits that were stricken will not be part of the
19 record.

20 JUDGE MOSS: They're not part of the record.
21 We granted the motion, so that has happened, struck or
22 stricken, I don't know, which is it? But in any event,
23 that's not part of our record, you're correct, but it
24 wasn't my intention to physically remove anything from
25 what's been prefiled. It's just a lot of trouble to do

0801

1 that and a lot of paper.

2 All right, any other questions, objections?

3 Apparently not, so with that, you all are
4 familiar with the exhibit list that's been
5 predistributed, and it does at least include all of the
6 witnesses and hopefully all of their prefiled materials,
7 and I have provided that to the court reporter, and I
8 will also provide her an updated version of that
9 tomorrow, as I will also provide to all of you. And as
10 is my usual practice, I will invite any editorial
11 suggestions you may have, because in something of this
12 length, there are almost invariably some glitches. So
13 we'll have that, and those testimonies and exhibits that
14 have not previously been admitted that are identified on
15 the exhibit list which I just referred are admitted and
16 will be part of the record subject to the previous
17 granting of the motion to strike certain segments of
18 that prefiled material.

19 MR. FFITCH: May I ask, Your Honor, regarding
20 errata, we have provided an errata sheet for
21 Mr. Dittmer. I have with me errata sheets for
22 Mr. Norwood which I can now provide to you and counsel.

23 JUDGE MOSS: Sure.

24 MR. FFITCH: I endeavored to file both of
25 those with the records center, and they refused to

0802

1 accept them without a cover letter, so I have to take
2 another run at that.

3 JUDGE MOSS: All right.

4 MR. FFITCH: Is that appropriate that we
5 should go ahead and file those with the record center?

6 JUDGE MOSS: That seems to be the current
7 convention, and while we try to accommodate you on the
8 cross-examination, and I don't mean just you, but all
9 the parties on the cross-examination exhibits as we're
10 all familiar, we will file everything following that
11 current convention. May change in the future.

12 And if others have errata or typographical
13 corrections and so forth, you can simply submit those.

14 I mentioned before that I would give exhibit
15 numbers to the revenue requirements exhibits, and I will
16 just do that when they come in, it will be B hyphen
17 whatever, and I don't think that will pose a problem.

18 So with respect to our record, is there
19 anything else we need to consider?

20 MR. FFITCH: Your Honor, we had an
21 outstanding record requisition to Dr. Morin to adjust
22 the numbers on page 56 of his rebuttal.

23 JUDGE MOSS: Do we have that available?

24 He apparently didn't get to that.

25 MS. CARSON: No, we do not have that

0803

1 available at this time, I apologize.

2 JUDGE MOSS: That will be furnished when?

3 MS. CARSON: Tomorrow.

4 JUDGE MOSS: Okay, if you can have that
5 tomorrow, maybe you can furnish it to Mr. ffitch
6 electronically so we'll have that for the record.

7 MR. FFITCH: Would that be a Bench request,
8 Your Honor, or how would --

9 JUDGE MOSS: Did we identify it as a Bench
10 request? I don't recall.

11 MS. CARSON: I don't think you gave it a
12 number.

13 JUDGE MOSS: All right, 7, how's that.

14 MR. FFITCH: Thank you.

15 JUDGE MOSS: That will be Bench Request 7,
16 okay, fine, so we'll get that response, Mr. ffitch, and
17 make that part of the record.

18 Anything else on that subject of the record?

19 MR. CEDARBAUM: Before when we received the
20 Bench Request Number 3, we had some discussion this
21 morning about the scope of corrections the parties might
22 make, and you had asked the parties to discuss that. We
23 haven't done that, so I guess I would just wonder should
24 we do that and report back to you, or should we have
25 that discussion now or --

0804

1 JUDGE MOSS: Well, I think that maybe we
2 don't need to do that now. This is going to be a
3 situation where we're all sort of cooperating to get the
4 information right, and I don't think there's going to be
5 anything controversial about it. To the extent there is
6 some issue that arises in this context, then everybody
7 can get me on the phone and we'll work it out. I think
8 that's probably the best way. And we can be a little
9 informal about it because it's coming from the Bench and
10 you all understand basically what we want. And to the
11 extent there are some details, we may need to get
12 Mr. Twitchell involved, some discussion with him as
13 well, so let's handle it that way.

14 All right, now as to other matters, we
15 already have a briefing schedule established in this
16 proceeding, and it calls for initial briefs and reply
17 briefs if memory serves, and we probably put a page
18 limitation on the reply briefs, did we?

19 MS. CARSON: Yes, 15 pages.

20 JUDGE MOSS: How much?

21 MR. CEDARBAUM: My recollection is 15 pages.

22 JUDGE MOSS: Right, and the purpose of those
23 is to address points that weren't anticipated, so that
24 should be sufficient. And of course we have our
25 standard briefing guidelines as to the initial rounds of

0805

1 briefs, and you all can follow those.

2 MR. CEDARBAUM: Your Honor, with respect to
3 briefs, yesterday there was discussion about the
4 Northwest Energy Coalition brief.

5 JUDGE MOSS: Right.

6 MR. CEDARBAUM: And your direction was that
7 we should, Mr. ffitch and I should talk to Mr. Johnson.
8 We haven't had a chance to make that call as well.
9 Should we make that call and report back if there are
10 any issues?

11 JUDGE MOSS: Well, if there are any issues.
12 You know, frankly I thought about this one overnight,
13 you know, I think we can rely on Mr. Johnson's good
14 judgment in not filing a 60 page brief on one single
15 issue if that's all he has, and I'm not inclined sitting
16 here today to impose restrictions on particular parties.
17 You've all become familiar over the years with the
18 famous quote about the usefulness or uselessness of
19 overlength briefs, so I think we'll depend on, as I
20 said, the counsel's good judgment in that regard.

21 And, you know, for the rest of you, I think
22 frankly 60 pages is usually quite adequate for
23 everything. I know this case has a lot of issues, but
24 some of them will undoubtedly be grouped, arguments on
25 the pro forma adjustments for example need not be

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1 repeated 25 times and that sort of thing.

2 So if any issues arise during the course of
3 your post hearing efforts, then you can bring them to my
4 attention, and we'll do whatever we need to do to ensure
5 fairness.

6 MR. FFITCH: Your Honor, I guess I will just
7 state for the record I know I created all this by
8 jumping to the microphone at one point on the Coalition
9 position, and I heard the comments from the Bench about
10 the Coalition having party rights, full party rights,
11 and on reflection I had a concern about the essentially
12 fairness of not taking a position until after the
13 hearing and how it affects parties, but particularly in
14 view of the fact we have a reply brief and in view of
15 your statement about party rights, I think I'm
16 withdrawing that concern. I think that under the rules
17 it is permitted for a party to proceed as the Coalition
18 has, and other parties may wish to in other cases, and
19 so we're at this point comfortable going forward on that
20 basis.

21 JUDGE MOSS: Well, thank you for that
22 statement.

23 Do we have any other housekeeping matters we
24 need to take up? At this stage of things my mind is a
25 little bit tired and slow, so you all might remind me of

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1 something if you think of anything we need to do.

2 MR. FFITCH: I have one item, Your Honor,
3 which may require reflection, but that is the matter of
4 the electronic version of the cross exhibits. And as
5 this is an experimental approach, we I think would
6 request some further guidance from the Bench about how
7 and when we do that. For example, does each party
8 prepare its own set of electronic exhibits for its own
9 cross exhibits, when would those need to be filed, are
10 we required to file a redacted version of the electronic
11 cross exhibit if it's confidential, and maybe there's
12 other questions I can't think of right now.

13 JUDGE MOSS: Okay, let's take that up off the
14 record here in a couple of minutes so that we don't
15 devote transcript to it.

16 The one point that I do need to devote
17 transcript to is the closing of the record. This
18 hearing was scheduled to continue if needed through
19 Monday, the 25th. I think for purposes of receiving
20 public comments that may be filed with the Commission or
21 that Public Counsel may receive, we will treat the close
22 of business on Monday the 25th as the deadline for that,
23 the projected end of the hearing, rather than today.
24 So, Mr. ffitich, when you prepare your public comments
25 exhibit, it can include anything you received by that

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1 date and time.

2 MR. FFITCH: Thank you, Your Honor.

3 JUDGE MOSS: All right.

4 MR. FFITCH: As we routinely do, I will ask
5 if we can provide that in electronic form on a disk, and
6 if that's permitted how many disks would the Bench
7 request?

8 JUDGE MOSS: I think if we have the original
9 and one copy, if we have two disks, that will be fine.

10 MR. FFITCH: We would plan to simply serve a
11 disk on all the other parties as well.

12 JUDGE MOSS: That's fine. We will need one
13 for the records center and one for me.

14 Anything else?

15 All right, well, thank you all, it was an
16 excellent hearing I think, very interesting in many
17 regards, and I look forward to receiving and reading
18 your briefs, and we will bring this matter to a
19 hopefully prompt resolution once we have all the post
20 hearing process completed, thank you.

21 We're off the record.

22 (Hearing adjourned at 3:00 p.m.)

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