EXHIBIT NO. ___(MJS-10T)
DOCKET NOS. UE-111048/UG-111049
2011 PSE GENERAL RATE CASE
WITNESS: MICHAEL J. STRANIK

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-111048** **Docket No. UG-111049**

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF
MICHAEL J. STRANIK
ON BEHALF OF PUGET SOUND ENERGY, INC.

JANUARY 17, 2012

PUGET SOUND ENERGY, INC.

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF MICHAEL J. STRANIK

CONTENTS

PUGET SOUND ENERGY, INC.

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF MICHAEL J. STRANIK

I. INTRODUCTION

Q. Are you the same Michael J. Stranik who submitted prefiled direct testimony in this proceeding on June 13, 2011 on behalf of Puget Sound Energy, Inc. ("PSE" or "the Company")?

A. Yes.

Q. What is the purpose of your prefiled rebuttal testimony?

A. My testimony presents the overall natural gas revenue deficiency based on the updated restating and pro forma adjustments that the Company is proposing. I discuss a new gas pro forma revenue adjustment that adjusts the test year revenues to reflect the loss of an industrial customer in the rate year. I also discuss some common adjustments that relate to both gas and electric operations. I will present the uncontested adjustments between Commission Staff and the Company and explain why some of these adjustments have a different impact on the revenue requirement calculation than that of other parties. I will also discuss specific restating and pro forma adjustments that are common to electric and natural gas and are contested by Commission Staff and other parties.

Based on the pro forma and restating adjustments proposed by the Company, and presented in Exhibit No. ___(MJS-11), there is a total natural gas revenue deficiency of $28.6 million. This would represent an average 2.7% rate increase.

II. COMPARISON BETWEEN THE COMPANY'S REVENUE DEFICIENCY AND COMMISSION STAFF'S REVENUE DEFICIENCY

A. Have you prepared a reconciliation between the revenue deficiency filed by the Company and the revenue deficiency filed by Commission Staff?

A. Yes. The following table highlights the differences between the Company's direct filing, the Company's rebuttal filing and the Commission Staff's filing on December 7, 2011.

(in millions)	
PSE Direct Filing	$ 31.9
Differences by Adjustment vs. Direct Filing	
14.02 Rate of Return	(3.1)
13.02 Revenues & Expenses	0.6
13.19 Wage Increase	(0.8)
Total Change from Direct Filing	(3.3)
PSE Rebuttal Filing	$ 28.6
Differences by Adjustment vs. Staff	
Rate of Return on Actual Results of Operations	$ (17.9)
13.04 Federal Income Taxes	(3.0)
13.10 Incentive Pay	(1.4)
13.11 Property Tax	(1.8)
13.22 Working Capital	(1.5)
Other miscellaneous adjustments	(1.5)
Total Change	$ (27.1)
Commission Staff Revenue Deficiency	$ 1.5

Q. What are the major differences between the Company's gas revenue deficiency and the Commission Staff's gas revenue deficiency?

A. Included in Exhibit No. ___(MJS-15) is a comparison of the revenue deficiencies by adjustment currently filed by the Company and Commission Staff. The major differences between the Company and Commission Staff are the capital structure and the return on equity embedded in the rate of return along with the other differences highlighted in the above table. The capital structure and return on equity are discussed by Mr. Gaines and Dr. Olson in their prefiled rebuttal testimony, Exhibit Nos. ___(DEG-14T) and (CEO-10T), respectively. The other differences will be discussed in the relevant pro forma or restating adjustment discussions which occur later in my testimony.

Q. Did you prepare a reconciliation between the other parties' restating and pro forma adjustments and the Company's adjustments?

A. No. The other parties did not present their exhibits in a manner that would allow such a comparison. Where there are differences between the Company and other parties on specific adjustments these differences will be discussed when I present the actual adjustment.

III. UNCONTESTED NATURAL GAS AND COMMON ADJUSTMENTS BETWEEN THE COMPANY AND COMMISSION STAFF

Q. Have you prepared exhibits which detail the updated restating and pro forma adjustments that the Company is proposing?

A. Yes. I have prepared Exhibit No. ___(MJS-11) for this purpose. I have also prepared Exhibit Nos. ___(MJS-12) and ___(MJS-13) which contain the detail pages supporting the summarized adjustments in Exhibit No. ___(MJS-11). Exhibit Nos. ___(MJS-11) through ___(MJS-13) are presented in the same format as my Exhibit Nos. ___(MJS-4) through ___(MJS-6), and in the same format as Mr. Mickelson's Exhibit No. ___(CTM-2). As stated earlier, Exhibit No. ___(MJS-15) provides an additional overview of all natural gas adjustments as to whether they are contested or uncontested and the effect on net operating income, rate base and the contribution to revenue deficiency when comparing the results between the Company and Commission Staff.

Q. Please explain the adjustments where the Company is in agreement with Commission Staff.

A. The uncontested natural gas adjustments that result in no difference between the Company and Commission Staff and their impact on Net Operating Income ("NOI") or rate base are as follows:

Adjustment	NOI	Rate Base
12.01 Water Heater Depreciation	4,071,209	(2,218,846)
12.02 Reclass Bare to Wrapped Steel	(195,347)	(97,673)
12.03 Contract Charges	640,161	0
13.01 Temperature Normalization	6,651,267	0
13.03 Pass-Through Revenue & Expense	154,724	0
13.07 General Plant Depreciation	384,999	(113,067)
13.08 Injuries & Damages	(54,310)	0
13.09 Bad Debt	1,574,431	0
13.12 Excise Tax & Filing Fee	(49,256)	0
13.14 Interest on Customer Deposits	(21,705)	0
13.16 Deferred G/L on Property Sales	(92,595)	0
13.17 Property & Liability Insurance	35,752	0
13.18 Pension Plan	(582,788)	0
13.19 Wage Increase	(769,423)	0
13.20 Investment Plan	(40,613)	0

Q. Is this list of uncontested adjustments different from the list of uncontested adjustments that Mr. Mickelson presents in his prefiled response testimony?

A. Yes. Mr. Mickelson includes his Adjustments 13.19 Wage Increase and 13.20 Investment Plan as contested. The Company has adopted Commission Staff's proposed changes, resulting in these adjustments no longer being contested. Finally, Commission Staff lists Adjustment 13.02, Revenues and Expenses as uncontested. However, as discussed later in my testimony, the Company has been informed that a major industrial natural gas customer intends to cease operations in March 2012. As a result, the Company has updated its original adjustment to reflect the loss of revenue associated with this customer.

Q. Are there adjustments that the Company and Commission Staff are in agreement as to the methodology used to calculate the adjustment but that are not listed in the above table?

A. Yes. Commission Staff and the Company are in agreement as to the methodology used to calculate Adjustment 13.05, Tax Benefit of Pro Forma Interest, which is not listed in the table. The difference between the Company's and Commission Staff's adjustments is strictly the result of differences between the weighted average cost of debt and rate base.

IV. CONTESTED ADJUSTMENTS

Q. Would you please describe the difference between the Company and other parties on the contested adjustments you are covering in your testimony?

A. The impact on natural gas net operating income and rate base for each of the Company adjustments is summarized on Exhibit No. ___(MJS-11). With the exception of adjustment 13.02 Revenues & Expenses, all the contested adjustments I will discuss are common to both electric and gas. However, I am only presenting the overall impact on the natural gas revenue deficiency in my testimony. Later I will discuss why the Commission should adopt PSE's proposed common adjustments for both electric and natural gas. In his prefiled rebuttal testimony, Exhibit No. ___(JHS-21), Mr. John H. Story will present the impacts for these common adjustments on electric operations.

Revenues and Expenses, 13.02

Q. Please explain the differences between the Company's direct filing and rebuttal filing for this adjustment.

A. As discussed in the Prefiled Rebuttal Testimony of Janet K. Phelps, Exhibit No. ___(JKP-14CT), during the course of this proceeding PSE learned that a major industrial natural gas customer will be ceasing operations in spring of 2012. The Company's rebuttal adjustment reflects the loss of test year revenues that will occur.

The new pro forma adjustment removes test year revenue of $616,471 from the pro forma revenue at existing rates. The $616,471 revenues consist of $604,649 in gas margin and $11,822 associated with balancing charges, which are gas cost related. Inclusion of this adjustment impacts the adjustments for the 2009 general rate case ("GRC") and the 2010 gas tariff increase filing ("GTIF") reflected on lines 2 and 3. After these changes are made, this adjustment results in an increase in NOI of $16,913,083 which is lower than the adjustment proposed in the Company's direct filing by $386,329.

Federal Income Tax , MJS adjustment 13.04 and JHS adjustment 21.04

Both Commission Staff witness Ralph Smith, in Exhibit No. ___(RAS-1T), and Public Counsel witness Ms. Andrea C. Crane, in Exhibit No. ___(ACC-1T), propose an adjustment reducing electric rate base by $41,414,322 and gas rate base by $24,564,298. This reduction represents the impact of offsetting PSE's Accumulated Deferred Tax Balances associated with the adoption of tax accounting method changes for repairs and retirements against rate base. Additionally, Ms. Crane proposes to exclude from rate base the net operating loss associated with bonus depreciation. Additionally, ICNU's witness, Ms. Ellen Blumenthal, proposes a consolidated tax adjustment as a separate tax adjustment that would reduce electric rate base by $68,250.138 and natural gas rate base by $23,075,042. Company witness, Mr. Matthew R. Marcelia discusses why these adjustments are inappropriate and should not be accepted by the Commission.

See Exhibit No. ___(MRM-14T). These adjustments remain unchanged from PSE's direct/supplemental filings in this case. The effect of these adjustments is to decrease net operating income for electric operations by $60,471,551 and for natural gas operations by $28,834,101.

<u>Tax Benefit of Pro forma Interest, MJS adjustment 13.05 and JHS adjustment 21.05</u>

Q. Please describe this adjustment.

A. Both Commission Staff and the Company agree to the methodology used in the calculation. The only differences among the parties are the proposed rate base and the weighted cost of debt which are used in the calculation of the tax benefit of pro forma interest. This adjustment will change based on the final rate base determined in this proceeding. The electric and natural gas adjustments are based on the Company's updated Cost of Capital as shown in the Prefiled Rebuttal Testimony of Donald E. Gaines, Exhibit No. ___(DEG-14T). The effect of these adjustments is to increase net operating income for electric operations by $53,097,697 and for natural gas operations by $17,987,052.

<u>Miscellaneous Operating Expense and Rate Base, MJS adjustment 13.06 and JHS adjustment 21.06</u>

Q. Please explain the differences between the Company's direct filing and rebuttal filing regarding this adjustment.

A. The Company's rebuttal adjustment decreases the amount of wages allocated to utility operations for PSE's President and CEO, Ms. Kimberly J. Harris. The updated allocation to utility operations is based on the test year allocation to utility for Mr. Stephen Reynolds, the Company's previous CEO. This update was proposed by Commission Staff witness Ms. Betty A. Erdahl in her prefiled response testimony, Exhibit No. ___(BAE-1T). After making this change, this adjustment now impacts net operating income as an increase of $261,609 for natural gas operations and a decrease of $4,308,881 for electric operations.

Q. Did Commission Staff propose any other changes to this adjustment?

A. Yes. Ms. Erdahl proposed to exclude 50 percent of the Board of Director fees and meeting expenses included by PSE in this filing.

Q. Do you agree with Ms. Erdahl's proposed adjustment to Board of Director Fees and Meeting Expenses?

A. The Company disagrees with the exclusion of 50 percent of Board of Director fees and meeting expenses included by PSE in this filing. The Board of Director fees and expenses are a necessary cost of doing business and are required to properly operate the utility. The underlying premise of Ms. Erdahl's adjustment is that these fees and meeting expenses should be shared equally between ratepayers and shareholders based on her assumption that the Board of Directors provides services equally benefiting shareholders and ratepayers.[1] Ms. Erdahl states that her adjustment is consistent with the Commission's decision in the Avista 2009 general rate case.[2]

Ms. Erdahl's reliance on the Commission's decision in the Avista 2009 general rate case to support removal of 50 percent of the Board fees and meeting expenses is not appropriate. Ms. Erdahl appears to believe that the Commission accepted Public Counsel's argument that these costs benefit the shareholder and ratepayer equally. That is not the case.[3] While it is true that the Commission removed 50 percent of the Board fees and meeting expenses in the Avista case, the Commission's decision in that case relied on the fact that the Board meeting expenses incurred by Avista included items that were determined extravagant, excessive, and not providing ratepayer benefit.[4] Therefore, based on the record before the Commission in that case, a sharing of the expenses was determined to be appropriate. Specifically, the Commission stated: "our focus here is on Board activities and expenses incurred during the year, many of which are shown by the

---

[1] Exhibit No. ___ (BAE-1T), page 5, lines 3 to 5.
[2] *Washington Utilities & Transportation Commission v. Avista*, Dockets UE-090134, UG-099135, UG-060158, Order 10 (December 22, 2009).
[3] *Id.* n. 172.
[4] *Id.* ¶142, n. 171.

record to not provide ratepayer benefit."[5]

This is not the situation with PSE's Board fees and meeting expenses. Nothing in Commission Staff's testimony suggests that the Company's Board fees and meeting expenses are excessive or unreasonable. In fact, PSE's level of Board expenses and fees are significantly less than in prior general rate cases where they went unchallenged. As demonstrated in Exhibit No. ___(MJS-17), PSE's Supplemental Response to Public Counsel Data Request 120, PSE's Board fees are less than 40 percent of the pre-merger levels. Additionally, Exhibit No. ___(MJS-18), Attachment B to PSE's Response to Public Counsel Data Request 265, demonstrates that the expenses associated with the Board of Directors that have been charged to PSE are very small. Exhibit No. ___(MJS-19) demonstrates the significant portion of PSE's Board expenses that have been directly charged to the holding companies within the corporate structure. The total for these costs were $183,320 in 2010 and only $78,657 was charged to PSE. Of this amount $7,827 was charged below the line. Ms. Erdahl's adjustment was taken against what was properly charged above the line after the allocations discussed above and neglects to recognize the significant level of expense that was already charged to non-utility and the various holding companies in the corporate organizational structure. The Commission should reject Commission Staff's adjustment. PSE's assignment of costs between utility, non-utility and holding companies is reasonable and should be accepted by the Commission.

[5] *Id.* ¶ 142.

PSE has allocated Board fees based on the time spent on utility topics pursuant to the Board meeting agendas throughout the test year. Since the utility is the major source of operations, it is reasonable that these fees are recoverable and the adjustment should be adopted as filed by PSE for both its natural gas and electric operations. Ms. Erdahl's proposed allocation has no foundation, is inconsistent with the Commission's established treatment of such costs and should be rejected.

Q. Please continue with your review of the contested adjustments.

A. The following adjustments are also contested:

<u>Incentive Pay, MJS adjustment 13.10 and JHS adjustment 21.10</u>

Commission Staff proposes to remove 50 percent of the incentive pay from the test year stating that is the portion relating to the financial metrics component of the incentive payout calculation and only those portions relating to the service quality component of the payout calculation should be included.[6]

Q. Does the Company agree with Commission Staff's adjustment to remove the incentive pay relating to financial metrics?

A. No. As described in the Prefiled Rebuttal Testimony of Thomas M. Hunt, Exhibit No. ___(TMH-11T), the Goals and Incentive Plan is part of overall employee compensation and operates as a variable pay plan where employees have "pay at risk" tied to performance. The Commission accepted PSE's Goals and Incentive Plan in PSE's 2004 general rate case, (Docket UG-040640, Order 6 at paragraph 144) and more recently accepted PacifiCorp's incentive plan expenses in its 2010 general rate case (Docket UE-100749, Order 06 at paragraphs 248-49). Commission Staff incorrectly concluded that customers do not benefit from the financial metrics included in the incentive plan. The Commission has recognized in the past that cost control is a direct benefit to customers. It is just erroneous to claim that customers do not benefit from financial goals that focus employees on cost control and efficient operation.

These adjustments remain unchanged from PSE's original/supplemental filings in this case. The effect of these adjustments is to increase net operating income for electric operations by $482,220 and for natural gas operations by $246,621.

Q. Please continue with your review of the contested adjustments.

A. The following adjustments are also contested:

<u>Property Tax, MJS adjustment 13.11 and JHS adjustment 21.11</u>

In their prefiled rebuttal testimony, Mr. Matthew R. Marcelia and Mr. Story discuss the differences between the Company's adjustments and Commission Staff's adjustments. *See* Exhibit No. ___ (MRM-14 T) and Exhibit No. ___ (JHS-

---

[6] Exhibit No.___ (BAE-1T), page 6, lines 8-13.

18T). These adjustments remain unchanged from PSE's original/supplemental filings in this case. The effect of these adjustments is to decrease net operating income for electric operations by $3,359,921 and for natural gas operations by $1,668,296.

Directors and Officers Insurance, MJS adjustment 13.13 and JHS adjustment 21.13

Commission Staff argues that approximately 50 percent of the Directors and Officers ("D&O") insurance expense is related to the directors and that half of that amount should be moved below the line. Commission Staff argues that the Board of Directors provides services that benefit shareholders to the same extent they benefit ratepayers and therefore the shareholders should equally share this cost that serves their financial interest in PSE.[7]

Q. Does the Company agree with Commission Staff's adjustment to remove the additional D&O insurance costs?

No. Director and Officers insurance is a necessary cost of doing business and the majority of the risk that D&O insurance addresses is derived from operations of the utility. In addition, as a result of the merger in 2009, the cost of D&O insurance premiums has decreased due to the lower risk of shareholder lawsuits. This is demonstrated in Exhibit No. ___(MJS-20), which is a copy of Attachment

[7] Exhibit No.___ (BAE-1T), page 9, lines 9-13.

C to PSE's Response to Commission Staff Data Request No. 052. Risks still exist with bond holders due to the operations of the utility. Additionally, the Company's calculation already allocates a portion of these insurance expenses to its subsidiaries and accomplishes the sharing of risk and costs that the Commission has previously approved

Ms. Erdahl's calculation assumes this insurance is allocated 50 percent to cover liability for Company officers and 50 percent to cover liability for directors, and she removes 50 percent of the cost that she allocates to directors. She claims that "The Board of Directors provides services that benefit shareholders to the same extent they benefit ratepayers"[8], implying a 50 percent weighting of costs allocated to directors. However, she presents no evidence to justify this statement or the presumed 50 percent weighting. This additional allocation of 50 percent of the assumed premiums associated with the Board of Directors to shareholders has no foundation and is inconsistent with the Commission's established treatment of such costs. Commission Staff claims this approach is different from the approach to remove 50 percent of all D&O insurance expense that it advocated in the last PSE rate case, and which was rejected by the Commission[9]. In fact she is using the same approach the Commission rejected in PSE's last general rate case, except she is no longer removing the insurance costs that she arbitrarily allocated to Company officers. Commission Staff relies upon the Commission's

---

[8] Exhibit No. ___(BAE-1T), 9:11.

[9] *Washington Utilities & Transportation Commission v. Puget Sound Energy, Inc.*, Docket Nos. UE-090704 and UG-090705 Order 11 (April 2, 2010) ¶¶ 64-65.

determination regarding Board of Directors *expenses and fees* in Avista's 2009 general rate case[10] rather than the Commission's determination regarding *D&O insurance premiums*, in which the Commission determined that Avista's D&O insurance premium costs should be shared 90/10 between utility and non-utility operations. PSE had already allocated the costs as directed by the Commission. The Company's filed case allocates 9.95% of these insurance expenses to shareholders based on the time spent on non-utility activities. The Company's calculation allocates a portion of this insurance to subsidiaries and accomplishes the sharing of risk and costs that the Commission has previously approved.

PSE's approach is consistent with the Company's past allocation of D&O insurance, is similar to the methodology approved in the Avista order, and represents a much more realistic and supportable allocation than the arbitrary methodology proposed by Commission Staff. Therefore, the Commission Staff adjustment should be rejected.

These adjustments remain unchanged from PSE's original/supplemental filings in this case. The effect of these adjustments is to increase net operating income for electric operations by $33,584 and for natural gas operations by $23,376.

Q. Please continue with your review of the contested adjustments.

A. The following adjustments are also contested:

[10] *Washington Utilities & Transportation Commission v. Avista*, Dockets UE-090134, UG-099135, UG-060158, Order 10 (December 22, 2009).

<u>Rate Case Expenses, MJS adjustment 13.15 and JHS adjustment 21.15</u>

Commission Staff proposes to abandon the normalization of rate case expenses that was proposed by Commission Staff in PSE's 2004 general rate case, Dockets UG-040640, UE-040641, and which has been accepted by the Commission since that date. The new proposal is to include only actual rate case expenses included during the calendar 2010 test year.[11]

Q. Do you agree with Commission Staff's Rate Case Expense adjustment?

A. No. The normalization approach originally proposed by Commission Staff was unopposed in the 2006, 2007 and 2009 general rate cases (Docket Nos. UE-060277/UG-060267, UE-072300/ UG-072301 and UE-090704/UG-090705) and should be retained.

Commission Staff's proposed use of actual 2010 expenses is inconsistent with the Commission's long established requirement to normalize rate case expenses for several reasons. First, normalization of expenses provides a smoothing effect for fluctuating costs that are not consistent from year to year and is a common practice that does not violate the matching principle as suggested by Mr. Applegate. The bulk of rate case expenses are spent in between test years, when the case is being litigated, and therefore, seldom will actual test year expenses be representative of the costs of filing and processing a general rate case. Additionally, under Mr. Applegate's proposed methodology, customers would be worse off, as the Company's approach normalizes average rate case expenses over a two-year period. Mr. Applegate's approach would significantly increase the costs to customers when the test period is perfectly aligned with the statutory processing period, as was the case with the 2009 general rate case. I have prepared Exhibit No. ___(MJS-21) that provides a comparison of rate case expenses occurring in a test year, the amount set in rates based on the average cost over a two-year normalized period, and the actual expenses incurred to process the case for the past four general rate case proceedings. The exhibit provides the timeline associated with each test period along with the statutory processing period associated with each case. The lines identified as "Expenses in the test year" are the actual rate case expenses booked during the test period regardless of which rate case they are related to (e.g., 2009 actual rate case expenses are primarily related to costs incurred to process the 2007 general rate case).

The last column on Exhibit No. ___(MJS-21) compares the amount included in rates using PSE's current normalization of average rate case cost methodology and what it would have been under Mr. Applegate's proposed test year approach. The 2009 general rate case shows that under the test year approach, customers would have been worse off than the current methodology. Additionally, in comparing the 2006 through 2009 general rate cases the test year approach would introduce greater volatility for rate recovery. In fact, because of the high variance

[11] Exhibit No.___ (RTA-1T), page 16, lines 8-9.

in the 2009 general rate case, customers would have been worse off over all of the last three rate cases than they are under the current methodology.

It has been shown in Exhibit No. ___(MJS-21) that in a period of frequent rate case filings, the test year approach results in a higher level of expense being set in rates than under the current methodology. The impact of the test year approach in the inverse situation should also be examined. When the Company finds itself in a period when it has not had a general rate case in three years, the regulatory lag associated with rate case expense recovery would be extensive under the test year approach because of the timing of when rate case expenses are incurred compared to a test year. Even worse, if the Company were to have three or more years between a filing, and then not have another filing for an extended period of time, the test year approach would prevent recovery of any rate case costs.

As has been demonstrated, the normalized methodology which the Commission has used for the past several years is superior to the test year approach that Commission Staff has proposed in this case. The normalized methodology reduces volatility, accommodates for differing rate case schedules and filing frequencies, and provides a more levelized, representative expense.

Additionally, Mr. Applegate claims that because the test period includes costs associated with Docket UG-101644, the natural gas tariff filing ("GTIF") that increased natural gas revenues on margin, along with a portion of the litigation costs associated with the 2009 general rate case, the expense levels for the 2010 test year are “a fair and sufficient compensation” to the Company for its rate case expenses.[12] However, Mr. Applegate’s conclusion is not supported by the facts. The natural gas tariff filing (Docket UG-101644) was limited in scope, did not include cost of capital witnesses and was not a fully litigated proceeding. The costs associated with the GTIF filing included in the 2010 test period were only $107,000 which is clearly not representative of the expenses experienced with either the 2007 or the 2009 general rate cases, or even the expenses experienced to date for this proceeding.

Q. Do you agree with the other reasons Commission Staff gives for abandoning normalization?

A. No. Mr. Applegate claims that a two-year normalization of the average cost of a general rate case creates a mismatch when comparing this revenue stream with costs for specific rate cases that extend over three years. He also claims that PSE’s PCORC costs have been fully recovered and should therefore no longer be included in rates. In making these claims, Mr. Applegate appears to be confused about the differences between (1) deferring and amortizing and (2) normalization. Deferring and amortizing allows direct recovery of specific costs, whereas normalization provides the Company with the ability to recover like type costs in any given period. The Company has the ability to file both general rate cases and power cost only rate cases when needed and the Company’s adjustment merely

---

[12] Exhibit No.___ (RTA-1T), page 16, lines 11-21.

provides levelized, representative recovery for these types of costs. It does not provide specific recovery for the actual costs spent, as Mr. Applegate appears to believe. Therefore, the matching principle that he argues is neither relevant nor applicable.

Q. Do you agree with Mr. Applegate's concern regarding the allocation of rate case expense between natural gas and electric operations?

A. No. Mr. Applegate challenges the 50/50 allocation of rate case expenses between natural gas and electric operation, stating that such an allocation is unfair to natural gas customers when electric costs represent a disproportionately larger share of PSE's overall costs.[13] Mr. Applegate is correct that, in general, electric costs represent a large share of the Company's overall costs. However, he provides no explanation as to how these costs impact the cost of regulation. General rate case expenses relate to the legal and consulting services provided to litigate a regulatory filing. These costs can vary depending on what is being litigated but are not dependent on the underlying costs of the electric or natural gas side of the business.

For the reasons stated, the Commission should reject Commission Staff's adjustments. These adjustments remain unchanged from PSE's original/supplemental filings in this case. The effect of these adjustments on net

---

[13] Exhibit No.___ (RTA-1T), page 17, lines 10-13.

operating income is an increase for electric operations of $44,411 and a decrease for natural gas operations of $142,724.

<u>Employee Insurance, MJS adjustment 13.21 and JHS adjustment 20.21</u>

Company witness Mr. Thomas M. Hunt discusses the difference between PSE and Commission Staff for these adjustments in his prefiled rebuttal testimony, Exhibit No. ___(TMH-9T). In summary, for calculating this adjustment, Commission Staff witness Ms. Erdahl uses the end of period, rather than average, participant count from the test year, after excluding employees that were laid-off in the test year. Commission Staff's adjustment also uses the average Company cost of $953 per month per participant from the UA contract, rather than the actual average rate experienced by the Company for the five months ending May 2011 of $988 per month per participant used in PSE's adjustments.

Q. Please explain whether you have adopted any of Commission Staff's proposals.

A. Based on Company witness Mr. Thomas Hunt's rebuttal testimony, I have removed the employees that were laid-off in the test year from my calculation of the average participant counts. However, I continue to use an average participant count as supported by Mr. Hunt, versus an end of period count. Mr. Hunt also discusses why the Commission should not adopt the average UA rate used by Ms. Erdahl. Accordingly, I have not changed my calculation of employee insurance from the proper actual current average rate per participant for UA employees.

Including the impact of these changes, these adjustments now result in a decrease to net operating income for electric operations by $11,276 and for natural gas operations by $5,476.

Q. Please continue with your review of the contested adjustments.

A. The following adjustments are also contested:

<u>Working Capital, MJS adjustment 13.22 and JHS adjustment 21.22</u>

Q. Please explain your new adjustment titled Working Capital shown on your page MJS-13.22 and JHS-21.22.

A. In PSE's Response to Commission Staff Data Request No. 091, the Company agreed to correct the ratemaking treatment included in its direct supplemental filing for two balance sheet accounts. These accounts in FERC account 134 "Other special deposits" were treated as Investor Supplied Working Capital in the supplemental filing. During the course of the proceeding, it was discovered that the two accounts earned interest separately. This adjustment was also proposed by Commission Staff witnesses Mr. Roland C. Martin and Mr. Christopher T. Mickelson in their adjustments RCM 14.22 and CTM 6.22.

These adjustments decrease rate base by $1,378,828 for electric operations and $512,748 for natural gas operations.

Q. Did opposing parties propose any other changes to working capital?

A. Yes. Commission Staff witness, Ralph Smith, in Exhibit No.___ (RAS-1T), proposes removal of the debit balance in FERC account 236 from working capital. Additionally, Ms. Crane's proposed adjustment regarding net operating loss ("NOL") would impact the working capital calculation. Mr. Marcelia provides an overview of these proposed adjustments and why they should not be approved by the Commission in his prefiled rebuttal testimony, Exhibit No ___(MRM-14T).

Q. Are there any other adjustments proposed by the parties that you have not addressed?

A. Yes, Commission Staff witness Ralph Smith proposes that the Company's current income tax expense be reclassified to deferred federal income tax expenses. Mr. Marcelia discusses why this adjustment should not be made in Exhibit No.___(MRM-14T).

Q. Does this complete your discussion of pro forma and restating adjustments?

A. Yes.

V. REVENUE DEFICIENCY

Q. Would you please explain Exhibit No. ___(MJS-14)?

A. Exhibit No. ___(MJS-14) presents the calculation of the revenue deficiency based on the pro forma and restating adjustments proposed by the Company and discussed above. As shown on page 1 of Exhibit No. ___(MJS-14), based on $1,657,792,777 invested in rate base and $119,149,110 of net operating income, the Company has a gas revenue deficiency of $28,616,025.

Cost of Capital

This schedule, shown on page 2 of Exhibit No. ___(MJS-14) reflects the Company's proposed capital structure for this proceeding and the associated costs for each capital category. The capital structure and costs are presented in the Prefiled Rebuttal Testimony of Mr. Donald E. Gaines, Exhibit No. ___(DEG-14T). The rate of return is 8.26%.

Conversion Factor

The conversion factor, shown on page 3 of Exhibit No. ___(MJS-14), is uncontested in this proceeding and is unchanged at 62.1490%.

VI. UNIT COST ANALYSIS

Q. Has PSE updated its unit cost analysis?

A. Yes. PSE has updated its unit cost analysis. Please see Exhibit No. ___(MJS-16) for the natural gas unit cost analysis. The unit cost analysis consists of a comparison of the major categories of the income statement and rate base that have been pro formed and restated for each of the test periods for this general rate proceeding and the last general rate proceeding. The major categories of the income statement are divided by the delivered load for the appropriate test period to determine the major categories' unit cost for that particular period. The differences between the current period and prior period unit costs are then multiplied by the delivered load for the current regulatory period. This product determines how much that major category has increased or decreased in cost since the last regulatory period taking into consideration load growth and its associated revenue growth. This exhibit is presented for informational purposes.

VII. CONCLUSION

Q. Does that conclude your prefiled rebuttal testimony?

A. Yes.