

0011

BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

In the Matter of the Petition of)
)
 PUGET SOUND ENERGY, INC.)
)
 For an Accounting order Approving)
 the Allocation of Proceeds of the) Docket No. UE-132027
 Sale of Certain Assets to Public)
 Utility District #1 of Jefferson)
 County)
)
)
)

HEARING - VOLUME II
PAGES 11 - 261

ADMINISTRATIVE LAW JUDGE DENNIS MOSS

9:30 A.M.
MAY 21, 2014

Washington Utilities and Transportation Commission
1300 South Evergreen Park Drive Southwest
Olympia, Washington 98504-7250

REPORTED BY: LESLIE M. SHERMAN, RMR, CCR 2629

Buell Realtime Reporting, LLC
1325 Fourth Avenue, Suite 1840
Seattle, Washington 98101
206-287-9066 Seattle
206-534-9066 Olympia
206-846-6989 National
www.buellrealtime.com

0012

1 A P P E A R A N C E S

2 ADMINISTRATIVE LAW JUDGE:
3 DENNIS MOSS
4 Washington Utilities and Transportation
5 Commission
6 1300 South Evergreen Park Drive SW
7 PO Box 47250
8 Olympia, Washington 98504
9 360.664.1136

10 WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION:
11 DANIEL W. DANNER, CHAIRMAN
12 JEFFREY GOLTZ, COMMISSIONER
13 PHILIP B. JONES, COMMISSIONER

14 FOR PUGET SOUND ENERGY:
15 MARKHAM A. QUEHRN
16 DONNA L. BARNETT
17 Attorneys at Law
18 mquehrn@perkinscoie.com
19 dbarnett@perkinscoie.com
20 Perkins Coie
21 The PSE Building
22 10885 NE Fourth Street, Suite 700
23 Bellevue, Washington 98004
24 425-635-1402

25 FOR INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES:
26 TYLER C. PEPPE
27 Attorney at Law
28 tcp@dvclaw.com
29 Davison Van Cleve
30 333 SW Taylor, Suite 400
31 portland, Oregon 97204
32 503-241-7242

33 FOR PUBLIC COUNSEL DIVISION:
34 LISA GAFKEN
35 Assistant Attorney General
36 lisaw4@atg.wa.gov
37 Washington State Attorney General's Office
38 800 Fifth Avenue, Suite 2000
39 Seattle, Washington 98104
40 206-464-6595

41

0013

1 A P P E A R A N C E S (Continued)

2 FOR COMMISSION STAFF:

 DANIEL T. TROTTER

3 Attorney at Law

 dtrotter@utc.wa.gov

4 Office of the Attorney General

 Utilities and Transportation Division

5 1400 S. Evergreen Park Drive SW

 PO Box 40128

6 Olympia, Washington 98504

 360-664-1189

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1 I N D E X

2 EXAMINATION PAGE

3 SAMUEL OSBORNE
 4 DIRECT EXAMINATION BY MR. QUEHRN..... 46
 5 CROSS-EXAMINATION BY MR. TROTTER..... 47
 6 CROSS-EXAMINATION BY MS. GAFKEN..... 50
 7 CROSS-EXAMINATION BY MR. PEPPLER..... 59
 8 Questions from panel.....66

9 JON PILIARIS
 10 DIRECT EXAMINATION BY MR. QUEHRN..... 71
 11 CROSS-EXAMINATION BY MR. TROTTER..... 72
 12 CROSS-EXAMINATION BY MS. GAFKEN..... 84
 13 REDIRECT EXAMINATION BY MR. QUEHRN....93

14 MATTHEW MARCELIA
 15 DIRECT EXAMINATION BY MR. QUEHRN..... 94
 16 CROSS-EXAMINATION BY MR. TROTTER..... 95
 17 Questions from panel..... 100

18 STANFORD LEVIN
 19 DIRECT EXAMINATION BY MR. QUEHRN.....124
 20 CROSS-EXAMINATION BY MR. TROTTER.....125
 21 CROSS-EXAMINATION BY MS. GAFKEN..... 133
 22 Questions from panel..... 135
 23 REDIRECT EXAMINATION BY MR. QUEHRN...157
 24 Questions from panel..... 160

25 ROBERT BELLEMARE
 26 DIRECT EXAMINATION BY MR. QUEHRN.....162
 27 CROSS-EXAMINATION BY MR. TROTTER.....163
 28 CROSS-EXAMINATION BY MS. GAFKEN..... 169
 29 Questions from panel..... 173
 30 REDIRECT EXAMINATION BY MR. QUEHRN...186
 31 Questions from panel.....190

32 MICHAEL GORMAN (Telephonically)
 33 DIRECT EXAMINATION BY MR. PEPPLER.....201
 34 Questions from panel..... 203

35 JAMES DITTMER
 36 DIRECT EXAMINATION BY MS. GAFKEN.....212
 37 Questions from panel.....213
 38 FURTHER DIRECT EXAMINATION BY
 39 MS. GAFKEN.....224

0015

1 I N D E X (Continued)

EDWARD KEATING
2 DIRECT EXAMINATION BY MR. TROTTER....226
CROSS-EXAMINATION BY MR. QUEHRN..... 227
3 Questions from panel..... 235
4 REQUESTS
Bench Request No. 1.....115
5

6 E X H I B I T S

7	EXHIBIT	ADMITTED
8	SSO-11CX	58
	SSO-13CX	58
9	SSO-9CX	62
	SSO-10CX	66
10		
	MRM-9CX	84
11		
	JAP-16CX	202
12	JAP-17CX	202
	JAP-18CX	202
13	JAP-19CX	202
14	RCB-5CX	202
	RCB-6CX	202
15		
	MPG-4CX	203
16	MPG-5CX	203
	MPG-6CX	203
17	MPG-7CX	203
	MPG-8CX	203
18	MPG-9CX	203
19	MRM-7CX	212
	MRM-8CX	212
20	MRM-9CX	212
	MRM-10CX	212
21		
	JRD-4CX	213
22	JRD-5CX	213
	JRD-6CX	213
23	JRD-7CX	213
	JRD-8CX	213
24	JRD-9CX	213
25	//	

0016

1

E X H I B I T S (Continued)

2	EJK-9X	258
	EJK-10X	258
3	EJK-11X	258
	EJK-12X	258
4	EJK-13X	258
	EJK-14X	258
5	EJK-15X	258
	EJK-16X	258
6	EJK-17X	258
	EJK-18X	258
7	EJK-19X	258
	EJK-20X	258
8	EJK-21X	258
	EJK-22X	258
9	EJK-23X	258

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

0017

1

HEARING

2

Olympia, Washington May 21, 2014

3

9:30 a.m.

4

5

P R O C E E D I N G S

6

7

JUDGE MOSS: Judging from the silence, counsel

8

are ready. All right. Why don't we go on the

9

record. Good morning, everybody. My name is Dennis

10

Moss. I am an administrative law judge with the

11

Washington Utilities and Transportation Commission.

12

We are convening this morning in our hearing room in

13

the matter of the Petition of Puget Sound Energy,

14

Inc., for an accounting order approving the allocation

15

of proceeds of the sale of certain assets to Public

16

Utility District No. 1 of Jefferson County. Our

17

docket number is UE-132027.

18

And we will begin this morning's activities

19

with appearances and start with the company. And the

20

short form of appearance will be sufficient.

21

MR. QUEHRN: Yes. Good morning.

22

JUDGE MOSS: You do need to pull it fairly

23

close.

24

MR. QUEHRN: Good morning. This is Mark

25

Quehrn appearing on behalf of Puget Sound Energy, and

0018

1 also appearing with me this morning is my co-counsel
2 Donna Barnett.

3 JUDGE MOSS: All right. Thank you. Did
4 Ms. Barnett enter an appearance?

5 MS. BARNETT: No, your Honor, I haven't.

6 JUDGE MOSS: Okay. Well, I will note you
7 down.

8 MS. BARNETT: Same contact information.

9 JUDGE MOSS: Yes, I'm sure. Did Ms. Carson
10 enter an appearance in this?

11 MS. BARNETT: Yes.

12 JUDGE MOSS: I think she did. Okay, very
13 well. Thanks. Go ahead. ICNU?

14 MR. PEPPLER: This is Tyler Pepple for the
15 Industrial Customers and Northwest Utilities.

16 JUDGE MOSS: All right. Just for the
17 record, Ms. Davis had also entered an appearance.

18 All right. Public counsel?

19 MS. GAFKEN: Good morning. Lisa Gafken,
20 Assistant Attorney General, Public Counsel Division of
21 the Attorney General's Office.

22 JUDGE MOSS: And you are faring to the lions
23 by yourself, as I recall.

24 MS. GAFKEN: That's right.

25 JUDGE MOSS: For the staff?

0019

1 MR. TROTTER: Donald T. Trotter, Assistant
2 Attorney General for Commission staff.

3 JUDGE MOSS: Thank you, Mr. Trotter.

4 All right. I guess I'll skip around a
5 little bit on my prepared agenda, which none of you
6 have anyway so you don't really know what I'm doing.

7 Are there any preliminary matters that we
8 need to take up, any motions or such as that? And
9 then I'll move to the idea of stipulating the
10 exhibits.

11 Nothing? Okay. Can we stipulate into the
12 record the pre-filed testimonies and exhibits? By
13 that I mean the direct, the response and the rebuttal
14 rounds, not the cross exhibits, just the prefiled
15 exhibits other than cross? Any problem with that from
16 counsel?

17 MR. QUEHRN: No.

18 MR. PEPPE: No.

19 JUDGE MOSS: Ms. Gafken?

20 MS. GAFKEN: No objection.

21 JUDGE MOSS: Okay. Excuse me. We will
22 stipulate that.

23 And now let's turn to the cross exhibits and
24 see, are there any cross exhibits as to which parties
25 anticipate they would like to interpose an objection?

0020

1 Hearing nothing, I assume then we can
2 stipulate those as well.

3 MR. QUEHRN: Your Honor, clarification.

4 JUDGE MOSS: Yes.

5 MR. QUEHRN: Where we have stated objections
6 to those questions, we would renew those objections.
7 I would have to go back and look at it on an exhibit
8 by exhibit basis. So, subject to being able to renew
9 those objections.

10 JUDGE MOSS: Okay. Well, we'll just go
11 forward without admitting those at this time, and to
12 the extent we have objections to them, we will take
13 them up at the time that counsel offers them --

14 MR. QUEHRN: Thank you.

15 JUDGE MOSS: -- when the witness is on the
16 stand.

17 As far as our witnesses today, all the
18 witnesses, as I understand it, will be appearing live
19 with the exception of Mr. Gorman, who we have by
20 previous arrangement allowed to participate by
21 telephone. And Mr. Pepple has assured me that that
22 arrangement is in place.

23 We have an order of witnesses today which we
24 will follow. And in terms of cross, I'll set that up
25 when we get there.

0021

1 Now, it was informal, but I did give counsel
2 notice that we would have some opening statements
3 today, and that will be useful to the bench. And so
4 what I asked you to do was to prepare a 15 minutes or
5 less in terms of comments, explaining what you'd like
6 to show us, demonstrate in the way of any contested
7 facts in the case, and then summarize briefly your
8 policy and legal arguments in the case.

9 I note there are a number of people
10 participating or listening in today on teleconference
11 bridge lines. Since all parties are present I did not
12 ask for appearances on the bridge line. So, I think
13 we can begin then.

14 Anything preliminary from the bench? Nothing
15 apparently, so, why don't we begin with the company.

16 MR. QUEHRN: Thank you, Judge Moss,
17 Commissioners.

18 The issue that's presented to the Commission
19 in this proceeding is the allocation of gain from the
20 sale of Jefferson County assets to Jefferson County
21 PUD. The proceeds from the sale were approximately
22 \$109 million, and gained is the excess of the proceeds
23 over net book value less transaction costs, or
24 approximately \$60 million.

25 The parties are in agreement in this case

0022

1 that 46.4, roughly \$47 million of the net book value
2 of those assets are returned to shareholders. There
3 is a modest disagreement over the amount of the
4 transaction costs, but I think the parties are also in
5 agreement that the transaction costs are to be backed
6 off of the purchase price in order to determine gain.

7 There is a separate question that's also
8 before the Commission, and that is independent of the
9 determination of gain, is there harm to the remaining
10 customers that needs to be addressed and compensated
11 in this proceeding.

12 Now, in order to address the legal
13 principles that are applicable to these questions,
14 what I'd like to do is actually turn to the context
15 within which this transaction arose, because I think
16 that context is important and gives rise to some of
17 the principles that will hopefully guide your decision
18 in this case.

19 And I want to start by talking about what
20 this case is not about. This Commission frequently
21 has before it situations where assets are being
22 transferred, and in connection with your jurisdiction
23 to approve an asset transfer, you undertake a
24 consideration of the public interest. That is a broad
25 inquiry undertaken in accordance with RCW 80.12.020,

0023

1 and in connection with undertaking that inquiry in
2 determining the public interest you have many tools
3 available, tools available to you to determine and
4 make sure that that transfer does incur -- occur,
5 excuse me, consistent with the public interest.

6 One of those tools in that context is
7 allocation of gain to customers. However, the
8 decision before you or the case that's presented
9 before you in this case does not involve the approval
10 of the transfer. We in fact address that question in
11 the declaratory order. And in fact, in this instance
12 the approval of the transfer is a -- occurs as a
13 matter of statute. The legislature in this instance
14 has taken that question away from the Commission, and
15 has determined that a sale of assets to a public
16 utility district does not require the approval of the
17 Commission to the transfer, nor does it require you to
18 undertake public interest analysis in connection with
19 approving that transfer.

20 So, the point here is the question that's
21 presented in this case is a different question than we
22 normally address in connection with reviewing and
23 approving a transfer in cases such like the Centralia
24 case which is much discussed in the materials.

25 The second point that I think is important

0024

1 to the context is we have some missing persons in this
2 case. In addition to lack of jurisdiction over the
3 approval of the transfer, the former customers that
4 are former customers who are now JPUD customers, their
5 interests are really not presented in this
6 proceeding. RCW 54.16.040 states that a PUD may
7 acquire an operating and electrical distribution
8 system and furnish service to its customers, quote,
9 "free from the jurisdiction and control of the
10 Commission in all things."

11 So, what this means for purposes of your
12 analysis, any burdens that were borne by the remaining
13 customers, any benefits that those remaining -- excuse
14 me, any burdens that were borne by the former
15 customers, any benefits that might be owed to the
16 former customers, are essentially not matters that we
17 can address in this proceeding. They took those
18 burdens and they took those benefits with them when
19 they left the system.

20 But we do of course have our remaining
21 customers. And as I said previously, you have two
22 questions: The allocation of gain; and then what I
23 believe to be a very separate question, and that is to
24 determine whether or not as a result of this
25 transaction the remaining customers were harmed.

0025

1 And indeed I think it's important that we
2 think about it as a separate question because in
3 theory, customers could be harmed in an amount more or
4 less than the gain, or sale could result in a loss.
5 And in either instance, if the transaction results in
6 a harm to customers, that is a matter that we would
7 need to address.

8 And indeed, there is a parallel to this in
9 the condemnation context, which is really the
10 structure in which this transaction was created. In a
11 condemnation case the entity that is being condemned
12 is entitled to the fair market value of the assets
13 that are being taken, and in this case, in the case of
14 a utility, they are entitled to going concern
15 damages.

16 But they are also entitled to something
17 called separation costs or severance damages or
18 stranded costs, are a number of terms which refer to
19 it, which really address specifically the question of
20 whether or not there are consequences of the sale,
21 maybe it's rendering transmission assets uneconomic or
22 some other aspect that harm their many customers that
23 can be compensated in the condemnation context.

24 As you go through the evidence of the
25 proceeding, what we believe you will see and find is

0026

1 that those facts aren't presented. There were not
2 harms to the remaining customers associated with this
3 transaction. To the extent it is relevant, the amount
4 of the accumulated depreciation that was paid on the
5 Jefferson County assets was paid proportionally by the
6 departing customers.

7 The evidence that you will consider and
8 present, some of it is contested within degrees, it
9 will show, we believe, that the former customers fully
10 paid their costs of service. In other words, serving
11 Jefferson County was not a burden to the remaining
12 customers.

13 And the evidence will also show that the
14 departure of the former customers resulted in a load
15 reduction that was not only not a harm to the
16 remaining customers, but in fact as a result of that
17 load reduction they will receive a substantial
18 benefit.

19 Now, unfortunately in this instance the
20 company's shareholders or investors are not so
21 fortunate. The company and their investors in this
22 instance suffered a permanent loss of service area and
23 18,000 customers. And again, this is clearly a
24 distinction from the normal, an ordinary in the normal
25 course asset sale against such as Centralia where

0027

1 there is no loss of customers and there is no loss of
2 service area.

3 This is a unique and extraordinary harm,
4 because when you lose your service area there is no
5 adjoining service area you can just go pick up. Those
6 former 18,000 customers are now paying revenues to
7 JPUD, not to PSE. Investing the proceeds, the book
8 value back into the company is not a new investment
9 opportunity, nor does it make up for the 18,000
10 customers that are no longer providing PSE return on
11 investment.

12 Now, in terms of which principles should
13 apply to these facts, in our briefing and in our
14 petition we refer you to a rule making that was
15 undertaken by the California PUC referred to in the
16 materials as Redding 2. And the California PUC
17 embraced these unique circumstances and distinguished
18 their rules from what they would apply in the ordinary
19 course, but they were careful to do so, and they
20 pointed to four criteria that they believe is
21 important to determine when they would apply the rules
22 or the allocation argument that we're making in this
23 case.

24 The first important criteria was that the
25 sale must be to a public or government entity under

0028

1 threat of condemnation, JPUD in this case. It also
2 says that the sale must involve the sale of all of the
3 utility's operating system within a geographically
4 defined area. Jefferson County, we are no longer
5 serving there. It must also be found that the
6 components of the system that were sold were in the
7 rate base, which is true in this case. And it must
8 also be the case that the sale is concurrent with the
9 utility being relieved of its public service
10 obligations to serve its former service area. We are
11 no longer serving Jefferson County.

12 Under these circumstances the California PUD
13 says -- PUC says that -- PUC says that 100% of the
14 gain should be allocated to the shareholders, but they
15 too do not forget the important question, is there
16 harm to the remaining customers. To the extent that
17 there is demonstrated that there is remaining harm to
18 the customers of California PUC, would also as we are
19 arguing in this proceeding, want to discern that harm
20 and appropriately compensate that harm.

21 But again, what does the evidence show in
22 this case? As you go through the case, we believe
23 what you will find is that there is no harm or no
24 significant harm. It's not an exact science when I
25 you are you are trying to cut up the service area like

0029

1 this, but the evidence will show that there is no
2 significant harm to the remaining customers. There is
3 in fact a significant benefit, and in that case we
4 believe that the Redding 2 rule is directly applicable
5 and supports our proposed accounting, request for
6 accounting treatment in this case.

7 There is one further point that I think
8 distinguishes this case from the others. It's
9 important, and it's really important to the extent
10 that this Commission is called upon to write an order
11 that is unique and specific to this circumstance.
12 This was not a voluntary asset transfer. This was not
13 a situation where the counter-parties could sit down
14 and put together a transaction, weigh their own burden
15 and benefits, and decide that there was a business
16 opportunity that they wanted to pursue.

17 This was a forced sale. In a normal
18 transaction you can put contingencies in. I want
19 financing on the right terms, a regulatory
20 contingency. This was a forced sale. PSE had no such
21 option. We were compelled to try to make the best
22 situation we could out of a bad situation from our
23 perspective, and certainly in that instance there are
24 two issues that I think, because it's an involuntary
25 transfer, that I think are important to the decision

0030

1 you make. One is I think it bears on the equities,
2 and how you consider the facts and how you -- the
3 balance that you strike here, and also it's a very
4 important point to distinguish this from other cases
5 that involve voluntary transfers.

6 So, in conclusion, we are not arguing nor is
7 there any need, nor do we ask you to upset, revisit or
8 disturb the established precedent in this jurisdiction
9 that would apply to a voluntary asset transfer. The
10 rule of Centralia should apply to those type of
11 situations.

12 But that's not the question that's presented
13 in this proceeding. This was not a voluntary asset
14 transfer; it was loss of service area, loss of
15 customers, it is a unique and extraordinary case. It
16 is a case where there has been significant harm to the
17 shareholders. And again, the evidence will show as we
18 go through it, there is no harm or no showing of harm
19 to the customers.

20 And for those reasons, we respectfully
21 request that you issue an order granting us the
22 requested accounting treatment. Thank you.

23 JUDGE MOSS: Thank you, Mr. Quehrn. Right
24 on time.

25 ICNU?

0031

1 MR. PEPPE: Good morning, Commissioners,
2 Judge Moss. It will not surprise the Commission to
3 learn that ICNU does not agree with the company's
4 analysis of this transaction. And frankly, the
5 company's analysis has shifted over the course of even
6 before this proceeding. It's taken numerous and
7 contradictory positions on how this Commission should
8 allocate the proceeds of this sale of distribution
9 assets to the Jefferson County Public Utility
10 District.

11 In 2010 the company filed a petition for a
12 declaratory ruling in which it was seemingly satisfied
13 with an order that allowed customers at least in
14 theory to later receive up to the entire purchase
15 price. Today it argues that giving customers anything
16 at all would be confiscatory.

17 The company has attempted to distinguish
18 this case from other transactions, as Mr. Quehrn
19 already said, by arguing that essentially without
20 anything more that this transaction is unique and
21 harsh. There is no reason the Commission cannot
22 evaluate this transaction under its traditional
23 framework, and indeed the Company has also tried to
24 fit this transaction into that framework, but it does
25 so in a way that asks the Commission to base its order

0032

1 on pure guesswork about whether the company or its
2 customers would be better off 20 years from now as a
3 result of this transaction.

4 There is no reason to complicate this case
5 in these ways. The Commission has an established
6 framework for how to evaluate property sales, and that
7 framework looks at the risks and rewards and the
8 benefits and burdens to customers. With respect to
9 this test, nothing distinguishes this transaction from
10 any other with regard to what is knowable about the
11 risks that the customers and the company bear.

12 By paying PSE a return on and return of its
13 investment in the Jefferson County distribution of
14 assets, customers have borne the risk of those
15 assets. Similarly, customers bear the risk if those
16 assets are sold at a loss. When PSE sells rate-based
17 utility assets for a loss, customers are asked to
18 cover the remaining net book value even though those
19 assets are no longer used and useful for service.

20 Now PSE has sold property for a gain and it
21 seeks to flip the script by collecting the remaining
22 net book value and walking away with the vast majority
23 of the gain.

24 PSE argues that it is rightfully entitled to
25 everything because it is the owner of the assets,

0033

1 excuse me, was the owner of the assets. PSE offers to
2 customers 25 percent out of apparent generosity, but
3 PSE does not face the risks of ownership in a
4 competitive business space. These businesses cannot
5 turn to their customers to make them whole for a loss
6 without facing the risk that another business will
7 come in and undercut their prices.

8 While no one disputes that PSE was the owner
9 of the assets before their sale to JPUD, the
10 Commission has already found that customers bear the
11 full burden of cost responsibilities for such assets.
12 This includes operating expenses, depreciation and
13 return on the capital invested.

14 Due to the real risks that customers face
15 upon the sale of utility assets, they are the ones who
16 are entitled to the gain. It is no more complicated
17 than that. ICNU recommends that the company be
18 reimbursed for its remaining equitable value and
19 transaction costs which will make the company whole,
20 the customers be allocated the accumulated
21 depreciation which represents the amount they've
22 already paid to support the assets, and that the
23 remaining proceeds be split 90 percent going to the
24 customers and 10 percent to the company.

25 Thank you.

0034

1 JUDGE MOSS: Thank you very much.

2 Ms. Gafken?

3 MS. GAFKEN: Thank you. In this case the
4 Commission is being asked a basic question to
5 determine the appropriate allocation of the gain on
6 sale of assets once used in providing utility
7 service. Each sale is unique, and this sale was
8 conducted as a result of 2008 vote in which customers
9 of PSE approved a ballot initiative to authorize
10 Jefferson County PUD to take steps to acquire
11 facilities so it could provide the electric service to
12 those customers.

13 The facts regarding how we arrived here
14 today are largely uncontroversial: The vote, the
15 sale, the gain, the declaratory order specifically
16 tabling allocation and the accounting treatment of the
17 sales proceeds.

18 Now the Commission has squarely before it
19 the question of how to allocate that gain. As has
20 been already noted by my colleagues who went before
21 me, similar to other gain cases, there is no
22 disagreement among the parties that the company should
23 receive the net book value and transaction costs
24 associated with this transaction.

25 The disagreement between the company and the

0035

1 non-company parties arises when we look at the book
2 gain, the difference between the net book value and
3 the amount of the purchase proceeds. PSE is asking
4 the Commission to adopt a policy decision that was
5 made in California to treat gain resulting a
6 municipalization sale differently than gain from other
7 sales of utility property.

8 There are several reasons why this
9 Commission should decline to adopt the California --
10 adopt California's policy decision. The Commission
11 has robust precedent regarding allocation of gain on
12 sale of utility assets described in part by public
13 counsel witness James Dittmer in his testimony, and
14 which will also be analyzed more fully in our post-
15 hearing brief.

16 This Commission has consistently recognized
17 that sharing gain with rate payers is in the public
18 interest. In many cases, rate payers have received
19 the vast majority of gain with a smaller portion of
20 the gain being allocated to shareholders.

21 To analyze how the gain should be split
22 between rate payers and shareholders, the Commission
23 has used the equitable principles that benefit follows
24 burden and reward follows risk, as was articulated in
25 the 1999 sale of Centralia case which cites the

0036

1 Democratic Central case.

2 In this case, PSE argues that the
3 municipalization aspect of the sale obviates the need
4 to consider the equitable principles, but does propose
5 that a small portion of the gain be shared with rate
6 payers.

7 Public counsel argues that the gain in this
8 case is not so different from the gain in other sales
9 transactions, and the application of the equitable
10 principles is still appropriate. In evaluating the
11 risks shouldered by rate payers and shareholders, the
12 analysis in this case is not unique. First, prior to
13 the sale, rate payers bore the risk of loss with
14 respect to the assets in Jefferson County. It's
15 important to note that all rate payers bore that risk
16 of loss, not just the rate payers of Jefferson County.

17 This Commission has noted that the costs and
18 risks of ownership after the initial acquisition are
19 borne by rate payers. Items such as taxes, insurance
20 or self insurance in instances where costs have been
21 passed on to rate payers after loss, maintenance, the
22 cost of money for the acquisition, those are all
23 generally borne by the rate payers. And because PSE
24 has uniform rates across its service territory, all
25 PSE rate payers pay for all of PSE's assets.

0037

1 Second, allocating gain to rate payers is
2 consistent with the Regulatory Compact. As I just
3 noted, all of PSE's customers pay for all of the
4 assets, and they paid for the assets in question in
5 this case, and they bore the risk of that loss.

6 Shareholders have been compensated for the
7 risks they took in investing in the utility. They
8 have been compensated for the risks they took and have
9 received a return on their investment through the
10 company's return on equity. And shareholders are made
11 whole. They received a return of their investment, or
12 they will through the sales proceeds and the net book
13 value component there, but also through the
14 accumulated depreciation amount that they received
15 through rates during the time they held the assets.

16 Under public counsel's and the other
17 non-company parties' recommendations, shareholders
18 would also receive a portion of the gain from the
19 sale.

20 Third, there is no disagreement among the
21 parties that there is at least short-term harm to
22 remaining rate payers during the first four to five
23 years after the sale. Measures of long-term benefit
24 are more speculative and unreliable as we will address
25 during cross-examination of the company's witnesses.

0038

1 Mr. Dittmer also provides testimony about the harms
2 resulting from the sale including stranded costs and
3 the effect upon power and non-power costs.

4 Our cross during today's hearing will focus
5 on the circumstances leading up to and the risks
6 associated with municipalization. We will look at the
7 use of the PSM III model to quantify a particular
8 dollar amount versus to justify an acquisition
9 decision.

10 We will look at the stranded cost issue, the
11 role of accumulated depreciation, and the idea that
12 allocating gain to rate payers will be confiscatory.

13 We will also look at a few of the analogies
14 made by the companies. There is a lot of analogies,
15 so I want to note by not addressing an analogy through
16 cross we are not adopting or approving any of those,
17 but we will address a few of them.

18 Public counsel urges the Commission after
19 consideration of the evidence and the record, and the
20 arguments the parties will make today and on brief, to
21 reject treating the sale related to a municipalization
22 differently, but rather to analyze treatment of the
23 gain consistent with this Commission's precedent.

24 Public counsel ultimately recommends that
25 the Commission allocate a substantial portion of the

0039

1 gain to rate payers with a smaller portion allocated
2 to shareholders. Thank you.

3 JUDGE MOSS: Thank you. Mr. Trotter?

4 MR. TROTTER: Thank you, your Honor, and
5 good morning. My name is Donald T. Trotter. I will
6 be arguing on behalf of the Commission staff.

7 I think it would be very helpful to the
8 Commission as you requested to clearly delineate the
9 legal theories from the policy implications of this
10 case, and I think company counsel started on that
11 road, but immediately took a wrong turn, so I'm going
12 to try to keep the legal argument separate from the
13 policy arguments.

14 And where counsel made the wrong turn was,
15 not that 282.12 may not apply, but even if it doesn't,
16 the overall requirement in the statute that the
17 Commission regulate in the public interest is an
18 overriding standard that applies to Commission
19 regulation generally.

20 So, if the public interest standard is does
21 not apply under 80.12, the transfer of property
22 statute, it certainly applies in this docket under the
23 general regulating the public interest requirement.
24 So most of what he said is not particularly helpful to
25 the Commission.

0040

1 The fundamental legal principle under which
2 staff takes its base is really the foundation of
3 public service regulation in this country and in this
4 state, since the 20's, 30's or 40's. Really the
5 landmark decision was the Hope Natural Gas case in
6 1943, where the Court expressly approved the form of
7 regulation of a company based on its net book value.
8 Original cost less depreciation, that's what we are
9 calling net book value. And the Court said that is
10 acceptable, that is proper, the company is made whole
11 under that sort of arrangement.

12 And of course there were constitutional
13 challenges in that docket, that case. But that's what
14 the Court held.

15 And as we all know, ever since then, for the
16 most part, electric utilities and specifically have
17 been regulated under that procedure, under that
18 standard, under that legal principle.

19 Consequently, when a company devotes its
20 capital to public service obligations, it is entitled
21 to receive its net book value when that plant no
22 longer becomes available for public service. And no
23 party in this case, in fact let me put it more
24 affirmatively, all parties in this case propose to
25 give the company back its net book value. That is

0041

1 what is what is legally required, and transaction
2 costs you can throw in, that's fine.

3 But the fundamental legal foundation is the
4 company is entitled to its net book value, period.
5 Anything more than that is no longer a legal question
6 in our opinion, but a policy question. Now, we are
7 aware of the City of Redding and the City of Redding
8 2, I believe, company counsel cited that, and it is in
9 their petition for gratification.

10 However, my reading of that case is that
11 that was a policy call, it's not a legal call. The
12 Commission is not bound by that policy. And of course
13 in that policy determination, the California
14 Commission balanced the equities and applied a
15 risk/reward standard.

16 What is before you today are four parties
17 that weigh the standard, the same standard,
18 differently. At least three parties weigh it
19 differently than the California Commission would. And
20 really what it comes down to, and how I'm going to
21 turn to the policy side of it, what it really comes
22 down to is the balancing of risk/reward,
23 benefit/burden. And the company takes the expected
24 position that it bears the risk of loss because it
25 owns the assets.

0042

1 Well, I first point out that the District of
2 Columbia Circuit, federal Circuit Court, rejected that
3 legal theory in the Democratic Central Committee
4 Case. But beyond that, our experience disproves that
5 proposition, that the company bears the risk of loss
6 because they own the asset.

7 Commission staff witness Mr. Keating
8 provides several examples, but by no means an
9 exhaustive list. One of those is the Electron hydro
10 project. The company took a loss on that project when
11 it sold it. The sale is still pending, but the
12 Commission has conditionally approved it, and has
13 allowed the company to recover that loss.

14 Well, if it's true that the company owns it,
15 that's true, and it bears the risk of loss, we contest
16 that, that it should simply take the loss. But it
17 didn't do that. Another example is the Pebble Springs
18 case, where the company had a power project that it
19 did not complete, it abandoned. It came to the
20 Commission for recovery and got recovery of its
21 investment on that project.

22 The same is true of the Skagit Hanford
23 project. After the energy crisis of 2000-2001, the
24 company found its equity ratio was extremely low and
25 created threats to the company's financial security.

0043

1 It came to the Commission asking for money through
2 rates to remedy the problem, and the rate payers
3 stepped up and helped fund the equity improvement
4 program in that case.

5 I can go on and talk about storm damage and
6 the dozens and dozens and dozens, literally dozens of
7 deferred accounting petitions this company has filed
8 to defer costs, add carrying costs to it, and
9 eventually recover it through rates. Investors don't
10 bear those costs.

11 So, the list goes on and on and on, but I
12 submit to you that the experience is that the notion
13 that the investor bears the risk of loss because they
14 own the asset is an illusory proposition, and the
15 Commission should recognize that.

16 Now, there are equitable considerations in
17 the company's favor in this case, and primarily they
18 got an extremely good deal here. I think Mr. Keating
19 testifies to that, give the company credit a full 25
20 percent.

21 The company does make the point, well, gee,
22 we lost our revenue opportunity with the sale of these
23 assets. But what they're ignoring is, first on the
24 legal matter, they are not entitled to a guaranteed
25 return on any asset. And number two, in the policy

0044

1 column, they can redeploy that capital. And if it's
2 in not in PSE they can deploy it elsewhere. They can
3 earn a return on that. They can return it to its
4 investors so they can earn a return on it in some
5 alternative investment. The return doesn't go away
6 unless they put it in a savings account.

7 JUDGE MOSS: Even then there might be a
8 minuscule return.

9 MR. TROTTER: Well, I've got to tell you, in
10 a savings account it's pretty much zero.

11 Anyway, so I think when you separate the
12 legal from the policy, the investors get the net book
13 value, and anything beyond that is before you for
14 equitable determination.

15 And the parties differ on that. We have
16 four different proposals. So we urge you to keep
17 those areas distinct and clear, and if you do, you'll
18 meet your fair decision. Thank you.

19 JUDGE MOSS: Thank you very much. And I'll
20 express my appreciation for counsel staying well
21 within the hour I had allotted for this, setting the
22 tone for the day, which will direct itself ultimately
23 toward completing our hearing in a single day, I Hope.

24 We'll see. The cross-examination estimates
25 run about 5.6 hours at the outside, which is a full

0045

1 hearing day. And with this, there would be some
2 spillover, but if counsel will be mindful of the
3 importance of brevity, then we can perhaps get through
4 today.

5 With that, unless there is anything
6 preliminary, Mr. Trotter?

7 MR. TROTTER: Just for your information, we
8 have, in the course of time, trimmed down our cross
9 estimates, so I'd say around 10 minutes for each
10 witness.

11 JUDGE MOSS: Okay. I had thought the
12 estimates were probably on the high side, so that's
13 encouraging too, thank you.

14 All right. With that I believe we can have
15 Mr. Osborne as our first witness.

16 I will go ahead and swear you while you are
17 standing.

18 SAMUEL OSBORNE,
19 having been duly sworn was called as a witness herein,
20 and was examined and testified as follows:

21 THE WITNESS: I do.

22 JUDGE MOSS: Please be seated when you are
23 comfortable doing so, and we will await the chairman's
24 return before we begin.

25 All right. Mr. Osborne has been sworn, so

0046

1 if you would like to proceed this morning.

2 DIRECT EXAMINATION

3 BY MR. QUEHRN:

4 Q. Yes, thank you. MR. Osborne, could you
5 please state your name, title, and spell your name for
6 the court reporter.

7 A. My name is Samuel Osborne, last name
8 O-S-B-O-R-N-E. I am assistant general counsel and
9 assistant secretary at PSE.

10 Q. Mr. Osborne, your testimony exhibits have
11 already been admitted. Do you have any corrections to
12 any of that at this time?

13 A. No, I don't.

14 MR. QUEHRN: Your Honor, I believe this
15 witness is ready for cross-examination.

16 JUDGE MOSS: All right. Very well. Do the
17 counsel have any preference about the order here? I
18 will recommend that staff go first if not.

19 MS. GAFKEN: That's fine.

20 JUDGE MOSS: Is that all right?

21 Okay, Mr. Trotter, I am picking on you.

22 MR. TROTTER: That's fine.

23 JUDGE MOSS: You can have a minute if you
24 need it.

25 MR. TROTTER: I'm fine. I thought I had a

0047

1 wrong cite. I now understand. I am ready to proceed.

2 JUDGE MOSS: Please do.

3 MR. TROTTER: Thank you.

4 CROSS-EXAMINATION

5 BY MR. TROTTER:

6 Q. Good morning, Mr. Osborne.

7 A. Good morning.

8 Q. Could you turn to your Exhibit SSO-5, which
9 is the -- it's your response, it was the prefiled
10 direct testimony of Mr. Karl Karzmar on behalf of PSE.

11 A. I've got it. Thanks.

12 Q. Okay. And I want you to turn to page 16 of
13 the exhibit, of SSO-5, which, if you look at the
14 bottom of the page is page 15. At the top it says 16,
15 at the bottom it says 15.

16 A. I believe I'm there.

17 Q. Okay.

18 MR. TROTTER: And counsel for PSE, is it
19 true that the testimony beginning on line 10 is no
20 longer confidential?

21 MR. QUEHRN: That's correct.

22 MR. TROTTER: Okay. Thank you. So your
23 Honor, I'm going to be talking about that.

24 BY MR. TROTTER:

25 Q. Looking at line 12, you say, quote, "The

0048

1 high cost of serving Jefferson County in relation to
2 the number of customers in the service territory
3 limits its revenue potential." Do you see that?

4 A. I do see it.

5 Q. And can you explain why that is a true
6 statement?

7 A. First, if I could interject one thing, I
8 think you said that I say this. I believe this was
9 testimony of Mr. --

10 Q. Microphone.

11 A. I'm sorry. Is this on now? That will
12 help.

13 I'm sorry, I think you said that "you,"
14 meaning me, said this. I believe this was
15 Mr. Karzmar's testimony.

16 Q. Right. And you are sponsoring it?

17 A. I am.

18 Q. Okay. Go ahead.

19 A. But he indicated that I am that testimony.
20 And having not been involved in analysis directly of
21 the cost of service, I can't speak to Mr. Karzmar's
22 statement. I believe that, however, that Mr. Piliaris
23 is able to and ready to speak to that.

24 Q. Okay. Well, it's true, is it not, that
25 Jefferson County is a sparsely populated county in

0049

1 this state?

2 A. Relatively speaking, yes.

3 Q. The next sentence, quote, "There is no
4 expectation of any significant load growth in the
5 service territory within the foreseeable future." Do
6 you see that?

7 A. I do.

8 Q. And by "service territory" there you're
9 referring to the Jefferson County area?

10 A. Yes.

11 Q. And can you explain why that is true?

12 A. My understanding is that there was analysis
13 performed by the company generally with respect to
14 load growth as part of its integrated resource
15 planning process, and that was the expectation at the
16 time that this was prepared, that there was not
17 significant load growth anticipated. I can't quantify
18 "significant," however.

19 Q. Are these statements no longer true? I
20 mean, apart from the sale, I mean --

21 A. I wouldn't have the ability to say whether
22 or not they are.

23 Q. Okay. You've asserted today by the company
24 offering this exhibit into evidence that it is true
25 and correct, do you understand that? The question is

0050

1 do you understand that?

2 A. I understand that.

3 Q. Is there any part of your testimony or any
4 exhibit that you are sponsoring today that is not
5 correct?

6 A. I am not aware of any.

7 Q. You don't have a very large -- did you have
8 any industrial customers in Jefferson County before
9 the sale?

10 A. I don't recall if the Port Townsend paper
11 mill was a customer or whether they were a direct BPA
12 customer. That's the only one I can think of.

13 MR. TROTTER: Those of all my questions.

14 Thank you, Mr. Osborne.

15 JUDGE MOSS: Thank you, Mr. Trotter.

16 Ms. Gafken? We will just go around the room.

17 CROSS-EXAMINATION

18 BY MS. GAFKEN:

19 Q. Good morning, Mr. Osborne.

20 A. Good morning.

21 Q. Is it your testimony that you're familiar
22 with the events leading up to the settlement between
23 PSE and Jefferson County PUD, including the 2008
24 election in which voters considered Proposition 1?

25 A. Yes, it is.

0051

1 Q. Would you please turn to your testimony
2 which is Exhibit SSO-1T and go to page 3.

3 A. I have it.

4 Q. Okay. If you would please direct your
5 attention to lines 1 through 3 on page 3, you describe
6 there that the public debate was vigorous, correct?

7 A. Yes.

8 Q. And Jefferson County was not the only county
9 with a ballot measure in 2008 regarding whether to
10 pursue public power, is that correct?

11 A. That's correct.

12 Q. And the other two counties that were
13 considering such a ballot measure were Skagit County
14 and Whidbey Island --

15 A. Island County.

16 Q. -- or Island County?

17 A. Yes.

18 Q. To your knowledge, was there media coverage
19 about the vigorous debate on public versus private
20 power?

21 A. There was vigorous debate about the ballot
22 propositions. I'm not certain if it was necessarily
23 about public versus private. I believe it was.

24 Q. Okay. And the question is, to your
25 knowledge was there media coverage regarding the

0052

1 debate?

2 A. There was media coverage about, yes, the
3 propositions on the ballot in each county.

4 Q. If you could turn to two cross exhibits that
5 have been marked, SSO-11CX and SSO-12CX.

6 A. I'm sorry, Rick, could you help me with
7 that? I have 11CX and I'm looking for 12. Okay.
8 Thank you, got it.

9 Q. And just to make sure that we're on the same
10 page, I believe that we sent them in with different
11 exhibit numbers before they were then assigned exhibit
12 numbers. So you should have before you two articles.

13 A. Both from Crosscut.

14 Q. Okay. Can you identify the examples that
15 are contained in Exhibits 11 and 12?

16 A. I'm sorry, I don't understand. Identify the
17 examples?

18 Q. All right. Could you -- can you identify
19 the exhibits?

20 A. Yes. Exhibit SSO-11CX is an article from
21 Crosscut, "Voters might pull the plug on Puget Sound
22 Energy."

23 And SSO-12CX is another Crosscut, appears to
24 be a Crosscut article entitled "Voters in one county
25 reject Puget Sound Energy."

0053

1 Q. Thank you. Let's focus on Exhibit
2 SSO-11CX. And I'd like to take you to the third
3 paragraph that begins, "Puget Sound executives," or
4 "Puget Sound Energy executives."

5 A. Okay.

6 Q. And that paragraph indicates that the
7 election debate regarding Proposition 1 in Jefferson
8 County occurred while PSE was seeking approval to
9 purchase -- approval of the purchase by the investment
10 consortium, is that correct?

11 A. That's what it says, and indeed this
12 occurred during the pendency of a merger case.

13 Q. Do you recall that the petition for approval
14 of the merger case was filed in December of 2007?

15 A. I'll have to take your word on that. I
16 believe that's right. The merger agreement was signed
17 in late October of 2007, and so it would have taken
18 some time to prepare the filing. So I think it was
19 probably December of '07.

20 Q. Okay. And you can accept it subject to
21 check if that's helpful.

22 A. Okay.

23 Q. And then would you accept subject to check
24 that the Commission entered its order in that case in
25 December of 2008?

0054

1 A. Yes.

2 Q. Thank you. Right, I think it was the last
3 day, last business day of the year?

4 JUDGE MOSS: I can verify that for you.

5 BY MS. GAFKEN:

6 Q. Is it true that foreign ownership was a
7 concern expressed during the vigorous debate over
8 Proposition 1?

9 A. It was.

10 Q. And did other concerns that were expressed
11 during that debate include PSE rate increases and
12 customer service?

13 A. I believe so.

14 Q. If we could turn to page 2 of Exhibit
15 SSO-11CX, and I'd like to draw your attention to the
16 last paragraph that begins, "Meanwhile, Puget Sound
17 Energy's."

18 A. Okay, I see it.

19 COMMISSIONER GOLTZ: What exhibit is that?

20 MS. GAFKEN: I'm sorry, it's SSO-11CX. It's
21 the Crosscut article, "Voters might pull the plug."

22 JUDGE MOSS: Okay. If you look at the upper
23 right-hand corner of the two exhibits Ms. Gafken is
24 asking about, they are pre-marked as 9CX and 10CX.
25 However, that didn't work out the way things were

0055

1 presented. So they are remarked for purposes of our
2 exhibit list as 11CX and 12CX. She is currently
3 talking about the one that has the printed 9CX which
4 is titled "Voters might pull the plug on Puget Sound
5 Energy" and she is on page 2 of that in the last
6 paragraph.

7 COMMISSIONER GOLTZ: That clarifies it.

8 Thank you.

9 MS. GAFKEN: Thank you, Judge Moss. I do
10 apologize for the confusion. I shouldn't have guessed
11 the exhibit numbers when we turned it in. I won't do
12 that next time.

13 JUDGE MOSS: There was a lot of failure to
14 follow instructions this time because I did not send
15 out the instructions I normally send out. So I
16 learned my lesson. I thought after five years
17 everybody would know how, but, okay. Go ahead.

18 BY MS. GAFKEN:

19 Q. Okay. So, looking back at page 2 of Exhibit
20 SSO-11CX, if I could draw your attention to the last
21 paragraph on that, on that page, that paragraph
22 indicates that Macquarie was aware of the ballot
23 measures in 2008. To your knowledge, Mr. Osborne, was
24 that the case?

25 A. Yes.

0056

1 Q. And is it true that Jefferson County PUD
2 rates, their current rates mirror PSE's rates in
3 effect on the date the service area was transferred
4 from PSE to JPUD?

5 A. You're asking that at the time of closing of
6 the sale in March 31st of this year, if the PSE rates
7 and the JPUD rates as of April 1st of this year were
8 equivalent?

9 Q. Well, let me make it a little easier. Let's
10 turn to cross exhibit SSO-13CX, which is PSE's
11 Response to Public Counsel's Data Request No. 2.

12 MR. QUEHRN: Excuse me, your Honor. I am
13 going to have to renew the objection here that those
14 questions were not relevant or lead to any relevant --
15 evidence that is relevant to the questions regarding
16 this proceeding.

17 JUDGE MOSS: All right. We will carry the
18 objection for now and let her proceed and see this
19 goes.

20 MS. GAFKEN: It will be quite brief.

21 BY MS. GAFKEN:

22 Q. Would you please go to page 2 of SSO-CX13?

23 A. I've got it.

24 Q. And the last sentence on that page states
25 that, "JPUD's current rate schedule mirrors PSE's

0057

1 rates in effect as of the date of the transition of
2 the service area," is that correct?

3 A. Yes. That is correct.

4 COMMISSIONER DANNER: Okay. Just, I'm sorry
5 to interrupt. My exhibit list is not --

6 JUDGE MOSS: What we are looking at here was
7 pre-marked for identification by counsel as SSO-11CX.
8 That number is printed in the upper right-hand corner
9 of the exhibit, which has been remarked as 13CX. It
10 is Public Counsel Data Request No. 002, actually it is
11 PSE's response to that data request.

12 COMMISSIONER DANNER: Okay. I have that
13 marked as 11CX.

14 JUDGE MOSS: Right. It was pre-marked for
15 identification, but I had to remark it because of
16 other exhibits in the record.

17 Okay, now we are there, and we are on page
18 2, are we not?

19 MS. GAFKEN: Correct.

20 JUDGE MOSS: And we are in the last
21 paragraph?

22 MS. GAFKEN: That's right, the last
23 sentence.

24 JUDGE MOSS: Last sentence of the last
25 paragraph.

0058

1 THE WITNESS: Looking again at the full
2 paragraph, that's my understanding. I believe that
3 JPUD is undergoing a -- I forget the proper
4 terminology for it, but a rate study right now. But
5 my understanding is that at the cutover they continued
6 the rates that were in effect as PSE rates prior to
7 the cutover. And by cutover, I mean closing of the
8 transaction and the transfer of service from PSE to
9 JPUD.

10 MS. GAFKEN: Okay. Thank you, Mr. Osborne,
11 those are all the questions I have.

12 JUDGE MOSS: And I think seeing this
13 evidence and hearing the question and answer, I think
14 I will overrule your objection, Mr. Quehrn.

15 All right. So, and you also want to move
16 the other two exhibits, I presume?

17 MS. GAFKEN: Yes.

18 JUDGE MOSS: Any objection?

19 MS. GAFKEN: I was going to ask about them.

20 JUDGE MOSS: They will also be admitted.

21 All right.

22 (Exhibits SSO-11CX and SSO-13CX were
23 admitted.)

24 JUDGE MOSS: Now, I want to be sure I'm
25 pronouncing your name correctly. "Pepp-el"?

0059

1 MR. PEPPLE: Yes.

2 JUDGE MOSS: Okay. That's what I thought I
3 heard, but I've been thinking "people," and that's not
4 right.

5 MR. PEPPLE: You would not be the first.

6 JUDGE MOSS: I'm sure. Okay, Mr. Pepple,
7 please proceed.

8 CROSS-EXAMINATION

9 BY MR. PEPPLE:

10 Q. Good morning, Mr. Osborne.

11 A. Good morning.

12 Q. Do you mind turning to page 2 of your direct
13 testimony, SSO-1T. I believe both staff and the
14 public counsel touched on this a little bit, but I was
15 just -- you say starting on line 8 that you are
16 familiar with the events that led up to the sale of
17 distribution of assets to Jefferson County PUD?

18 A. Yes.

19 Q. I was just hoping you could elaborate a
20 little on that, what exactly your role was in that
21 process.

22 A. Specifically, I'm sorry, which process?

23 Q. The process of negotiating the agreement
24 with Jefferson County and any involvement you had
25 regarding Proposition 1.

0060

1 A. I had very little direct involvement in the
2 transaction prior to the signing of the APA. I became
3 familiar with the history of it. My boss is Steve
4 Secrist. He is general counsel. At the time of the
5 negotiation he was deputy general counsel and I was
6 one of the, I forget my title at the time, but one of
7 the other staff attorneys at the utility.

8 And I was familiar from talking with Steve
9 and talking with Karl Karzmar about the process of
10 both the negotiations with JPUD, and certainly as a
11 director, let alone employee of the company at the
12 time, familiar with the ballot proposition in
13 Jefferson as well as in Island and Skagit.

14 Q. Thank you. Mr. Osborne, to your knowledge
15 why did Jefferson County want to acquire PSE's
16 distribution assets?

17 A. To my knowledge, there was a strong desire
18 for public ownership.

19 Q. In order to -- in other words, in order to
20 get BPA power?

21 A. That would -- that was part of the goal. I
22 think the ultimate goal was to have a publicly owned
23 utility.

24 Q. And what was the -- why would Jefferson
25 County want to have a publicly owned utility?

0061

1 MR. QUEHRN: Excuse me. I'm going to
2 object. He is asking the witness to speculate as to
3 somebody else's impressions.

4 MR. PEPPLER: I am simply asking what his
5 understanding is.

6 JUDGE MOSS: He is asking for his
7 impressions. He has testified he is familiar with it.

8 THE WITNESS: My impressions were that they
9 were interested in local control, however that is
10 defined. I believe that they argued that their rates
11 could be lower by virtue of having access to BPA tier
12 1 power.

13 And what were other -- as the -- as the vote
14 proceeded, or the campaign took place, the whole issue
15 of foreign ownership became relevant apparently to at
16 least some voters. It was a topic. And by foreign
17 ownership I mean the prospect that at the time we
18 had -- PSE had signed a merger agreement with a
19 consortium of investors that were -- that included
20 Australian-based and Canadian-based pension plans.

21 BY MR. PEPPLER:

22 Q. Thank you. Mr. Osborne, if you could turn
23 to what has been marked SSO-9CX.

24 JUDGE MOSS: And since we've been having a
25 little trouble with these cross-examination exhibits,

0062

1 I'll say that this is -- it should be the first one in
2 everyone's notebooks, and it is an article entitled
3 "PSE's chief executive addresses foreign ownership,
4 bonus, and other issues." Actually, it doesn't say
5 "and," but by Scott Wilson.

6 MR. PEPPLE: And in addition to that I'll
7 represent to you that this is an article dated October
8 8th, 2008 from the Port Townsend Reader.

9 Ms. Gafken covered most of the substance of
10 my questions that would be related to this article, so
11 if it's okay with counsel I might just move the
12 admission of this exhibit and skip those questions.

13 MR. QUEHRN: No objections.

14 JUDGE MOSS: That's fine, it's admitted.

15 (Exhibit SSO-9CX was admitted.)

16 BY MR. PEPPLE:

17 Q. And after PSE agreed to sell its
18 distribution assets to the Jefferson County Public
19 Utility District, did PSE file on July 15th, 2010 a
20 petition for a declaratory ruling with this Commission
21 related to that sale?

22 A. Yes.

23 Q. And if you could turn to Exhibit SSO-10X,
24 which I'll represent to you is the petition that PSE
25 filed.

0063

1 MR. PEPPLE: And just to confirm with
2 counsel for PSE, this was originally filed as
3 confidential but is no longer?

4 MR. QUEHRN: That is correct.

5 BY MR. PEPPLE:

6 Q. As part of this petition, PSE sought a
7 ruling that Commission approval was not necessary to
8 transfer its assets to Jefferson County, is that
9 correct?

10 A. That's correct.

11 Q. And in addition to that, PSE also sought an
12 order that the purchase price, which at the time was
13 \$103 million, was sufficient to fully compensate PSE
14 for the sale of the assets, is that correct?

15 A. That's right.

16 Q. If you would turn to page 6.

17 A. In the context of a settlement, settlement
18 of litigation.

19 Q. Okay. If you could just turn to page 6,
20 please, and I'm looking at footnote 7 on that page.
21 It appears based on this footnote that the purpose of
22 PSE seeking this ruling from the Commission is that
23 the company wanted to make sure that the Commission
24 would not later determine, for instance in this
25 proceeding, that PSE's customers were entitled to more

0064

1 than the \$103 million purchase price, is that
2 correct? You can take some time to read that.

3 A. I'm sorry, could you -- I was reading that
4 while you were speaking.

5 Q. I'm sorry.

6 A. Would you mind, I'll read it, and then if
7 you could repeat the question if that's okay.

8 Q. Sure.

9 COMMISSIONER GOLTZ: We are in the petition
10 for the declaratory order?

11 MR. PEPPLE: Correct.

12 COMMISSIONER GOLTZ: What page?

13 MR. PEPPLE: On page 6, and then looking at
14 footnote 7.

15 JUDGE MOSS: He's on page 6, footnote 7.

16 THE WITNESS: Okay. Would you mind
17 repeating that question?

18 BY MR. PEPPLE:

19 Q. We just established that PSE sought an order
20 from the Commission that the purchase price was
21 sufficient to fully compensate PSE for the sale of the
22 assets. Now, my reading of footnote 7 is that the
23 reason PSE wanted this ruling was that it wanted to
24 make sure that the Commission would not determine
25 later in this proceeding that customers were entitled

0065

1 to more than the \$103 million purchase price, is that
2 a fair characterization?

3 A. Yeah. And in the context of a deal that had
4 been signed but not closed.

5 Q. Correct. So, yes, so this Commission ruling
6 was a condition precedent to PSE performing its
7 obligations under the Asset Purchase Agreement?

8 A. Right.

9 Q. So, just to be clear, if the Commission did
10 not find that the \$103 million purchase price was
11 sufficient to fully compensate PSE, the company could
12 have walked away from the Asset Purchase Agreement and
13 litigated the case with Jefferson County, correct?

14 A. That's right.

15 Q. If you would refer to your Exhibit SSO-3,
16 which is the Asset Purchase Agreement. Specifically
17 I'm looking at page 10 of the Asset Purchase
18 Agreement, SSO-3. Are you there?

19 A. I'm there, thanks.

20 Q. Do you see where it gives the definition of
21 WUTC confirmations?

22 A. I do.

23 Q. Do you mind reading that definition through
24 subsection (a) for me, please?

25 A. "WUTC confirmations means a WUTC order or

0066

1 such other determination satisfactory to PSE
2 confirming that, (a), the amount of the purchase price
3 is an amount that is sufficient to fully compensate
4 PSE customers for the sale of the assets."

5 Q. Thank you. Now, since PSE went ahead with
6 this transaction, am I correct in assuming that the
7 company was satisfied that the Commission made this
8 finding appropriately in its order approving PSE's
9 positions preferably?

10 A. Yes.

11 MR. PEPPLE: I would move the admission of
12 SSO-10CX.

13 JUDGE MOSS: Any objection to the ICNU cross
14 exhibits?

15 MR. QUEHRN: No objection.

16 JUDGE MOSS: Hearing that, they will be
17 admitted.

18 (Exhibit SSO-10CX was admitted.)

19 MR. PEPPLE: No more questions.

20 JUDGE MOSS: All right. I will allow an
21 opportunity for questions from the bench before we
22 think about any redirect, so that might save a little
23 time. Are there questions from the bench?

24 Commissioner Jones?

25 COMMISSIONER JONES: Good morning,

0067

1 Mr. Osborne.

2 THE WITNESS: Good morning.

3 COMMISSIONER JONES: Your testimony, as I
4 read it, largely supports the previous testimony with
5 Karl Karzmar in SSO-5, correct?

6 THE WITNESS: That's correct.

7 COMMISSIONER JONES: So, I just want to get
8 at, I think Mr. Pepple -- so you are affirming by
9 sponsoring his testimony that it is truthful and
10 relevant to this proceeding, right?

11 THE WITNESS: I am.

12 COMMISSIONER JONES: Okay. So, I would just
13 like to ask the question, what was the role of
14 oversight that the company had of Mr. Karzmar? He was
15 the lead negotiator, right, for this agreement?

16 THE WITNESS: He was the lead negotiator.
17 He worked very closely, not just with outside counsel,
18 but with my colleague Steve Secrist, who reported to
19 Jennifer O'Connor, former general counsel, and I
20 believe Karl and Steve Reynolds, the CEO at the time,
21 had at least a week -- this is my understanding, I
22 don't know for certain, but my understanding was that
23 Karl had a, in effect a direct, almost a reporting
24 relationship to the Steve Secrist during that period.

25 COMMISSIONER JONES: Okay. Was it a formal

0068

1 committee or was it an informal chain of command from
2 Karl to Secrist to Reynolds, the CEO at the time?

3 THE WITNESS: I don't believe it was a
4 formal committee. It was more of an ad hoc project
5 team, Steve and Karl and other people working for
6 Karl. At different points, for instance, different
7 aspects of the analysis, Karl would enlist other
8 directors, director level employees, to help, and they
9 would report to Karl. Karl and Steve would confer.
10 Steve Secrist and the two would confer with Reynolds.

11 COMMISSIONER JONES: I think you stated
12 earlier that you were not directly involved in the
13 negotiations leading to the Asset Purchase Agreement,
14 the APA, correct?

15 THE WITNESS: That's correct. I got
16 involved after the signing of the that and was
17 involved in negotiations of the Customer Transition
18 Agreement, the CTA. And then the closing process of
19 both the APA the CTA.

20 COMMISSIONER JONES: Could you turn to page
21 7 of your testimony, SSO-1T?

22 THE WITNESS: Just one moment, please.

23 COMMISSIONER JONES: Just tell me when
24 you're there.

25 THE WITNESS: I'm here.

0069

1 COMMISSIONER JONES: So, on two bullets, the
2 bullet on line 11 and the bullet on line 14 I'm going
3 to ask you a little bit about. So basically in your
4 testimony in 11 through 14, PSE concluded that the
5 all-in number for fair market value was a hundred
6 million, and that included recovery for going concern
7 damages, right?

8 THE WITNESS: Yes.

9 COMMISSIONER JONES: Okay. Now, and then in
10 the following bullet, and I think Karzmar addresses
11 this in his testimony, he basically -- actually, both
12 sides chose to use the replacement costs new less
13 depreciation, what is referred to as RCLND valuation
14 methodologies, right?

15 THE WITNESS: Right.

16 COMMISSIONER JONES: So, Karzmar said, you
17 know, here was the range of values with the RCLND for
18 Puget, and JPUD had a different number, and I think
19 the company decided that \$85 million was a fair number
20 for that, right?

21 THE WITNESS: Without the -- without
22 including the value of the real estate, I believe.

23 COMMISSIONER JONES: Yeah. And then the
24 real estate was added afterwards, the assessment and
25 the appraisal of eminent domain and rights of way,

0070

1 right?

2 THE WITNESS: Came afterwards.

3 COMMISSIONER JONES: Okay. My question, and
4 this gets to the process and who was involved for the
5 company in determining litigation risk, okay, so in
6 order to determine -- Karzmar was not a lawyer, right?

7 THE WITNESS: Correct. He is an accountant.

8 COMMISSIONER JONES: Right. So he had to
9 have smart people assisting him on precedents. Karl
10 was, God rest his soul, I wish Karl were here today,
11 he was a very smart guy, he used to work at the
12 Commission, but he had to have a bevy of lawyers, I
13 would imagine, working with him to assess litigation
14 risk because he's not a lawyer, right?

15 THE WITNESS: A bevy or a flotilla. There
16 were a number of lawyers.

17 COMMISSIONER JONES: So my question is, who
18 were they? Was it basically O'Connor, Jennifer
19 O'Connor. Steve Secrist? It wasn't you?

20 THE WITNESS: No, it wasn't me at this
21 time. It was Jennifer O'Connor, Steve Secrist, Mark
22 Quehrn, other outside counsel. I believe Sheree
23 Carson. Don, I'm not sure if you were involved in
24 that.

25 COMMISSIONER JONES: Okay. Those are all my

0071

1 questions.

2 JUDGE MOSS: Thank you. Nothing further
3 from the bench? Any redirect, Mr. Quehrn?

4 MR. QUEHRN: I have no redirect. Thank you,
5 your Honor.

6 JUDGE MOSS: All right. Thank you.
7 Mr. Osborne, with that we can excuse you from the
8 witness stand. We can thank you very much for your
9 testimony.

10 We are about at the point in time we take
11 our morning recess, so why don't we do that. 10
12 minutes? Is 10 minutes sufficient? All right. We
13 will take a 10 minute recess.

14 (Short recess.)

15 JUDGE MOSS: Let's come back to order,
16 please.

17 JON PILIARIS,
18 having been duly sworn was called as a witness herein,
19 And was examined and testified as follows:

20 THE WITNESS: I do.

21 JUDGE MOSS: Thank you. Please be seated.
22 Go ahead, Mr. Quehrn.

23 MR. QUEHRN: Thank you.

24 DIRECT EXAMINATION

25 BY MR. QUEHRN:

0072

1 Q. Mr. Piliaris, could you please state your
2 name, title, and spell your name for the court
3 reporter, please?

4 A. Thank you. My name is Jon Piliaris. I am
5 manager of pricing and cost of service at -- thank
6 you. Shall I start from the top?

7 My name is John Piliaris. I am manager of
8 pricing and cost of service at Puget Sound Energy.
9 The spelling of my name is J-O-N, P-I-L-I-A-R-I-S.

10 Q. Mr. Piliaris, your testimony and exhibits
11 have been admitted into evidence. Do you have any
12 corrections to your testimony or exhibits at this
13 time?

14 A. I do not.

15 MR. QUEHRN: Thank you. Your Honor,
16 Mr. Piliaris is ready for cross-examination.

17 JUDGE MOSS: All right. Mr. Trotter, please
18 proceed.

19 CROSS-EXAMINATION

20 BY MR. TROTTER:

21 Q. Thank you. Good morning, Mr. Piliaris.

22 A. Good morning.

23 Q. In your testimony you calculate the net
24 power supply-related benefits to customers associated
25 with PSE's loss of load in Jefferson County as roughly

0073

1 \$83 million, is that right?

2 A. That's the estimate provided in Exhibit
3 JAP-7. That has been subsequently updated in later
4 exhibits.

5 Q. And what's your number today?

6 A. Can you clarify what you mean by "what is
7 your number"?

8 Q. How you calculate today the net present
9 value of the net power supply-related benefits
10 associated with PSE's loss of load in Jefferson
11 County?

12 A. The company's estimate would be reflected in
13 JAP-13. The number in that exhibit is 102,565,000.

14 Q. Now, under the company's proposal in this
15 case, the benefits of the sale to investors will be
16 immediate, correct? Once the commissioners submit the
17 order, the investors will get their money, right?

18 A. I believe so.

19 Q. And the \$83 million and the \$102 million
20 that you were talking about are based on what you
21 forecast to happen over the next 20 years, is that
22 right?

23 A. That's correct.

24 Q. The company is not proposing to set up a
25 deferred account to create a regulatory liability to

0074

1 assure that rate payers actually receive those
2 benefits over the next 20 years, is that right?

3 A. That's correct.

4 Q. And the dollars, the 83 million and the 102
5 million, those are based on long-term forecasts, and
6 the company has used such forecasts for many years,
7 hasn't it?

8 A. It has.

9 Q. The company didn't forecast the energy
10 crisis of 2000-2001, did it?

11 A. I have no knowledge of that. I was not at
12 the company at that time.

13 Q. Can you accept subject to check that it did
14 not?

15 A. I'm not sure how to check that. I
16 apologize.

17 Q. Did the company forecast the recession that
18 started in 2008?

19 A. I have no knowledge of that either.

20 Q. Would you accept subject to check it did
21 not?

22 A. Again, I'm not sure that I would know how to
23 necessarily verify that with certainty. Perhaps
24 through the IRP process and some of the analysis
25 relating to that there may have been some

0075

1 assumptions. But specific to your questions, I don't
2 know what the company was forecasting.

3 Q. Are you finished? I'm sorry, I didn't mean
4 to interrupt.

5 A. I don't believe the company was forecasting
6 necessarily economic variables. Typically when it
7 uses -- when it uses economic variables for its long
8 range forecasts, it relies on published sources.

9 Q. And is it true that the company adjusted its
10 forecast in light of the recession in 2008, and its
11 impact on load growth in your service territory?

12 A. Well, surely it was reflected as time went
13 on. I'm not sure what specific update you're
14 referring to.

15 Q. The company, in fact, in the context of that
16 recession, put certain projects on hold and took other
17 actions in response to the lower economic activity in
18 its service territory, isn't that true?

19 A. I'm not sure what specific action you are
20 talking about.

21 Q. So, it's your testimony the Commission took
22 -- the Commission -- the company took no specific
23 action in response to the impacts of the 2008
24 recession in load?

25 A. It may very well have. I'm not specifically

0076

1 aware of any specific actions that were taken.

2 Q. Were you at the company in that time frame?

3 A. I was not.

4 Q. Did you read the newspapers during that time
5 frame?

6 MR. QUEHRN: About PSE?

7 THE WITNESS: About PSE, I don't recall
8 any.

9 BY MR. TROTTER:

10 Q. The company sold its share of the Centralia
11 steam plant shortly before the energy crisis of 2000-
12 2001, isn't that right?

13 A. I believe that's correct.

14 Q. Had PSE kept that project, kept that plant,
15 it would have made millions and millions of dollars
16 selling into the market during that crisis, wouldn't
17 it?

18 A. I have no idea. I haven't performed the
19 analysis. I have not seen such analysis.

20 Q. Well, the Centralia steam plant generated
21 around 3 to 3 and a half cent power, didn't it?

22 A. I don't know specifically how -- its
23 operating cost.

24 Q. I will ask you just to assume that.

25 A. Okay.

0077

1 Q. Do you know how high wholesale power costs
2 got during that energy crisis?

3 A. Not specifically, but they were very high.
4 I was in the industry at the time, so yes, they were
5 very high.

6 Q. Very, very high, weren't they?

7 A. Yes.

8 Q. And as a result of that energy crisis, PSE's
9 equity ratio tanked and it came to the Commission
10 seeking interim rate relief which resulted in an
11 equity building program, didn't it?

12 A. I've heard that, yes.

13 Q. And you are telling me you don't know that
14 if the company had the Centralia plant and could sell
15 power into the market at those high prices, that that
16 equity tanking event would not have happened? You
17 have no opinion on that?

18 A. I probably shouldn't form an opinion where I
19 haven't an opportunity to actually perform the
20 analysis.

21 Q. Okay. And let's just ask it a different
22 way. Had the company known that the energy crisis was
23 coming and that wholesale prices would spike to very,
24 very high levels and continue for several months, that
25 would have significantly altered the economics of the

0078

1 decision to sell the Centralia plant, would it not?

2 A. It would have certainly been factored into
3 it, yes.

4 Q. And by significantly affected, it would
5 significantly affect against the sale, correct, in
6 favor of keeping it?

7 A. Again, I'm not exactly sure without having
8 performed the analysis.

9 Q. And you think you need to actually perform
10 an analysis to render an opinion on that?

11 A. Well, it seems that you are specifically --
12 you are -- your focus is very narrow on the actual
13 cost of the unit and the -- vis-a-vis the market.
14 There was a lot of very weird market turbulence at
15 that time, and there was a lot of lawsuits back and
16 forth with unjust pricing and whatnot.

17 And if history would have been different
18 insofar as PSE's ownership plant, I don't know how any
19 of that would have turned out. It could very well
20 have been that PSE would have been sued for billions
21 of dollars for price gouging or whatever that we
22 continue to talk about today with the various lawsuits
23 at the federal level.

24 Q. Or it could have made hundreds of millions
25 of dollars selling wholesale power?

0079

1 A. Perhaps.

2 Q. Turn to page 6 of your rebuttal testimony,
3 which is JAP-9T.

4 A. I'm there.

5 Q. On lines 13 to 15 you say, "Corporate staff,
6 public counsel and ICNU all contend that the
7 Commission should rely on results presented in the
8 first five years of PSE's analysis, and that results
9 beyond that time are speculative." Do you see that?

10 A. I do see it.

11 Q. Turning to page 14, on line 4, you say,
12 quote, "First the parties' election to accept only the
13 results in early years is arbitrary," and to your
14 knowledge, "has no basis in relevant regulatory
15 precedent." Do you see that?

16 A. I do.

17 Q. I'd like to refer to an exhibit that we
18 identified for you but only one copy was provided, and
19 it is Mr. Marcellia's exhibits, MRM-9CX.

20 A. I have it.

21 Q. Do you recognize this as PSE's post hearing
22 brief in the Centralia sale docket?

23 A. Yes.

24 Q. Turn to page 11, and the caption on lines 1
25 to 3 says, "The near term economic benefits of the

0080

1 sale should be given greater weight than the more
2 speculative longer term economic benefits of keeping
3 the plant." Do you see that?

4 A. I do.

5 Q. And on line 7 the company said, "The out
6 year benefits are based on highly speculative long-
7 term forecasts." Do you see that?

8 A. I do.

9 Q. And on lines 18 -- excuse me, 17 through 20,
10 it says, the company said, "In any event, in light of
11 the assumptions underlying the out year benefits, it
12 makes little sense to use speculative out year
13 benefits in continuing to hold Centralia as an excuse
14 not to approve the sale and force customers to
15 continue to bear the risks of ownership in the
16 Centralia facilities." Do you see that?

17 A. I do.

18 Q. Now turn to the next page, and on lines 18
19 to 20 the company said, "Public counsel's analysis
20 stress some broad assumptions, relying on an analysis
21 that ignores qualitative factors and that relies
22 heavily on speculative benefits from out year
23 projected savings. Public counsel argues that the
24 Centralia facility should not be sold." Do you see
25 that?

0081

1 A. I'm sorry, Mr. Trotter, I didn't get the
2 reference.

3 Q. Page 12, lines 18 to 21.

4 A. What I'm looking at on page 12, are we still
5 on the brief?

6 Q. Yes.

7 A. Starts number 4, "Public counsel's analysis
8 rests on" --

9 Q. Yes. And that's what I quoted.

10 A. Okay.

11 Q. Okay. All right. Now I'd like to switch
12 gears and turn to page 23 of your rebuttal testimony,
13 JAP-9T.

14 A. Can you repeat the citation?

15 Q. Sure, your rebuttal testimony, 9T, page 23.

16 A. 23.

17 Q. And at the bottom of the page, the last
18 line, and over to the next page, you criticize staff
19 for failing to take into account cost savings due to
20 fewer bills being sent out because you have fewer
21 customers due to the loss of Jefferson County
22 customers, fewer calls to the customer center, working
23 capital and so on, is that right?

24 A. Yes, I see that.

25 Q. And on page 24, on the last sentence, you

0082

1 say, "Staff's unequivocal use of page 1 of Exhibit
2 JAP-3 completely dismisses this reality." Do you see
3 that?

4 A. Yes.

5 Q. Let's turn to JAP-3, and turn to the second
6 page, page 2. And this is what you call scenario 2,
7 correct?

8 A. I believe so, yes.

9 Q. And this shows the types of cost savings
10 you're referring to on page 23 and 24 of your
11 rebuttal, is that right?

12 A. I don't see any cost savings per se in this
13 exhibit. This exhibit represents direct and allocated
14 costs to Jefferson County.

15 Q. Well --

16 A. Not necessarily the costs that would be
17 avoided.

18 Q. All right. Let's go to line 20, customer
19 accounts expense. You show under column A a cost of
20 40.3 million for Jefferson, 670,000, and then in
21 column C, the total less Jefferson is a reduction in
22 customer accounts expense. Am I misreading that?

23 A. That's correct.

24 Q. Is that a cost savings in customer accounts
25 expense?

0083

1 A. That is a reduction in the allocated costs.
2 That is not necessarily a reduction in the expense.
3 The expenses may -- the 670,000 that you see in row
4 20, column B, which is the difference between column A
5 and column C, that represents what Jefferson County
6 customers would be allocated. This does not
7 necessarily mean that the company will avoid the full
8 670,000. There may be costs that continue on.

9 Q. So the cost savings would be included in
10 that amount, but may not be a total amount, is that
11 right?

12 A. They're included in that amount, correct.

13 Q. And staff relied on scenario 2, did it not?

14 A. I believe it -- yes.

15 MR. TROTTER: Those are all my questions.

16 Thank you. I move the admission of Exhibit 9-CX,
17 excuse me, MRM-9CX.

18 JUDGE MOSS: Okay. We do have a that, I had
19 it marked for identification in the exhibit list as
20 both as MTM -- what is Mr. Marcellia's initials.

21 MRM-9CX and also as JAP-20CX. Mr. Quehrn, do you have
22 any objection to doing it as MRM, since I have --

23 MR. QUEHRN: I have no objection.

24 JUDGE MOSS: All right. We'll just leave it
25 at MRM-9CX and it will be admitted.

0084

1 (Exhibit MRM-9CX was admitted.)

2 JUDGE MOSS: Did you have any other
3 exhibits? It appears you did not, Mr. Trotter.

4 MR. TROTTER: No.

5 JUDGE MOSS: All right. Then let's move on
6 to you, Ms. Gafken.

7 MS. GAFKEN: Thank you. And I believe we
8 won't run into the same numbering problem with this
9 set of cross exhibits.

10 JUDGE MOSS: That's correct. The previous
11 one was the only one that was problematic in that way.

12 MS. GAFKEN: That will make things a little
13 easier this time around.

14 CROSS-EXAMINATION

15 BY MS. GAFKEN:

16 Q. Good morning, Mr. Piliaris.

17 A. Good morning.

18 Q. I'm going to go ahead and ask the
19 foundation. Mr. Trotter did go over some of this with
20 you, but just for the foundational question, I'll have
21 you look at your direct testimony, which is JAP-1T,
22 and if you would turn to page 11 of that exhibit.

23 A. I'm there.

24 Q. And if I could direct your attention to
25 lines 7 through 12, there you testify that you

0085

1 forecast the amount of potential avoided power costs
2 resulting from the loss of Jefferson County customers,
3 is that correct?

4 A. Correct.

5 Q. And in order to conduct the forecast of the
6 potential avoided power costs, you used PSM III model,
7 is that correct?

8 A. Correct.

9 Q. Would you please turn to cross exhibit
10 JAP-18CX.

11 A. I'm there.

12 Q. Would you identify the document that's
13 contained in cross exhibit JAP-18CX?

14 A. This is PSE's Response to Public Counsel
15 Data Request No. 46.

16 Q. Please turn your attention to Section 8 of
17 the response, and there it states that the study
18 presented in this case to forecast the potential
19 avoided power cost is the same base case study that
20 PSE used to support the transmission renewal decisions
21 in PSE's 2013 PCORC, is that correct?

22 A. Correct.

23 Q. And if you could turn your attention to
24 section B in the response in cross exhibit JAP-18CX.
25 Section B states that the base case model used in

0086

1 PSE's 2013 PCORC is identical to the base case model
2 used in PSE's 2013 IRP, is that correct?

3 A. Yes.

4 Q. Is it true that one of the assumptions used
5 in the PSM III model relates to load growth?

6 A. Yes.

7 Q. Please turn to cross Exhibit JAP-19CX.

8 A. Uh-hum.

9 Q. Do you recognize the first two pages
10 contained in JAP-19CX as the Commission's
11 acknowledgement letter regarding PSE's 2013 IRP?

12 A. Yes.

13 Q. And do you recognize the last two pages of
14 that exhibit as containing excerpt from Attachment A
15 to the Commission's acknowledgement letter?

16 A. I didn't verify it as such, but I will take
17 it as such.

18 Q. I will accept it subject to subject to
19 check.

20 Okay. If you could refer to page 4 of
21 Exhibit JAP-19CX, and by page 4 I'm referring to the
22 page numbers up in the top right corner.

23 A. I'm there.

24 Q. Would you read the second sentence in the
25 last paragraph that begins, "The load growth

0087

1 projections"?

2 A. "The load growth projections from 2017 and
3 beyond are mostly driven by inputs to the econometric
4 model and are themselves projections of the level of
5 economic growth."

6 Q. To your knowledge, will the load growth
7 assumptions remain the same or will be they updated in
8 PSE's next IRP?

9 A. I would expect that they would be updated.

10 Q. Please refer to Cross Exhibit JAP-16CX. And
11 once you're there, if you would please turn to page
12 12. And I should ask you if you recognize the excerpt
13 in Cross Exhibit JAP-16CX as excerpt from Aliza
14 Seelig's testimony and related exhibits that were
15 filed by PSE in its 2013 PCORC?

16 A. I believe that's the case, yes.

17 Q. And are you on page 12?

18 A. I am.

19 Q. In the PCORC analysis PSE used several
20 different scenarios to analyze possible outcomes, is
21 that correct?

22 A. It did.

23 Q. And it's illustrated on the chart that's on
24 page 12?

25 A. Uh-hum.

0088

1 Q. Please turn your attention to Cross Exhibit
2 JAP-17CX. Do you recognize the excerpt that's
3 contained in Exhibit JAP-17CX as an excerpt from
4 Michael Mullally's testimony from PSE's PCORC docket?

5 A. Yes.

6 Q. Please turn to page 4, lines 12 through 15.
7 Would you please read the sentence beginning,
8 "Although each scenario"?

9 A. "Although each scenario is not necessarily
10 equally weighted, selection across more scenarios are
11 considered more favorable because the proposal is
12 demonstrating that it is least cost across a wide
13 range of possible futures."

14 Q. The analysis you conducted in this case to
15 project the avoided power costs presents only one
16 possible future, is that correct?

17 A. It represents the base case future.

18 Q. And you only presented the base case future,
19 granted it was updated in your rebuttal testimony, but
20 it's still one base case future?

21 A. It is.

22 Q. Mr. Piliaris, please turn to your rebuttal
23 testimony, which is Exhibit JAP-9T, and please go to
24 page 8. And if you would turn your attention to lines
25 5 through 12. There you testify that the Commission

0089

1 has used long range projections to approve resource
2 acquisition decisions made by PSE since 2004, is that
3 correct?

4 A. Correct.

5 Q. And there is a number of examples of those
6 resource acquisition decisions in table 1 on page 8,
7 is that correct?

8 A. Correct.

9 Q. To your knowledge, in each of the examples
10 listed in table 1 of page 8 did PSE run just one
11 scenario?

12 A. I don't have any specific knowledge, but I
13 would assume that they -- many if not all would have
14 some scenario analysis attached to them.

15 Q. Let me make sure I understand your answer.
16 Are you saying that your understanding would be that
17 they would run a scenario or multiple scenarios?

18 A. I would assume multiple.

19 Q. Okay. Thank you. And to your
20 understanding, does the UTC calculate PSE's revenue
21 requirement based on the portfolio cost developed in
22 the PSM III model?

23 A. No, it does not.

24 Q. In fact, revenue requirement is calculated
25 based on the acquisition cost of the asset, is that

0090

1 correct?

2 A. Among other factors, yes.

3 Q. It could be adjusted but it's -- the
4 starting point is the acquisition cost?

5 A. Yes.

6 Q. Okay. I'd like to switch topics. We are
7 still on your rebuttal testimony, JAP-9T, but I'd like
8 to go to page 10. And beginning on page 10, you
9 analogize the loss of Jefferson County load to PSE's
10 conservation program, is that correct?

11 A. Correct.

12 Q. To your knowledge, does PSE model a loss of
13 service territory as a conservation strategy in its
14 IRP?

15 A. I do not believe so.

16 Q. And has PSE presented to its conservation
17 resource advisory group the option of removing a
18 portion of its service territory as a way to meet its
19 conservation requirements?

20 A. I'd say generally speaking, the answer would
21 be no. There have been some discussions in some
22 meetings around this particular transaction, and
23 conservation specific issues, but I think in speaking
24 directly to your question, I think the appropriate
25 answer is no.

0091

1 Q. Again, I just want to make sure that I
2 understand the question. You are saying that there
3 have been some discussions about the Jefferson County
4 situation in the CRAG, but that generally speaking,
5 PSE hasn't presented an option of removing another
6 part of your service territory as a conservation
7 method?

8 A. Correct.

9 Q. Please turn to page 19 of your rebuttal
10 testimony, Exhibit JAP-9T, and if I could draw your
11 attention to lines 6 through 8. There you criticize
12 public counsel for using a conservative assumption, is
13 that correct?

14 A. Correct.

15 Q. Is the conservative assumption you identify
16 the assumption that PSE's PCA fixed rate for existing
17 generation resources would remain constant during the
18 20-year period modeled by the analysis?

19 A. Correct.

20 Q. Would you please turn to your direct
21 testimony, JAP-1T, page 11.

22 A. Oh, I would append that my previous
23 response, that my specific objections to public
24 counsel's assumption was that it was adding PCA fixed
25 cost rate that was not declining to incremental, new

0092

1 incremental resources, putting them together. That
2 was the specific objection, not necessarily that they
3 were using that particular assumption. It was the
4 combination of those assumptions that I was objecting
5 to.

6 Q. Okay. But your testimony says that the
7 conservative assumption is the PCA fixed rate for
8 existing generation resources would remain consistent?

9 A. In addition to the increment, that public
10 counsel was also adding on top of that.

11 Q. Because it's true that you also use the
12 assumption that the PCA fixed rate would remain
13 constant?

14 A. And the underlying assumption there was that
15 the increment would be offset by the decrement of the
16 existing resources. So the assumption was that they
17 would offset each other. In public counsel's
18 situation, they added the increment, but they made no
19 acknowledge of the decrement to existing resources.

20 MS. GAFKEN: With that clarification, that
21 concludes my line of questioning.

22 JUDGE MOSS: All right. And I believe that
23 concludes the questions from counsel. Before we have
24 the redirect, I will ask if there are questions of
25 Mr. Piliaris from the bench?

0093

1 All right. Well, Mr. Piliaris, as I
2 predicted, it turns out it was mercifully brief for
3 you. Thank you for your testimony.

4 MR. QUEHRN: Excuse me, redirect.

5 JUDGE MOSS: I'm sorry, Mr. Quehrn, I was
6 jumping -- I am anxious. I thought we might get out
7 of here by noon with Mr. Marcellia then.

8 MR. QUEHRN: I will do my best to make sure
9 that we do.

10 JUDGE MOSS: I don't mean to restrict you in
11 any way.

12 REDIRECT EXAMINATION

13 BY MR. QUEHRN:

14 Q. Mr. Piliaris, I just want to clarify a
15 couple things here. What is the consequence of the
16 sale of the Jefferson County service area that gives
17 rise to the power cost benefit that you assessed in
18 your testimony?

19 A. There is an immediate and permanent
20 reduction in load.

21 Q. And when did this occur?

22 A. April 1st, 2013.

23 Q. And is the occurrence of that speculative?

24 A. It is not.

25 MR. QUEHRN: Thank you.

0094

1 JUDGE MOSS: Thank you, Mr. Quehrn. All
2 right. Now, Mr. Piliaris, you may step down from the
3 stand.

4 We do have 40 minutes at least until 12:00,
5 so Mr. Marcelia, I think you're next, aren't you? Why
6 don't you go ahead and take the stand after
7 Mr. Piliaris removes his tome.

8 MATTHEW MARCELIA,
9 having been duly sworn was called as a witness herein,
10 and was examined and testified as follows:

11 THE WITNESS: I do.

12 JUDGE MOSS: Please be seated. Mr. Quehrn?

13 DIRECT EXAMINATION

14 BY MR. QUEHRN:

15 Q. Mr. Marcelia, could you please state your
16 same, title and spell your name for the court
17 reporter.

18 A. Yes. My name is Matt Marcelia. Marcelia,
19 M-A-R-C-E-L-I-A. I am the tax director for Puget
20 Sound Energy, and the property accounting group also
21 reports to me.

22 Q. Mr. Marcelia, your testimony exhibits have
23 been submitted into the record. Do you have any
24 corrections to your testimony or exhibits at this
25 time?

0095

1 A. No.

2 MR. QUEHRN: Thank you. Your Honor,
3 Mr. Marcelia is ready for cross-examination.

4 JUDGE MOSS: Mr. Trotter?

5 MR. TROTTER: Thank you, your Honor.

6 CROSS-EXAMINATION

7 BY MR. TROTTER:

8 Q. Good morning, Mr. Marcelia.

9 A. Good morning.

10 Q. I am going to rebuttal testimony, MRM-5T,
11 page 29. And beginning on line 3 you testify that
12 "PSE faces all of the capital risk," do you see that?

13 A. Yes, I do.

14 Q. And you say, "The risk does not pass to
15 customers. Only the cost does." Do you see that?

16 A. Yes, I do.

17 Q. I'd like to refer you to Exhibit MRM-7CX.

18 COMMISSIONER JONES: What is the title to of
19 that exhibit?

20 MR. TROTTER: The rebuttal testimony of
21 William A. Gaines in Centralia docket.

22 COMMISSIONER JONES: December 1999?

23 MR. TROTTER: Correct. December 22, 1999.

24 BY MR. TROTTER:

25 Q. Do you have that?

0096

1 A. Yes, I do.

2 Q. Do you recognize that the rebuttal testimony
3 of PSE witness William Gaines inspect Centralia sale
4 docket?

5 A. Yes.

6 Q. Would you turn to page 1 of the exhibit, and
7 the page numbers are at the bottom.

8 A. Yes.

9 Q. On line 20 Mr. Gaines testified, "Perhaps
10 more important, Mr. Lazar's analysis ignores the
11 substantial risks posed to PSE and its customers by
12 the very real possibility that the Centralia
13 facilities will be subject to early closure. The
14 risks are significant; selling the facility eliminates
15 those risks to customers." Do you see that?

16 A. I do.

17 Q. Would you turn to page 7 of the same
18 exhibit, line 22. You say -- excuse me, Mr. Gaines
19 testified, quote, on behalf of PSE, quote, "As shown
20 in PSE's analysis, the proposed sale greatly reduces
21 risks to customers." Do you see that?

22 A. Which line are you on?

23 Q. 22.

24 A. I do, yes.

25 Q. Now I want you to turn to Exhibit 8CX, and

0097

1 do you recognize this as the direct testimony of
2 Mr. Gaines in that Centralia docket?

3 A. Yes.

4 Q. Would you turn to page 3.

5 A. Yes.

6 COMMISSIONER DANNER: I'm sorry,
7 Mr. Trotter, where are you?

8 MR. TROTTER: MRM-8CX, direct testimony of
9 Mr. Gaines for PSE, page 3.

10 COMMISSIONER DANNER: Thank you.

11 BY MR. TROTTER:

12 Q. And on lines 2 to 4 he testified, that,
13 quote, "The proposed sale eliminates PSE's
14 responsibility to install expensive new environmental
15 controls on the plant, including scrubbers. Absent a
16 sale, these costs and liabilities likely would fall on
17 PSE's customers." Do you see that?

18 A. Yes, I do.

19 Q. I would like you to turn to page 36 of your
20 rebuttal, 5T, and beginning on line 15 you address the
21 Electron hydro transaction under which PSE sold or
22 proposes to sell the Electron hydroelectric facility?

23 A. Yes.

24 Q. And the Commission approved that
25 transaction, if the deal goes through as

0098

1 consummated -- as contemplated?

2 A. Yes.

3 Q. And could you describe for me what -- well,
4 the Commission -- excuse me, the company came to the
5 Commission with an application for treatment of that
6 sale, right?

7 A. Correct.

8 Q. Can you describe what PSE requested in that
9 docket?

10 A. Well, after doing an analysis PSE
11 determined that that plant was not economical, and
12 decided to pursue a sale transaction. And so, what
13 the order asks for, I believe, was to deferral, and
14 future amortization of loss from that transaction.

15 Q. And did the company also request a return
16 pending the recovery through rates?

17 A. Yeah, yes. We requested a deferral
18 treatment and recovery of the costs over time, because
19 the plant wasn't economical. So it was in the
20 customers' best interests to sell that plant, assuming
21 the transaction goes through, which it hasn't.

22 Q. Right.

23 A. But that's the proposition.

24 Q. Okay. But the Commission did approve it
25 subject to -- let me start over. There was a

0099

1 transaction document, but it was subject to some
2 subsequent conditions that are still unfulfilled, but
3 the Commission ruled that if those conditions -- if
4 the deal goes through as contemplated, then it's
5 approved?

6 A. That's correct. And the Commission found in
7 that case that it was in the public interest, they
8 applied the public interest test, which is
9 unapplicable to the JPUD transaction, but in that case
10 they did determine that the transaction would be in
11 the customers' interest.

12 Q. You said the public interest test is
13 inapplicable to the Jefferson County transaction, did
14 I hear you correctly?

15 A. Yes. That goes back to that section, RCW
16 80.12.020, paragraph 2.

17 Q. So your testimony is you are relying on your
18 understanding that 80.12 does not apply?

19 A. Correct. It does apply.

20 Q. Well, the standard for Commission action in
21 that chapter does not apply, is that fair?

22 A. I think so.

23 Q. Fair characterization of your understanding?

24 A. Yup.

25 Q. Thank you. The company does propose to sell

0100

1 Electron at a loss, correct?

2 A. Yes.

3 MR. TROTTER: Those are all my questions.

4 Thank you.

5 JUDGE MOSS: Thank you, Mr. Trotter.

6 Ms. Gafken, I believe you had a few
7 questions for this witness as well.

8 MS. GAFKEN: I have no questions. Thank
9 you.

10 JUDGE MOSS: All right. Then we'll turn to
11 the bench and see if we have any questions from the
12 bench. Mr. Jones?

13 COMMISSIONER JONES: Good morning.

14 THE WITNESS: Good morning.

15 COMMISSIONER JONES: Good to see you back
16 here.

17 THE WITNESS: Glad to be back.

18 COMMISSIONER JONES: Your rebuttal
19 testimony, 5T, could you turn to page 10?

20 THE WITNESS: I'm there.

21 COMMISSIONER JONES: So, you cite two
22 different definitions of accounting, ASC and the FERC
23 uniform system of accounts, right?

24 THE WITNESS: Correct.

25 COMMISSIONER JONES: Which do you prefer to

0101

1 use as manager of accounting?

2 THE WITNESS: Well, I use both, because one
3 of them applies to how we report the financial
4 statements, and one of them applies to our rate payer
5 treatment. I think that they are -- they are both
6 describing the same thing. They get there in slightly
7 different verbiage. So, I don't necessarily have a
8 preference. I use them both.

9 COMMISSIONER JONES: Okay. Do either of
10 these definitions say anything about the ownership of
11 an asset that you refer to quite a bit in your
12 testimony?

13 THE WITNESS: No, they do not refer to the
14 ownership of the asset. This refers to allocation and
15 historical cost --

16 COMMISSIONER JONES: Right, I know that.
17 But there is nothing in here on ownership, is there?

18 THE WITNESS: No.

19 COMMISSIONER JONES: Okay. Could you turn
20 --

21 THE WITNESS: Well, I would clarify, there
22 is a presupposition there is ownership involved,
23 because in order to get depreciate an asset you must
24 have ownership. But these definitions do not address
25 that fact.

0102

1 COMMISSIONER JONES: No. I'm asking about
2 the definition.

3 THE WITNESS: Yeah, yeah, okay. I'm with
4 you.

5 COMMISSIONER JONES: Could you turn to page
6 28 of your testimony.

7 JUDGE MOSS: Would that be the rebuttal or
8 the direct?

9 COMMISSIONER JONES: The rebuttal. Same
10 exhibit.

11 THE WITNESS: Yes, I'm there.

12 COMMISSIONER JONES: Could you read for me
13 line 5 and 6 so I understand what you're trying to say
14 here?

15 THE WITNESS: "In any business enterprise,
16 regulated or not, prices must be set at a level which
17 compensates the business for the costs and risks it
18 undertakes."

19 COMMISSIONER JONES: That's fine. Thank
20 you. Is Puget Sound Energy in its operations of its
21 business in its servatory of a competitive business?

22 THE WITNESS: It is not a competitive
23 business.

24 COMMISSIONER JONES: Is it a regulated
25 monopoly?

0103

1 THE WITNESS: It is a regulated monopoly.

2 COMMISSIONER JONES: As a regulated
3 monopoly, is the accounting system the same as for
4 non-regulated companies that report to the SEC and are
5 publicly traded companies?

6 THE WITNESS: The accounting system is very
7 similar. The FERC rules are predicated on the GAAP
8 rules. There are differences, that in the FERC rules
9 between the FERC and GAAP, there are differences
10 between FERC and the WUTC's understanding. So there
11 are variations depending on which venue you're
12 reporting to.

13 COMMISSIONER JONES: In response to Counsel
14 Trotter we discussed the Electron transfer or sale.
15 The company is asking -- there is a capital loss in
16 that transaction, correct? You are selling it for
17 less than net book value?

18 THE WITNESS: That's correct.

19 COMMISSIONER JONES: And who are you asking
20 to bear the risks or pay for the costs of that
21 transaction?

22 THE WITNESS: We're asking customers to
23 cover the cost because that is a transaction, or that
24 is an asset that is being used for the provision of
25 electric services that is uneconomical. That goes

0104

1 into the cost of service. And it's different than
2 what you see in a -- in this transaction with the
3 Jefferson County.

4 COMMISSIONER JONES: No, I'm not asking
5 that. Just stick to my line of questioning.

6 THE WITNESS: Okay.

7 COMMISSIONER JONES: So, you say "yes"
8 there. My question then is, how would a competitive
9 enterprise, a non-regulated company, publicly traded,
10 reporting to FASB, SEC requirements, how would they
11 deal with a capital loss?

12 THE WITNESS: They would -- they would
13 simply report the capital loss, but where the
14 difference comes in is, that capital loss would go to
15 their income statement. The difference would be in
16 the fact that when they are setting their prices,
17 their prices would have to cover them for that risk.
18 It would be built in.

19 In a regulated environment you don't have
20 the same pricing mechanism, you have regulated
21 pricing. The only thing you can recover from the
22 regulated pricing mechanism is costs that have been
23 allowed or permitted, determined to be prudent, all
24 those types of things which you don't have in the
25 competitive environment because competition replaces

0105

1 regulation. Regulation replaces competition.

2 COMMISSIONER JONES: Right. And that gets
3 to issues of rate making and issues of capital
4 structure, ROE, other risks that the company bears
5 that the Commission has to deal with?

6 THE WITNESS: That's correct, yes.

7 COMMISSIONER JONES: But you are not saying
8 that the risks that you undertake in the provision of
9 electricity and gas service is the same sort of risk
10 as all other competitive enterprises, are you? You
11 are not making that broad statement, as you appear to
12 be in line 6?

13 THE WITNESS: Oh, I see what you're saying.

14 COMMISSIONER JONES: And frankly, just go to
15 the next page.

16 THE WITNESS: Okay.

17 COMMISSIONER JONES: Page 29.

18 THE WITNESS: Yes.

19 COMMISSIONER JONES: On line 3 you say, "PSE
20 faces all of the capital risk." I think Counsel
21 Trotter referred you to this section of your testimony
22 earlier.

23 THE WITNESS: Yes.

24 COMMISSIONER JONES: So again, you seem to
25 be saying there that all of the capital risk is borne

0106

1 by the company.

2 THE WITNESS: Capital risk is borne by the
3 company. What I was getting at is the distinction
4 between capital risk -- it's almost like the analogy
5 between the risk of being the owner of the house as
6 opposed to being the renter of the house. The owner
7 of the house bears all the capital risk, which is the
8 situation I'm pointing to here. And it's different
9 than the risk that the renter bears. The renter bears
10 simply the risks associated with being a renter, and
11 it's passed the cost.

12 COMMISSIONER JONES: Right.

13 THE WITNESS: That was the distinction I was
14 trying to make.

15 COMMISSIONER JONES: And I don't like that
16 analogy, and when Mr. Keating comes up he will deal
17 with the question from me on that. I think that
18 analogy is quite inept, but anyway.

19 So, Counsel Trotter asked you earlier, let's
20 talk about FASB 71 or what some people call ASC 980.
21 Are you familiar with those?

22 THE WITNESS: Yes, yes. I prefer FAS 71.

23 COMMISSIONER JONES: So you don't go by ASC
24 980 anymore?

25 THE WITNESS: Well, I have to, but my mind

0107

1 still thinks FAS 71.

2 COMMISSIONER JONES: Okay. FASB 71. These
3 are -- this is called deferred accounting, right?

4 THE WITNESS: Yes. It's where GAAP
5 basically will follow --

6 COMMISSIONER JONES: Right.

7 THE WITNESS: -- the regulatory standard
8 that is required.

9 COMMISSIONER JONES: Do competitive
10 enterprises that are not regulated by commissions, do
11 they take advantage of this?

12 THE WITNESS: No.

13 COMMISSIONER JONES: So it's just you? In
14 the regulated --

15 THE WITNESS: Not just us. It's all
16 regulated utilities.

17 COMMISSIONER JONES: No, no. By "you" I
18 mean collectively, the regulated utilities.

19 THE WITNESS: Yes.

20 COMMISSIONER JONES: Okay. So some people
21 refer to this as the tool in the Commission toolbox,
22 right? The Commission has a number of ways to help
23 utilities recover their costs in a timely way, right?

24 THE WITNESS: Yes.

25 COMMISSIONER JONES: This is one measure for

0108

1 the company to do so, and I think you responded to
2 Counsel Trotter, you have used this a great deal with
3 this Commission, have you not?

4 THE WITNESS: Yes.

5 COMMISSIONER JONES: Is this a risk
6 mitigation measure for the company?

7 THE WITNESS: I'm not -- it is a way, it is
8 a mechanism to pass through costs that have been
9 determined prudent in the provision of electric
10 utility service. So, is it a risk mitigation? I
11 don't know. The alternative would be to allow rates
12 that are calculated somehow differently, so it's a way
13 of passing through costs.

14 COMMISSIONER JONES: Oh, so, and who pays
15 the costs?

16 THE WITNESS: The customers pay the costs.

17 COMMISSIONER JONES: The customers pay the
18 costs, okay, not the shareholders. I don't know if
19 this is in the record, but are you aware of the other
20 regulatory assets that you carry on your balance sheet
21 filed with the SEC at this time?

22 THE WITNESS: I am aware that there is a
23 number of them. I am aware of some of them in
24 particular, and some of them less in particular.

25 COMMISSIONER JONES: Would you, subject to

0109

1 check, would you agree that the company, as of March
2 31, 2014, had \$709 million of other regulatory assets
3 upon your balance sheet?

4 THE WITNESS: I guess I could accept that.

5 COMMISSIONER JONES: Okay. Are you aware of
6 the way the process works is you submit a deferred
7 accounting petition to the Commission, we generally
8 approve it, and I think we almost always approve it,
9 and then in the next rate case, or in -- we would
10 enter into a prudency determination, right; isn't that
11 the way the process kind of works?

12 THE WITNESS: That's the common process I'm
13 familiar with.

14 COMMISSIONER JONES: How long have you been
15 director of tax services for Puget?

16 THE WITNESS: 2005.

17 COMMISSIONER JONES: Okay. And I've been a
18 commissioner since 2005. So, I'm unaware of any
19 instance in which the Commission has disallowed an
20 accounting petition to be put into rates permanently
21 after a prudency test. Are you aware of any such
22 case?

23 THE WITNESS: I'm probably not the best
24 person to ask that to. But given the fact that it's
25 not my area, I don't recollect any.

0110

1 COMMISSIONER JONES: Okay.

2 THE WITNESS: But I don't know if there are
3 any or not. I'm not the right person for that.

4 COMMISSIONER JONES: \$709 million is a large
5 amount of money, isn't it?

6 THE WITNESS: It is, but what if it should
7 have been 900 million? I mean, you know, I don't
8 know. I don't know what the number could have
9 otherwise been. But you're right, that is a large
10 number.

11 COMMISSIONER JONES: And then finally, on
12 accumulated depreciation, just if you could summarize
13 your argument on accumulated depreciation now, and why
14 the remaining customers should not have the benefit of
15 this. I'm having trouble understanding the logic of
16 your argument.

17 THE WITNESS: Well, I think there is a
18 number of elements to my logic. The first is, I guess
19 I'll just start listing them off here, you have the
20 issue of did customers actually in fact pay
21 accumulated appreciation. If you look at our SEC
22 filing, page 33, you will see that we under collected
23 depreciation expense relative to what's included in
24 rates. Therefore, they haven't paid dollar for dollar
25 for the accumulated depreciation and shouldn't get it

0111

1 back for that reason.

2 The second issue would be, who paid the
3 accumulated depreciation? Mr. Piliaris' testimony
4 declared that we had -- that JPUD customers more or
5 less paid for what they -- paid for the assets and the
6 services relative to their size in the company. In
7 that case, they paid for the accumulated depreciation,
8 so why would the remaining customers get it back?

9 Now, rates are set in general so you can't
10 say who in particular paid for what. But it's not a
11 stretch of logic to say the departing customers paid
12 for their accumulated depreciation, not remaining
13 customers. So I think that's kind of the two points
14 there.

15 I think the issue with accumulated
16 depreciation goes back to the Centralia order. I
17 think if you look at the Centralia order, the
18 Commission ruled that that was not a mathematical
19 equation to be applied in all cases. You said that
20 those -- the factors that you used in that case would
21 be weighted differently based on the facts in evidence
22 there.

23 In Centralia you made a determination that
24 the accumulated depreciation would go to rate payers,
25 and you did so because you determined that the assets

0112

1 were appreciating, and that there was -- the customers
2 had paid excess depreciation. That's not the facts in
3 this case. There is no -- no one has claimed the
4 depreciation rates in this case were incorrect or
5 inappropriate.

6 In this case you also have the fact some of
7 the compensation that is being paid for is the fact of
8 the loss of customers and the loss of service
9 territory. Those are present. Those need to be
10 compensated and would therefore lead you to a
11 different conclusion.

12 So I think that when other parties just
13 rotely applied the fact that accumulated depreciation
14 automatically goes to customers who may not have been
15 paid it, I think that requires a different process in
16 this case because it is a unique situation of the
17 condemnation, and for the reasons that Mr. Quehrn laid
18 out at the beginning.

19 COMMISSIONER JONES: Let's go back to that
20 statement you just made. I think it's on -- could you
21 turn to page 13 of your 5T, MRM-5T where you refer to
22 the 2013 10-K on page 33.

23 THE WITNESS: Yes, yes.

24 COMMISSIONER JONES: So, Mr. Marcelia, what
25 are you trying to say here? Are you actually

0113

1 saying -- because ROE, the actual ROE and the
2 depreciation expense are kind of related to each
3 other, are they not? In terms of your reporting on
4 the financial, on this, on reporting to the SEC on a
5 regulatory accounting basis?

6 THE WITNESS: Yes.

7 COMMISSIONER JONES: So what you're saying
8 here is that you're not recovering all of your
9 depreciation expense? These numbers you quote here on
10 line 6 and 7, these are system-wide numbers, are they
11 not?

12 THE WITNESS: That's correct.

13 COMMISSIONER JONES: So it's not just
14 Jefferson County, it's all remaining customers as
15 well?

16 THE WITNESS: Yes, that's correct. On page
17 33 of the 10-K we have a table that reconciles the
18 earnings on an accounting basis to the earnings on a
19 regulatory basis. And in there we identified reasons
20 why the company is not earning it's allowed rate of
21 return. Depreciation is a line item on that schedule,
22 and it lays out -- this is -- this is imbalance that's
23 there.

24 COMMISSIONER JONES: So, that's my point
25 here. And I would just like you to confirm it, that

0114

1 this calculation that you are doing of actual
2 depreciation expense system-wide is integrally related
3 to the actual ROE that you report to the SEC, right?

4 THE WITNESS: Yes, it is. I'm not sure I'm
5 following your meaning there. It is, but that table
6 is calculating our Commission return, not our SEC
7 ROE. It's our regulatory ROE is the point of that
8 table.

9 COMMISSIONER JONES: Right. But from a cash
10 flow basis, are you trying to allege in this statement
11 that you are not recovering dollar for dollar all of
12 the depreciation expense?

13 THE WITNESS: That's correct.

14 COMMISSIONER JONES: That's what you are
15 alleging?

16 THE WITNESS: I'm not alleging. It's a
17 fact. I mean, that's what this is saying. This is --
18 the depreciation expense that is allowed in rates is a
19 smaller number than the depreciation that is being
20 reported today in our SEC statements and in our
21 statements that we provide to you.

22 COMMISSIONER JONES: And what was the actual
23 ROE that was quoted in that 10-K, page 33?

24 THE WITNESS: I don't have it in front of
25 me.

0115

1 COMMISSIONER JONES: Could you get it
2 later? That's fine.

3 THE WITNESS: Yes, certainly, I can get it,
4 yes.

5 COMMISSIONER JONES: Okay.

6 JUDGE MOSS: We will make that Bench Request
7 1.

8 COMMISSIONER JONES: Okay. Section 1033,
9 okay. So how is this \$103 million, how much do you
10 have on the books right now earning a return from the
11 gross proceeds from the sale? It's about 103
12 million? Has it all been paid?

13 THE WITNESS: Well, the gross proceeds are
14 109.

15 COMMISSIONER JONES: 109?

16 THE WITNESS: 109.

17 COMMISSIONER JONES: And those are sitting
18 on the books, on your balance sheet where?

19 THE WITNESS: Well, the proceeds is cash,
20 and cash is fungible, so it's gone through the whole
21 cash management process and it's been used.

22 COMMISSIONER JONES: Okay. I'm just looking
23 at your balance sheet now. Is it carried in cash and
24 cash equivalent, restricted cash, other regulatory
25 assets. It's not a regulatory asset, or is it?

0116

1 THE WITNESS: No, it's not. The
2 regulatory -- the only regulatory piece is the gain.
3 So we have -- the gain has been deferred into a
4 regulatory account.

5 COMMISSIONER JONES: Okay.

6 THE WITNESS: The cash has been disbursed
7 using our normal cash management policy.

8 COMMISSIONER JONES: Right.

9 THE WITNESS: So it is not sitting there as
10 a number. That wouldn't be a good use of cash.

11 COMMISSIONER JONES: No, it would not,
12 especially at these low interest rates, I agree.

13 THE WITNESS: Right, right.

14 COMMISSIONER JONES: So, tell me a little
15 bit more about section 1033 on this involuntary
16 conversion of gain subject to the Internal Revenue
17 code. As I understand it, you will receive an
18 indefinite tax deferral of that gain, whatever it is,
19 and in order for that tax deferral, you have to invest
20 it, you have to put it to use in some manner. So
21 could you give me the highlights of that?

22 THE WITNESS: Yeah. So, in order to defer
23 the tax gain on the transaction, the IRS allows you to
24 reinvest the proceeds, and asks us that are, quote,
25 "similar or related in service or use." So we call

0117

1 that SORISOU property.

2 So as long as you have related property, and
3 in this case it's distribution assets for distribution
4 assets, transmission for transmission.

5 So in order to avail ourselves of the
6 deferral, what we've done is we are using capital
7 expenditures that were already planned. This was not
8 an incremental increase to our capital expenditures.
9 This was we took dollars that are already in our
10 capital spend, and we assign them, so this is
11 transmission, so that would qualify for the deferral.

12 So, it is not a dollar for dollar matching.
13 We don't take the dollar of proceeds and then say
14 here, I spent it on this asset. It's simply a
15 labeling exercise saying, here is Capex that I had
16 after the sale. It qualifies and so we are gaining
17 the deferral that way. We don't have to do any -- we
18 don't have to do any incremental investment to achieve
19 the deferral.

20 COMMISSIONER JONES: So there is no -- and I
21 think you say that in your testimony. I don't know
22 which page it is, but there is no incremental Capex
23 that you are going to deploy to take advantage of this
24 gain, and that is confirmed by your CFO, Mr. Doyle?
25 He is not going to increase Capex budgets for the

0118

1 board to allow this incremental gain, whatever it is,
2 to be deployed?

3 THE WITNESS: That's correct. There has
4 been no incremental change in the Capex plan
5 associated with this transaction.

6 COMMISSIONER JONES: So basically what
7 you're doing is you are taking your existing Capex
8 budget approved by Mr. Doyle and the board?

9 THE WITNESS: Correct.

10 COMMISSIONER JONES: And you are assuming
11 that a certain amount of the gain, the Commission will
12 approve I guess, I don't know what you are assuming,
13 and then you -- Capex funded by debt and equity from
14 other means, you are substituting this gain and
15 plugging it into the Capex model, kind of, that's a
16 gross characterization, I know.

17 THE WITNESS: I would describe it a little
18 bit differently. I would say we have other Capex plan
19 approved by our CFO and the board, that's unchanged.
20 For IRS purposes, we are filling out reports that
21 achieve the deferral. Two separate things, related
22 because it's the gain deferral.

23 COMMISSIONER JONES: Okay.

24 THE WITNESS: But it's kind of, the Capex
25 plan is completely unchanged.

0119

1 COMMISSIONER JONES: Okay. Those are all
2 the questions I have. Thank you.

3 COMMISSIONER GOLTZ: You were asked a couple
4 of questions about your proposal on page 7 of your
5 Exhibit MRM-1T, which is your direct testimony, where
6 on page 7 you were asked the question how you arrived
7 at the allocation of 25 percent/75 percent.

8 And then on page 8 you discuss some of the
9 factors that led you to that allocation, is that
10 correct?

11 THE WITNESS: Yes, that's correct.

12 COMMISSIONER GOLTZ: And among the factors
13 is this is, quote", unusual and extraordinary," is
14 that correct?

15 THE WITNESS: Yes.

16 COMMISSIONER GOLTZ: And if this had been
17 usual and ordinary, you may have come to a different
18 conclusion?

19 THE WITNESS: Yes.

20 COMMISSIONER GOLTZ: So let me ask you about
21 this. Puget serves customers in just western
22 Washington with a little bit of Kittitas County,
23 correct?

24 THE WITNESS: Yes.

25 COMMISSIONER GOLTZ: So it's Whatcom,

0120

1 Skagit, some of Snohomish, some of King. Any in
2 Pierce?

3 THE WITNESS: Some in Pierce.

4 COMMISSIONER GOLTZ: Some in Pierce and
5 Thurston?

6 COMMISSIONER JONES: Yes.

7 COMMISSIONER GOLTZ: And Island?

8 THE WITNESS: Yes.

9 COMMISSIONER GOLTZ: San Juan?

10 THE WITNESS: Don't remember if there is
11 anybody in San Juan or not.

12 COMMISSIONER GOLTZ: And anybody left on the
13 peninsula? You don't do Clallam or Mason, do you?

14 THE WITNESS: I don't believe we do. No.

15 COMMISSIONER GOLTZ: And you do Kitsap?

16 THE WITNESS: Correct.

17 COMMISSIONER GOLTZ: Yeah. So, of those
18 counties, most of those have public utility districts
19 or municipal utilities, correct?

20 THE WITNESS: Yes.

21 COMMISSIONER GOLTZ: And in some of them, I
22 believe we heard this morning when Ms. Gafken was
23 talking with Mr. Osborne, that Skagit and Island were
24 considering creating a public utility district and
25 taking over some of the Puget's facilities?

0121

1 THE WITNESS: Yes.

2 COMMISSIONER GOLTZ: And you know, you know
3 in this room, many of us at least, that was considered
4 in Thurston?

5 THE WITNESS: Yes.

6 COMMISSIONER GOLTZ: And we know that, I
7 believe it was considered in Whatcom from time to time
8 in the past, in the recent past, correct?

9 THE WITNESS: Yes.

10 COMMISSIONER GOLTZ: Any others that you
11 know of?

12 THE WITNESS: Not that I remember.

13 COMMISSIONER GOLTZ: And do you also -- are
14 you also aware that in the state of Washington, the
15 minority of the electric load is served by investor-
16 owned utilities?

17 THE WITNESS: Uh-hum.

18 COMMISSIONER GOLTZ: So, at what point would
19 a post takeover of facilities of an investor-owned
20 utility be not unusual but usual, not extraordinary
21 but ordinary? It seems to me that the, in a sense, it
22 is more unusual to be served by an investor-owned
23 utility in this state than by a consumer-owned
24 utility.

25 THE WITNESS: I think the unusual part comes

0122

1 from the fact that how many of these efforts are
2 successful? And I think that was covered in the
3 testimony of I think Mr. Bellemare, that nationwide
4 it's very unusual. He can address that in more
5 detail.

6 But I think here, the fact that it comes up
7 isn't necessarily usual or unusual. The fact that
8 it's successful is unusual, as in when was the last
9 one that we dealt with here with PSE, it's been, I
10 don't even know, I wasn't even born then.

11 So, it is unusual. And so I think that's
12 the thing. The fact that the number of customers that
13 are served by one mode or another, I don't know that
14 that's germane to this topic, because I think here,
15 you've got, for PSE and to be successful, to have a
16 successful takeover, is uncommon and unusual even in
17 Washington.

18 COMMISSIONER GOLTZ: Well, except obviously
19 it took place in a number of places because we have a
20 large number of public utility districts serving a
21 large area, including in western Washington. And I
22 assume at some point those were investor-owned
23 utilities?

24 THE WITNESS: That's an assumption. I don't
25 know the history. The only one I can think of is

0123

1 Seattle, which that would be case in point. I don't
2 know about some of the others. Maybe they were always
3 public. I'm not sure.

4 COMMISSIONER GOLTZ: So you are saying that
5 it's not so much the fact that the number of -- the
6 majority of customers are served by consumer-owned
7 utilities, it's just that the progress or -- I
8 shouldn't say progress -- the move in that direction
9 has been relatively slow in recent years? The
10 successful move in that direction has been slow in
11 recent years?

12 THE WITNESS: It's been slow, yes. And I
13 think you also have a geographical difference because
14 if you go east, I think you will see a different
15 propensity where most of the people in the East would
16 be served by a public utility -- by a company, a
17 private utility, rather, not the public. But I'm not
18 sure of all that.

19 COMMISSIONER GOLTZ: No further questions.

20 COMMISSIONER DANNER: I have no questions.

21 JUDGE MOSS: That concludes the questions
22 from a the bench. Do you have any cross or redirect?

23 MR. QUEHRN: No, your Honor.

24 JUDGE MOSS: That is good timing for us
25 then. Mr. Marcellia, you may step down. And we may

0124

1 all retire for lunch, I think. 1:30?

2 We will compromise at 1:15. Please be back
3 at 1:15.

4 (Lunch recess at 12:00 p.m.)

5

6 AFTERNOON SESSION

7 (1:15 p.m.)

8 JUDGE MOSS: Okay. According to the wall
9 clock we're right on time. Looks like everyone's
10 here. Counsel, if you're ready. The bench is not
11 quite ready yet.

12 Let's have Dr. Levin then.

13 STANFORD LEVIN,

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

16 THE WITNESS: I do.

17 JUDGE MOSS: Please be seated. Thank you.

18 DIRECT EXAMINATION

19 BY MR. QUEHRN:

20 Q. Thank you. Dr. Levin, please state your
21 name, title --

22 A. My name is Stanford Levin.

23 Q. Your title, and please spell your name for
24 the court reporter.

25 A. S-T-A-N-F-O-R-D, L-E-V-I-N.

0125

1 Q. Dr. Levin, your testimony and exhibits have
2 been entered into the record. At this time do you
3 have any corrections to your testimony or your
4 exhibits?

5 A. No, I don't.

6 MR. QUEHRN: Okay. Your Honor, Dr. Levin is
7 ready for cross-examination.

8 JUDGE MOSS: All right. And Mr. Trotter,
9 you have indicated some cross for this witness. Is
10 that still the case?

11 MR. TROTTER: Yes.

12 CROSS-EXAMINATION

13 BY MR. TROTTER:

14 Q. Good afternoon, Dr. Levin.

15 A. Good afternoon.

16 Q. And welcome to Washington.

17 A. Thank you.

18 Q. Could you turn to page 11 of your testimony,
19 Exhibit SLL-1T, line 15.

20 A. Line 15.

21 Q. Okay. And you say, quote, "The risk of
22 ownership falls on to the investors and any gain or
23 loss accrues to them." Do you see that?

24 A. Yes.

25 Q. And you're talking about ownership of

0126

1 utility assets, correct?

2 A. Yes, the ownership of the -- of the assets
3 themselves.

4 Q. So, if a utility sells its office building
5 which it owns at a gain, it's your testimony they
6 should get a hundred percent of the gain?

7 A. Yes, assuming there was no issue about
8 depreciation or -- or any of those things. But yes,
9 if they sell the office building, they should get the
10 gain, or the loss.

11 Q. That's my next question. If they sell that
12 building at a loss, they should take the loss a
13 hundred percent?

14 A. Yes.

15 Q. And you mentioned something about
16 depreciation, but do you understand when we talk about
17 gain in my questions we mean net book value, gain as
18 measured by proceeds less net book value and
19 transaction costs?

20 A. Yes, I understand. But the net book value,
21 the net part of that has been determined by
22 depreciation. So if the depreciation rate had
23 something -- was connected to the economic value, then
24 we're okay. If the depreciation were too fast or too
25 slow, then there might be an issue about who is

0127

1 responsible for the inadequate or over-depreciation.

2 Q. But if we accept that the depreciation rates
3 that the utility observed were prescribed by the
4 Commission, and they were appropriate, then you have
5 no issue with -- no qualification on your answers?

6 A. Well, yeah. My assumption is that the
7 actual depreciation rate, which is an accounting
8 issue, is consistent with the economic life of the
9 asset.

10 Q. And if a utility were to abandon an asset
11 that it owns before it was completed, say a project
12 before it was completed, they invest their money in a
13 project, they abandon it before it's completed, does
14 the investor take the gain on the sale of that asset?

15 A. There is a lot of extenuating circumstances
16 to those situations, and I couldn't generalize an
17 answer.

18 Q. Did you read the testimony of Mr. Keating
19 for UTC staff?

20 A. Yes, I did.

21 Q. And he listed in his testimony several
22 examples, I believe six, of instances where the
23 Commission shared the gain on sale of utility assets
24 with rate payers. Do you recall that list?

25 A. No. If you tell me -- I have it right

0128

1 here. If you tell me what you're looking at.

2 Q. Page 19, it starts on page 19 at the bottom.

3 A. Okay. Yeah, he has, on pages 19 and 20, six
4 cases here that he mentions. I'm not particularly
5 familiar with those six cases.

6 Q. Okay. But assuming that the depreciation --
7 there was no depreciation issue is in any of those
8 cases and he's accurate in his description that the
9 Commission shared the gain or gave the gain, either/or
10 to the rate payer, that would have been improper under
11 your testimony, correct?

12 A. Well, I don't -- you know, I don't know what
13 was going on in those particular cases. What I have
14 said is that if customers are harmed by the sale, in
15 this particular case or any sale, they need to be
16 compensated. That is a separate issue from the gain.
17 If customers are harmed by the sale, they should be
18 compensated, and the gain might be more than that
19 harm, it might be less than that harm.

20 The asset might have been sold at a loss.
21 Customers need to be compensated for that. So I don't
22 know exactly what was going on in these cases, and I
23 don't know the circumstances, but my position is you
24 have one issue of the sale, and then you have another
25 issue of compensating for harm. And I don't think --

0129

1 I mean, they're not related in the sense that you take
2 part of the proceeds. They are related in that they
3 are both a result of the asset sale.

4 Q. Okay. And outside of depreciation that may
5 have been too fast or too slow, and outside the
6 context of harm, in a gain on sale case of a utility
7 asset, shareholders get the gain, right?

8 A. Well, you know, what I looked at in this
9 particular instance was this sale and what's on the
10 record. There are always possible other issues. You
11 could have had a ruling from the Commission, you could
12 have had a change in government emission controls.
13 There are lots of things going on that might have an
14 effect on who was going to cover the loss or who was
15 going to cover -- who was going to share in the gain.
16 Okay.

17 Q. Okay.

18 A. Those weren't present as I understand it in
19 this case.

20 Q. Okay. Well --

21 A. It's hard to generalize, just a hundred
22 percent.

23 Q. Well, I was focusing on your testimony on
24 page 11, and you go on from the sentence I read, you
25 say, "That is why in the case of the asset sale by

0130

1 PSE, the regulatory compact requires that the net
2 gains from the sale belong to investors." Do you see
3 that?

4 A. Yes, I see that. And it's exactly my
5 point. I said in the case of the asset sale by PSE.
6 So I was talking about this particular case. And I
7 didn't go into a lot of extenuating circumstances that
8 might be present that were not present in this
9 situation.

10 Q. You said earlier that if the company sells a
11 project it has abandoned before completion at a loss,
12 that you can't generalize what the proceeds of that
13 owned property sale would be. Why is that? Why can't
14 you generalize?

15 A. Well, it depends on why the project wasn't
16 completed and why it had to be shut down. I mean, I
17 actually dealt with things like this. We had nuclear
18 power plants under construction in Illinois when I was
19 a commissioner, we had to decide whether they should
20 be finished or not. Companies had come in and asked
21 to build a plant. Then the Commission said don't
22 build it. So there had been some earth moving going
23 on, and then those -- sometimes those costs, because
24 of the circumstances, are borne by customers. It
25 depends on the circumstance, and who told the company

0131

1 to do something and why it was cancelled.

2 Q. If the company made the decision on its own
3 and was not told by government to do it, then the
4 utility should bear the loss?

5 A. Well, you know, the problem I'm having is
6 that each of these cases is unique. And there is lots
7 of -- there is lots of circumstances. I'm comfortable
8 talking about the PSE sale and the regulatory compact
9 and what I think that means here. But I have trouble
10 answering hypotheticals when we don't know all the
11 facts. Okay? I'm sorry I can't be more helpful than
12 that. But these cases tend to be complex.

13 Q. So, I was reading your testimony here to be
14 relatively generic, and you are saying it applies only
15 to this case and the facts of this case, is that
16 right?

17 A. It is generic in the sense that we have a
18 regulatory compact which I think is generic, and we
19 have risk of ownership of assets which -- and those
20 statements are generic. I mean, if someone owns the
21 asset, they have the risk of owning the asset and they
22 get the benefit from any sale or they have to incur
23 the loss.

24 But there are extenuating circumstances.
25 One of them that came up in this case is customer

0132

1 harm. Customers need to be compensated if there is
2 customer harm. Okay. There could be other
3 circumstances. So as a general proposition, what I
4 said is correct. But we have to recognize that there
5 might be some special circumstances in any particular
6 instance.

7 Q. Is the source of the regulatory compact the
8 Hope and Bluefield decisions, Mr. Levin -- Dr. Levin?
9 Excuse me.

10 A. You know, I wouldn't say that particularly.
11 It goes even back farther than the Hope natural gas.

12 Q. But was it reiterated in Hope Natural Gas
13 then?

14 A. Partly. I mean, Hope Natural Gas was much
15 more specific than the regulatory compact. So, let me
16 say that Hope Natural Gas is consistent with it, but I
17 don't think it was an attempt to be a restatement of
18 Hope -- of regulatory compact, at least as I
19 understand it. And I have to say, I'm not a lawyer so
20 I'm giving you an economic reading of Hope Natural
21 Gas.

22 Q. Did you supply the text of the regulatory
23 compact in any of your exhibits?

24 A. I'm sorry, the text of the regulatory
25 compact?

0133

1 Q. In any of your exhibits?

2 A. No. I described it in my testimony.

3 MR. TROTTER: That's all I have. Thank you.

4 JUDGE MOSS: Thank you, Mr. Trotter. And
5 let's see. Looks like public counsel has designated
6 some cross. Go ahead.

7 MS. GAFKEN: Yes. And it will be brief.

8 CROSS-EXAMINATION

9 BY MS. GAFKEN:

10 Q. Dr. Levin, good afternoon.

11 A. Good afternoon.

12 Q. Would you please turn to your rebuttal
13 testimony which is SLL-1T, and go to page 7.

14 A. Okay.

15 Q. Beginning at line 22, and then continuing on
16 to page 8 through line 3, there you testify that
17 "Accumulated depreciation for the assets sold by PSE
18 to JPUD represents the money PSE investors received in
19 the past as their return of the investment in those
20 assets," correct?

21 A. Yes.

22 Q. And then further down on page 8 at lines 11
23 through 13, you testify that "allocating an amount
24 equal to the accumulated depreciation denies the
25 investors recovery of their investment," is that

0134

1 correct?

2 A. Yes.

3 Q. Public counsel, Commission staff, and ICNU
4 are not advocating that investors refund the dollars
5 received in the past, are they?

6 A. Yes, they are. In effect that's exactly
7 what they're advocating. They are saying that they
8 want a share of the -- they want to take the gain and
9 say that the amount that's equivalent to accumulated
10 depreciation should be refunded to rate payers. And
11 so I think that's exactly what they're saying, is to
12 refund the accumulated depreciation to rate payers.

13 Q. Is your understanding that those parties are
14 asking shareholders to purge dollars that they've
15 already received in the past?

16 A. I don't know what you mean by "purge
17 dollars." But what they are asking for is a refund of
18 accumulated depreciation. Depreciation was paid to
19 compensate the owners for using up their assets,
20 return of their investment. And the way I read this
21 is that the request is to come give that money back.
22 I want to refund that money to the rate payers.

23 MS. GAFKEN: Okay. I have no further
24 questions. Thank you.

25 JUDGE MOSS: Anything from the bench?

0135

1 COMMISSIONER GOLTZ: I have a question. So
2 it's Dr. Levin?

3 THE WITNESS: Yes.

4 COMMISSIONER GOLTZ: So, I am not an
5 economist, I'm a lawyer, so we have trouble
6 communicating. We'll see. So, I gather, am I correct
7 that your recommendation here in your analysis is
8 based on a policy recommendation as opposed to a legal
9 one? And the reason I -- let me go back a second.
10 Were you present in the room for the opening
11 statements of counsel?

12 THE WITNESS: Yes. I mean, I think that's a
13 fair statement, that it's not legal, certainly I'm not
14 giving a legal opinion. I think the concept of
15 regulatory compact is well understood, probably both
16 by lawyers and economists, and my recommendation I
17 believe is what you have to do to be consistent with
18 the regulatory compact.

19 COMMISSIONER GOLTZ: But your
20 recommendation, it's not your -- I gather it is not
21 your testimony that your recommendation is legally
22 compelled?

23 THE WITNESS: No. I offer no legal opinion
24 at all.

25 COMMISSIONER GOLTZ: Then I am a little bit

0136

1 confused by some of the responses you had to
2 Mr. Trotter's questions. You said you didn't want to
3 respond to hypotheticals, that a lot depends on
4 circumstances. These are complicated. These are I
5 think pretty close to quotes, it's hard to generalize.

6 THE WITNESS: Yes.

7 COMMISSIONER GOLTZ: But isn't it part of
8 the Commission's job to try to give the utility and
9 the public and investors and potential investors some
10 kind of regulatory guidance, some kind of clear
11 signals as to what the results would be even though
12 those may be -- because today's hypothetical may be
13 tomorrow's real world situation. And I'm just a
14 little bit afraid that if we don't try to articulate
15 some clear principles to which we -- that we can apply
16 to hypotheticals, we end up with a situation where we
17 would in effect say to potential investors, don't
18 know, it's tough, hard to generalize.

19 THE WITNESS: You know, I agree with what
20 you say, that you go back to the principles. And
21 you -- while each case is different, and it is a
22 policy decision, I think that what I would want to do
23 is be consistent with the principles. And the
24 principle in this instance, as I see it, is this idea
25 of a regulatory compact. So, while each case has to

0137

1 be analyzed on its unique set of facts, if I were
2 making a decision, and which I've done, I would want
3 to always be consistent with that regulatory compact.

4 And so, in this case, for instance, you say,
5 well, the owners of the assets have borne the risk and
6 they get the reward. And I'm saying, the issue of, is
7 there harm to customers that's come up. So we want to
8 address that. If customers are harmed, they should be
9 compensated. So those sorts of decisions to me are
10 all consistent with the regulatory compact.

11 COMMISSIONER GOLTZ: So, your principles, I
12 hear two there, ones that we could apply. One is that
13 reward follows risk.

14 THE WITNESS: Right.

15 COMMISSIONER GOLTZ: And the other one is,
16 we have to protect the existing customers from harm?

17 THE WITNESS: Yes.

18 COMMISSIONER GOLTZ: But I hear the same
19 reward follows risk principle being advocated by ICNU,
20 but public counsel and by Commission staff. They just
21 come to the opposite conclusion.

22 THE WITNESS: I understand. I address that
23 in my testimony, at least I tried to, because there is
24 two kinds of risk. And there is this risk that comes
25 with owning the assets that you may have to sell it

0138

1 for more or less than it's worth, or that you think
2 it's worth. And the other kind of risk is the risk of
3 doing business. Anything that you or I buy, any
4 product or service, there is, if it's in a competitive
5 market, part of that price is covering this business
6 risk, this idea that, well, maybe I have to pay a
7 little more or a little less than I thought. Maybe
8 the storm forced my business to close for a week.
9 People build that in to the price, either through
10 insurance or just an add-on to the price.

11 So, there is that risk. But that's not a
12 risk of ownership. And the reason that we're coming,
13 I think that we're coming to different
14 recommendations, is that those two kinds of risks are
15 confused, okay? So, that the business risk is getting
16 confused with the risk of owning the assets. I hope
17 that's clear.

18 COMMISSIONER GOLTZ: Yes. Maybe I'm
19 confusing those two as well, but it seems to me that
20 what I heard Mr. Trotter say in his opening was that
21 throughout the regulation of Puget and other
22 utilities, where there is -- that the rate payers and
23 the Commission have sort of come to the rescue of
24 utilities, in the sometimes rare event that there is
25 an abandoned plant, there is a sale at less than net

0139

1 book value, that there is some sort of type of almost
2 insurance that the Commission and the rate payers
3 provide to the utility that in effect lowers that risk
4 of owning an asset.

5 And what I hear you saying is, push that
6 aside. Puget ought to take all that risk, and if you
7 kind of came to the rescue in the past, you know,
8 don't do it anymore. They ought to bear that risk.

9 THE WITNESS: Let me tell you what I've been
10 thinking about in terms of your question. Let's say
11 that Puget Sound Energy and the Jefferson County
12 utility district failed to come to an agreement, and
13 they went to arbitration. And the judge or the jury,
14 whatever, awarded them less than net book value, and
15 they said, well, we don't think you should have to pay
16 the \$50 million. We will only give you \$30 million.

17 Now, I would be here telling you that that
18 risk fell on the company, okay, that that would be
19 shareholders' risk, that they were forced to sell the
20 asset, and that's their loss, and that's symmetrical
21 with what I'm telling you about the gain. Okay. And,
22 let me just say, if in that situation customers had
23 been harmed, they would have to still be compensated,
24 even though the sale was at a loss.

25 COMMISSIONER GOLTZ: Right. But if you make

0140

1 it symmetrical the way you do -- both arguments are
2 symmetrical. Mr. Trotter's argument is symmetrical
3 and yours is symmetrical, they just come out
4 differently.

5 THE WITNESS: Yes.

6 COMMISSIONER GOLTZ: But couldn't you make
7 the case that to adopt your view, where it's -- they
8 get the gain and they get the loss, that overall
9 uncertainty of how those play out makes the enterprise
10 more risky than under Mr. Trotter's argument, and
11 therefore the general business risk becomes greater
12 and that's to the detriment of the company and
13 ultimately to the rate payers as well?

14 THE WITNESS: The law in Washington, as I
15 understand, that enables a public utility district to
16 come to a company and force the sale of an asset, I
17 would say -- now, again I give you economic opinion, I
18 would say that that makes running an investor-owned
19 utility in Washington more risky than it does in areas
20 where that can't happen, okay?

21 Because I don't think this happens very
22 often, it's probably not a huge, a huge deal. But
23 this sort of risk that falls on investors, would -- is
24 different from the risk from a storm or the risk that
25 paper prices went up or whatever it is that you

0141

1 would -- that's a cost of doing business. People buy
2 electricity and they have to pay the cost of the
3 electricity. And that includes there are certain
4 unknowns there.

5 As I pointed out in my testimony, in a
6 competitive market, it's included in the price.
7 Regulators typically don't include that sort of cost
8 in the price. They do it on a case-by-case basis. So
9 the utility comes in and says, you know, we had this
10 big storm and we need a little extra money. And
11 that's how they get it. They don't get it as just an
12 add-on to the price as you would in a competitive
13 market.

14 COMMISSIONER GOLTZ: Okay. I have no
15 further questions.

16 THE WITNESS: I hope I'm being clear.

17 COMMISSIONER GOLTZ: I think so. It's
18 just -- but there is a lot of clarity coming on both
19 sides coming to different conclusions.

20 COMMISSIONER JONES: Dr. Levin, welcome.

21 THE WITNESS: Thank you.

22 COMMISSIONER JONES: You were here this
23 morning and you heard some of the my questions to
24 Mr. Marcelia and others on the regulatory tool kit
25 which I think is part of the regulatory compact,

0142

1 right?

2 THE WITNESS: I did.

3 COMMISSIONER JONES: So things like deferred
4 accounting, is that part of the regulatory compact?

5 THE WITNESS: Well, it's a means to
6 accomplish what you want to accomplish. I mean, the
7 regulatory compact in my mind is sort of this guiding
8 principle that we have agreed to -- companies have
9 agreed to be regulated, and the regulators have an
10 obligation that comes with that to make sure that they
11 earn a normal return.

12 COMMISSIONER JONES: Right.

13 THE WITNESS: And deferral accounts are one
14 tool that you have to do that.

15 COMMISSIONER JONES: Right. That's all I'm
16 asking.

17 THE WITNESS: Explicitly part of the
18 regulatory compact, but it is a way that you can
19 regulate.

20 COMMISSIONER JONES: So you just responded
21 to Commissioner Goltz and said those risks of storms,
22 environmental remediation, possible nuclear plant, I
23 mean Puget, doesn't own nuclear plants anymore, but
24 those, you said those are not generally included in
25 rates. That's what you said.

0143

1 THE WITNESS: Yes.

2 COMMISSIONER JONES: You heard my quote,
3 Puget has \$709 million in other regulatory assets on
4 its books.

5 THE WITNESS: Yes.

6 COMMISSIONER JONES: Aren't those included
7 in rates?

8 THE WITNESS: I don't know how your
9 accounting and how your rate setting work so --

10 COMMISSIONER JONES: So you don't know FASB
11 71 and the principles in FASB 71?

12 THE WITNESS: Whatever goes into the rate
13 base is included in rates.

14 COMMISSIONER JONES: It's not rate base.
15 Deferred accounting by definition of FASB 71 is
16 deferral --

17 THE WITNESS: I understand.

18 COMMISSIONER JONES: -- of a cost with a
19 return.

20 THE WITNESS: I understand.

21 COMMISSIONER JONES: And the prudence is to
22 be determined in a general rate case, right?

23 THE WITNESS: Typically when you defer
24 something, it means that you are going to recover it
25 later.

0144

1 COMMISSIONER JONES: Correct.

2 THE WITNESS: So it's not in today's rates,
3 but it will be in rates whenever you -- whenever you
4 decide to recover that deferral account.

5 COMMISSIONER JONES: But are you stating
6 that those are not included in rates now, if a
7 deferred accounting petition is presented to the
8 Commission, both for return of and return on, and we
9 approve it?

10 THE WITNESS: I don't know. I don't know
11 exactly how you are handling it, so let me not answer
12 that.

13 COMMISSIONER JONES: Could you turn to page
14 2 of your -- and like you, Dr. Levin, I am more of an
15 economist, a business guy. I'm not a lawyer. But on
16 page 2 of your testimony, you state what appears to be
17 a legal concept to me on line 19. You state -- are
18 you there?

19 THE WITNESS: I'm sorry, which line?

20 COMMISSIONER JONES: Line 17, it's that
21 first sentence on your summary of your testimony.
22 Line 17 through 20, you say, "The proposals made by
23 staff, public counsel and ICNU for the allocation of
24 the proceeds of the sale of the assets to Jefferson
25 County Public Utility District violate the regulatory

0145

1 compact." I get that, you just said that --

2 THE WITNESS: Yes.

3 COMMISSIONER JONES: -- several times. "And
4 are in fact a confiscation of proceeds that belong to
5 investors."

6 THE WITNESS: Okay. I don't attach any
7 legal meaning to --

8 COMMISSIONER JONES: Well, what do you --
9 well, you put it in your in your testimony, so as an
10 economist what do you mean by "confiscation"?

11 THE WITNESS: That one group was getting
12 money that belonged to somebody else.

13 COMMISSIONER JONES: Are you primarily
14 referring there to accumulated depreciation on the
15 assets of Jefferson County PUD?

16 THE WITNESS: No. My point is that I --
17 according to the regulatory compact, that all of the
18 proceeds should be going to the owners of the assets.

19 COMMISSIONER JONES: Correct.

20 THE WITNESS: And so, all I was saying is,
21 if any of those proceeds are taken from the owners and
22 given to rate payers, I said that's confiscating that
23 money. And I just mean it in a very dictionary sense,
24 not in a legal sense.

25 COMMISSIONER JONES: Okay. So what is your

0146

1 definition of rate-making and the rate-making formula,
2 revenue requirement? Just state it simply for me, and
3 tell me how depreciation fits into that.

4 THE WITNESS: Okay. Typically what you do
5 is you determine the company's expenses, like O&M,
6 operating and maintenance expenses, those sorts of
7 expenses.

8 COMMISSIONER JONES: Right.

9 THE WITNESS: Then you have the rate base.

10 COMMISSIONER JONES: Right.

11 THE WITNESS: And you have a rate of return
12 that you have established. And you multiply the rate
13 of return by the rate base, okay? And that gets you
14 an amount of money that you have to add on to cover a
15 return of -- on the investment, okay?

16 Depreciation is one of the costs that you
17 have. In a regulatory world, depreciation becomes a
18 cost. So you've got these O&M costs, you have
19 depreciation. You add all those things up and then
20 you add to it the return on the rate base, okay? And
21 that gets you the revenue requirement. And then you
22 set rates to yield that amount of money.

23 COMMISSIONER JONES: So does that sort of a
24 formula, either as an offset to rate base or a
25 specific adding on after you do the calculation, does

0147

1 that compensate fully the utility for its
2 depreciation?

3 THE WITNESS: It should.

4 COMMISSIONER JONES: It should, right, by
5 the very formula?

6 THE WITNESS: Yes. And yes, they should be
7 compensated for depreciation, which is the using up of
8 the assets.

9 COMMISSIONER JONES: Right. So, I had an
10 exchange with Mr. Marcellia this morning on ownership.
11 And you tend to use the use the word "ownership" a lot
12 in your testimony as well as part of depreciation.
13 And I can find no cite either in the FASB or the
14 definitions of depreciation that refers specifically
15 to ownership of the asset.

16 The asset is there, it's producing service,
17 electric service for the benefit of the public,
18 right? But there is nothing that I can find in the
19 definition of "depreciation" that relates to what you
20 constantly cite as ownership.

21 THE WITNESS: Well, usually the people who
22 pay for something own it. And investors have paid for
23 the assets. They own them.

24 COMMISSIONER JONES: Who is paying for the
25 electric service?

0148

1 THE WITNESS: The electricity --

2 COMMISSIONER JONES: Right.

3 THE WITNESS: -- is paid for by customers.

4 COMMISSIONER JONES: Customers, right?

5 THE WITNESS: Okay. And they pay all of the
6 expenses, and they pay for using up the assets. But
7 the assets were paid for by the investors, and they
8 own them, just as you or I own anything that we go
9 buy. I bought a computer and I paid for it and I own
10 it. And I don't -- and that seems pretty clear. I
11 could loan it out to you, if you didn't have one, I
12 could loan you mine and you pay me an amount of money
13 that made me happy, and it would cover depreciation on
14 my computer.

15 COMMISSIONER JONES: So, now we have another
16 analogy of --

17 THE WITNESS: I'm sorry.

18 COMMISSIONER JONES: -- computers. We had
19 home ownership and renters. I am getting lost in
20 this.

21 I would submit respectfully that that is a
22 competitive enterprise and is very different from a
23 regulated enterprise. But in any case, let's stop
24 there.

25 Let me see. Turn to page 3 and 4 of your

0149

1 testimony. Let's start at page 3, lines 18 and 19.
2 You state, the other is -- and you talk about
3 "violating the regulatory compact would have negative
4 consequences for all customers of Washington utilities
5 and for stockholders in Washington utilities." What
6 is the basis for that statement?

7 THE WITNESS: If investors who have -- can
8 invest anywhere in the world, okay, if investors
9 decide that they are not going to get a return on and
10 of their investment, and they are not going to be able
11 to keep the -- any gain or be charged with any loss
12 for the ownership of assets, they are going to demand
13 a higher rate of return to give money to utilities in
14 Washington. And that rate of return on equity is a
15 cost of -- for the company and it's a cost that you
16 probably recognize when you set rates. And that's
17 what I mean.

18 COMMISSIONER JONES: As part of your
19 testimony did you look at the credit ratings by S&P
20 and Moody's and Fitch and some of the Wall Street view
21 of the three IOUs that we regulate in this state, PSE,
22 Avista, PacifiCorp?

23 THE WITNESS: No. The only credit rating,
24 which now this is bond rating that we are talking
25 about.

0150

1 COMMISSIONER JONES: Correct, or you could
2 refer to the corporate credit rating of companies?

3 THE WITNESS: The only bond rating that I am
4 familiar with I think is the Puget Sound Energy, which
5 I understand is like a Bbb or something like that.

6 COMMISSIONER JONES: Are you familiar with
7 Avista, with the credit rating for Avista, either the
8 bond rating or the corporate rating?

9 THE WITNESS: Is that another utility?

10 COMMISSIONER JONES: Yes.

11 THE WITNESS: The only one I really know
12 about is Puget Sound Energy.

13 COMMISSIONER JONES: Have you heard of
14 Pacific Power?

15 THE WITNESS: Yes.

16 COMMISSIONER JONES: Have you heard of
17 Berkshire Hathaway?

18 THE WITNESS: Yes.

19 COMMISSIONER JONES: Okay. Well that's
20 another credit rating. Are you familiar with that
21 company?

22 THE WITNESS: Berkshire Hathaway?

23 COMMISSIONER JONES: Yes.

24 THE WITNESS: Of course.

25 COMMISSIONER JONES: So what you are saying

0151

1 here is that the decision we make on the allocation of
2 the gains in this particular transaction will have an
3 aspect on how Berkshire Hathaway views the investment
4 climate in this state?

5 THE WITNESS: Well, it will have an effect
6 on how investors view the --

7 COMMISSIONER JONES: He is an investor.
8 That company is an investor.

9 THE WITNESS: I understand. But, you know,
10 maybe Warren Buffet doesn't pay any attention to
11 Washington. But they have to get money from
12 somewhere. And people, investors in a general sense
13 will take -- they do watch. I mean, I'm sure you have
14 the same experience I do, when we would -- I would get
15 calls after a Commission meeting from bond agencies to
16 see what our decision was, because they were looking
17 at how we were treating the companies and how that
18 affected the bond rating.

19 COMMISSIONER JONES: Yes.

20 THE WITNESS: I'm sure you have the same
21 thing. So, investors in a general sense do pay
22 attention to these things.

23 COMMISSIONER JONES: No. And I have quite a
24 bit of interaction with Wall Street investors, both on
25 the debt and equity side. I'm not asking you that.

0152

1 I'm asking you, well, for your specific statement that
2 whatever we do on this allocation of proceeds in this
3 sale is going to have an impact on the investor
4 sentiment toward this Commission and the state of
5 Washington.

6 THE WITNESS: Well --

7 COMMISSIONER JONES: What is the --

8 THE WITNESS: Well, you said that you
9 interact with equity people, and those are the people
10 who are giving money to the company for investment.
11 So, yes, I think they are going to -- I think they
12 watch these things. And if they decide that
13 Washington is more risky, they are going to demand a
14 higher return.

15 COMMISSIONER JONES: Okay. On that point
16 let me just read you something from the most recent
17 10-K that Puget filed with the SEC. And as you know,
18 all companies file forward looking statements, right?

19 THE WITNESS: Yes.

20 COMMISSIONER JONES: Of all the risks and
21 things that could affect the material performance of
22 the company in the future. So, quote, "The loss of
23 significant customers, changes in the business of
24 significant customers, or the condemnation of PSE's
25 facilities as a result of municipalization or other

0153

1 government action or negotiated settlement which may
2 result in changes in demand for PSE services."

3 So, that is a disclosure to the investment
4 community of a potential risk, is it not?

5 THE WITNESS: Well, it's a disclosure of
6 sale. The risk would be whether they get to keep the
7 proceeds or not. I didn't hear anything about that in
8 your quote.

9 COMMISSIONER JONES: No. It's the
10 allocation of the gains of any potential sale. They
11 do talk about a negotiated settlement, but they don't
12 talk about allocation of gains.

13 THE WITNESS: So, I mean, I would say, and
14 you can disagree with me, but I would say that most
15 investors assume that regulators are honoring their
16 side of the regulatory compact. They assume -- and
17 so, if that's true, then the risk level stays the
18 same. If they find out that -- and I don't mean you,
19 Washington regulators, but there is a Commission
20 someplace, we won't name states, but there are some
21 south of you, that start behaving in a way that
22 companies get poor returns or the regulators are doing
23 things that investor think dishonor, break the
24 regulatory compact, then they take that into
25 consideration and they demand higher returns.

0154

1 COMMISSIONER JONES: Right.

2 THE WITNESS: Okay. So, the 10-K filing is
3 simply disclosing the municipalization. But it
4 doesn't really say anything about a change in risk,
5 because I believe there is an assumption that the
6 regulatory compact is honored by everyone.

7 COMMISSIONER JONES: Did you have a chance
8 to read Mr. Gorman's testimony --

9 THE WITNESS: Yes.

10 COMMISSIONER JONES: -- as part of this
11 case? So you disagree with his thesis that implicit
12 in the calculation of the ROE in Washington state and
13 many other commissions is the risk of condemnation and
14 municipalization? You disagree with that, that it's
15 already baked into the ROE?

16 THE WITNESS: I don't think -- again, it's
17 my opinion, I don't think that the risk of breaking
18 the regulatory compact is included. It's not the
19 municipalization that's so much, the revenue, how much
20 revenue there is and what happens to those revenues.

21 COMMISSIONER JONES: Right.

22 THE WITNESS: So, but I don't think that
23 the -- the risk of the regulatory compact not being
24 honored is included in the rate of return.

25 COMMISSIONER JONES: But if you were

0155

1 advising an investor, either equity or fixed income,
2 who was thinking of investing in the state of
3 Washington, and if you were advising them about risks,
4 various risks, you know, the Commission has too much
5 regulatory bang, the ROE is too low, the risk of
6 climate change, the risk of municipalization, there
7 are many, many, as you say, business risks and other
8 risks, and I think you heard Mr. Trotter today talk
9 about six cases that this Commission has ruled on the
10 allocation of the gains?

11 THE WITNESS: Yes.

12 COMMISSIONER JONES: Wouldn't you advise the
13 potential investor to read those cases as precedent
14 about how the Commission has allocated gains in the
15 past?

16 THE WITNESS: Yes, I probably would. I
17 don't know the circumstances in those cases, and I
18 don't -- so I don't know why you did what you did.

19 COMMISSIONER JONES: Are you familiar --
20 maybe when you were on the ICC, on the Illinois
21 Commerce Commission, are you familiar with Democratic
22 Central, the decision by the DC circuit in 1972?

23 THE WITNESS: Not really.

24 COMMISSIONER JONES: No?

25 THE WITNESS: No.

0156

1 COMMISSIONER JONES: Okay.

2 THE WITNESS: I mean, we -- I addressed
3 asset sale cases on the Illinois Commission with some
4 frequency.

5 COMMISSIONER JONES: Okay.

6 THE WITNESS: And my recollection is that we
7 always gave all the proceeds to the -- to the owners
8 of the company.

9 COMMISSIONER JONES: Okay. And did you hear
10 Commissioner Goltz earlier talk about the nature of
11 our state, that we were -- about 58 percent of the
12 load is delivered by consumer-owned or public
13 utilities, and about 42, 43 percent --

14 THE WITNESS: Yes.

15 COMMISSIONER JONES: -- delivered by IOUs?

16 THE WITNESS: Yes.

17 COMMISSIONER JONES: So don't you think the
18 investors know that already when they invest in the
19 utilities in our state? Aren't they doing their
20 homework?

21 THE WITNESS: I'm sure they know who is
22 supplying power, but that's not -- I mean, it could be
23 75 percent municipal power, and we're talking about
24 regulating the investor-owned utility.

25 COMMISSIONER JONES: I know.

0157

1 THE WITNESS: So, so it really depends on
2 how the investor-owned utility is treated by the
3 Commission, and how people outside Washington perceive
4 that risk.

5 COMMISSIONER JONES: Okay. That's all I
6 have. Thank you.

7 JUDGE MOSS: Anything else? All right. Any
8 redirect?

9 MR. QUEHRN: I just have a couple of
10 questions, your Honor.

11 REDIRECT EXAMINATION

12 BY MR. QUEHRN:

13 Q. Dr. Levin, you make a couple distinctions in
14 your testimony. I just want to be clear here. It's
15 your testimony, correct, that gains or losses
16 associated with the sale of the assets go to an owner,
17 is that a fair paraphrase?

18 A. Yes. I mean, given the qualifications that
19 we've been talking about.

20 Q. Right. What is the gain or loss? How is
21 that determined?

22 A. Well, the way we're using gain or loss is
23 simply the amount above the net book value transaction
24 costs. I prefer to just talk about the proceeds,
25 because I think all the proceeds should go to the

0158

1 owners of the assets.

2 Q. But the gain or the loss is what, then, a
3 consequence of the sale, is that the difference --

4 A. The gain or loss is simply, you take the
5 sale price, and you subtract the net book value and
6 transaction costs, and if there is anything left, it's
7 a gain.

8 Q. All right. So it's essentially a way to
9 measure the outcome of the sale, as to whether or not
10 it results in a gain or a loss over net book value?

11 A. Well, I'm not sure what you mean by
12 measuring the sale. I mean, it is what it is. You
13 have a sale price, and you have net book value and
14 transaction costs. And then you look at that, and if
15 there is either on top of that a gain, or it didn't
16 cover, the sale price didn't net book value and
17 transactions costs in which case you have a loss.

18 Q. So it's a sum of money?

19 A. It is a sum of money. It is absolutely a
20 sum of money.

21 Q. Now, if I look to page 15 of your testimony,
22 lines 6 and 7, I think it is, you also then refer to
23 in the context of another type of consequence of the
24 sale, that there could be harm to customers, correct?

25 A. Correct.

0159

1 Q. And what's your testimony with respect to
2 what a Commission should do with harm to customers
3 should that occur in connection with a sale?

4 A. Well, I mean, what I've been saying is if
5 customers are harmed as a result of the sale, that
6 they need to be compensated.

7 Q. And is that the same analysis as determining
8 gain or loss, or is it a separate analysis?

9 A. That's completely separate.

10 Q. And there could be other equitable factors
11 that would bear into how the gain ultimately gets
12 allocated once it's determined, is that correct?

13 A. Well --

14 Q. In other words, harm to customers may not be
15 the only thing that you would consider?

16 A. Well, I mean, I don't think -- if customers
17 are harmed, they need to be compensated. That's
18 independent from whether there was a gain on the sale.

19 Q. Correct.

20 A. So I'm not quite sure what you're asking.

21 Q. What I'm asking is, is it your testimony
22 that the Commission in this instance should look to
23 other equitable factors in terms of what they do with
24 the sum of money as distinct to how they calculate the
25 sum of money? I.e., they should consider customer

0160

1 harm?

2 A. Yes. Yes, they should consider customer
3 harm, but I have trouble when people want to express
4 customer harm and say, well, then we get 25 percent of
5 the gain. I mean, customer harm is a number, and --
6 if there is any. And that's a certain amount of
7 dollars. And customers should be compensated for
8 those dollars. And all the proceeds of the rest of
9 the sale should go to the owners of the assets. And
10 then they would have to compensate the customers for
11 any harm.

12 Q. And then finally, is it your testimony that
13 taking that into consideration, something like harm to
14 customers is also part of the regulatory compact?

15 A. Yes.

16 MR. QUEHRN: Thank you.

17 JUDGE MOSS: I don't want to prolong this
18 too much but I do have one point of curiosity that I
19 want to pursue with you, Dr. Levin, and that is this.
20 You, I believe your testimony earlier was that
21 acquainted yourself and are very familiar with the
22 circumstances of this particular transaction, and that
23 your testimony about -- all your testimony about
24 regulatory compacts is focused on this transaction,
25 not generalizations?

0161

1 THE WITNESS: Well, it could be, the
2 conclusions, the recommendation I have or the
3 conclusions that I'm drawing are based with the
4 regulatory compact as the principle, and then looking
5 at the specific facts in this case.

6 JUDGE MOSS: So you are quite familiar with
7 the specific facts in this case?

8 THE WITNESS: Well, I hope so.

9 JUDGE MOSS: Okay. Let me ask you this.
10 Let's suppose for just a moment, I'm going to give you
11 a hypothetical, I think you can answer, and it is
12 this. Let's suppose that the sale by PSE to the JPUD
13 was at less than net book value instead of more than
14 net book value. Should PSE have borne the loss?

15 THE WITNESS: Yes. And I think they should
16 have assuming that the rest, all the rest of the
17 circumstances are the same. And I gave an example of
18 going to arbitration and getting less than net book
19 value. I believe I said that in response to the
20 commissioner's question. And to my mind, then, that
21 loss would be borne by the owners of the asset.

22 JUDGE MOSS: So if this had gone to a
23 condemnation proceeding and the jury came back with
24 damages that were less than net book value, PSE would
25 have to absorb that loss?

0162

1 THE WITNESS: Well, I believe that's right,
2 assuming everything else is the same.

3 JUDGE MOSS: That's all I wanted to know.
4 Thanks. Anything further?

5 MR. QUEHRN: No, your Honor.

6 JUDGE MOSS: All right. Let's excuse you
7 from the stand, Dr. Levin, and we appreciate your
8 being here today and giving your testimony.

9 And we will have -- when you have settled we
10 will have our next witness. Is it "bell-mar" or
11 "bell-i-mar?"

12 MR. BELLEMARE: "Bell-mer."

13 JUDGE MOSS: "Bell-mer." Mr. Bellemare will
14 be our next witness.

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

18 THE WITNESS: I do.

19 JUDGE MOSS: Please be seated.

20 DIRECT EXAMINATION

21 BY MR. QUEHRN:

22 Q. Good afternoon, Mr. Bellemare. Could you
23 please state your name and title and spell your name
24 for the court reporter?

25 A. Sure. It's a hard name. Robert Bellemare.

0163

1 I am chief operating officer of Mykrobel, LLC. And
2 the way it's spelled is B-E-L-L-E-M-A-R-E, but most
3 people can't remember that so my e-mail address is
4 rbell. I shortened it.

5 Q. Mr. Bellemare, your testimony and exhibits
6 have been entered into the record in this proceeding.
7 At this point do you have any corrections to make to
8 your testimony or exhibits?

9 A. No, I do not.

10 MR. QUEHRN: Okay. Your Honor,
11 Mr. Bellemare is prepared for cross-examination.

12 JUDGE MOSS: All right. And again,
13 Mr. Trotter, you have designated some.

14 MR. TROTTER: Thank you, your Honor.

15 CROSS-EXAMINATION

16 BY MR. TROTTER:

17 Q. Mr. Bellemare, in preparing for this
18 testimony today did you review PSE's SEC 10-K reports
19 over the last several years?

20 A. No.

21 Q. Do you subscribe to the efficient market
22 theory?

23 A. Efficient market theory, just please define
24 it.

25 Q. Have you heard of it?

0164

1 A. That capital will flow efficiently?

2 Q. No, no. It's that all the available
3 information about a security, a stock, is embedded in
4 the price of that stock.

5 A. Okay.

6 Q. Do you subscribe to that theory?

7 A. All the available information?

8 Q. Yes.

9 A. I would say most of the information, or
10 information found is considered in determining a stock
11 price.

12 Q. I'd like you to turn to your Exhibit RCB-4.
13 And am I correct in understanding that this is a list
14 you prepared?

15 A. I'm sorry, which one is it?

16 Q. RCB-4.

17 A. I'm just looking for it here.

18 Q. It's entitled Electric Utilities Formed in
19 the past 40 years.

20 A. Yes, sir.

21 Q. And did you prepare this?

22 A. Yes. It's based on a variety of information
23 sources, but yes.

24 Q. What I meant by that is you just didn't find
25 it somewhere and put a copy in here. You put it

0165

1 together?

2 A. Oh, yes, right, yes.

3 Q. Okay. And this exhibit purports to show all
4 electric utilities formed in the last 40 years, and
5 then you, for the bolded ones, those are the ones, and
6 there are six, that were the result of a purchase of
7 an investor-owned utility or a part of an investor-
8 owned utility, is that right?

9 A. Yeah. There was some sort of hostile
10 process that I could identify, you know, in other
11 words, like a Jefferson County, where there was not
12 necessarily a willing seller at the beginning of the
13 process.

14 Q. Would it make a difference to you if PSE had
15 willingly sold its territory, or a utility had
16 willingly sold a piece of its territory rather than
17 through a condemnation, would that matter?

18 A. In terms of valuation, not, perhaps. But in
19 terms of, again I'm not trying to be a pretend lawyer
20 here, but it sounds like it may fall into a different
21 category as far as how Washington would treat it.

22 Q. Okay. Your list does not include any
23 instances of failed attempts at municipalization of
24 part or all of an investor-owned utility's service
25 area?

0166

1 A. That would be a list probably about 10 times
2 that amount.

3 Q. For the utilities in bold on your list,
4 let's start, first of all just acknowledge, the Long
5 Island Power Authority entry, that was a purchase, a
6 public purchase of the entirety of the Long Island
7 Lighting Company, wasn't it?

8 A. Right, right.

9 Q. And so the shares of Long Island Lighting
10 Company ceased to exist after that sale?

11 A. As far as I am aware, I believe.

12 Q. Okay. Well, apart from that, for the other
13 five, you did not analyze the impact of the sale on
14 that utility's stock price, regulated utility's stock
15 price, did you?

16 A. No.

17 Q. Is the City of Redding on your list?

18 A. No. I didn't see that.

19 Q. Is the city of Cody, Wyoming on your list?

20 A. No.

21 Q. Is there a reason why those two are not on
22 your list?

23 A. It's not purposeful. It's just the records
24 I had as to utility formation.

25 Q. Well, but you purport to show all utilities

0167

1 formed in the past 40 years by municipalization, don't
2 you?

3 A. This is the list I had records for.

4 Q. You are not suggesting --

5 A. It was also used in I believe the Hittle
6 report that was in here as their list, and I checked
7 it against records, for example, at the American
8 Public Power Association, where they give birth dates
9 of utilities. So, certainly there could be a couple
10 or a few that aren't included on this list. So I am
11 using the best records I this available. I just
12 learned about Redding, you know, so, you know.

13 Q. Let's take a look at the ones that are on
14 the list. Jefferson County, the proceeds are yet to
15 be -- division of proceeds, if any, is yet to be
16 determined, right?

17 A. Correct.

18 Q. And Winter Park, the gain, the investor-
19 owned utility's gain was shared 95 percent with rate
20 payers, wasn't it?

21 A. I actually don't know the treatment of that.

22 Q. You don't know?

23 A. No.

24 Q. And Hermiston, that was 95 percent to rate
25 payers, wasn't it, of the gain?

0168

1 A. Rate payers?

2 Q. Yes.

3 A. Perhaps.

4 Q. Only if you know. Do you know?

5 A. No, I don't.

6 Q. All right. And we talked about Long Island

7 Power. Paige Electric is the next one, in Arizona.

8 Do you know what share of the gain rate payers got in

9 that case?

10 A. No.

11 Q. What about Messina Electric Department, do

12 you know?

13 A. No.

14 Q. As an investor in -- for an investor in

15 utility stock, you would want to know that, wouldn't

16 you?

17 A. To the extent you thought it was a realistic

18 risk.

19 Q. Well, it was realistic for the seller of --

20 the seller to Winter Park, the seller to Hermiston,

21 the seller to Paige Electric and the seller to Messina

22 Electric, wasn't it?

23 A. Yes.

24 MR. TROTTER: I have nothing further. Thank

25 you.

0169

1 JUDGE MOSS: Thank you, Mr. Trotter.

2 Ms. Gafken?

3 CROSS-EXAMINATION

4 BY MS. GAFKEN:

5 Q. Good afternoon, Mr. Bellemare.

6 A. Good afternoon.

7 Q. Would you please turn to Cross Exhibit

8 RCB-5CX?

9 A. Sure.

10 Q. And I'll represent to you that the first
11 page is an exhibit cover sheet, but if you could turn
12 to the second page and the rest of the pages.

13 A. RCB.

14 Q. 5.

15 A. Got it. Thank you.

16 Q. Can you identify the document that's
17 contained in RCB-5CX?

18 A. This is the report done by the consulting
19 firm D. Hittle & Associates.

20 Q. And could you turn to Exhibit RCB-6CX.

21 A. Yes.

22 Q. And again, the first page is an exhibit
23 cover sheet.

24 A. Correct.

25 Q. But can you identify the document?

0170

1 A. It's a report prepared by UtiliPoint
2 International, of which I am CEO, COO.

3 Q. And you were primary author of the
4 UtiliPoint report that is in RBC-6CX?

5 A. Right.

6 Q. Let's return to RCB-5CX, and if you could
7 turn to page 22.

8 JUDGE MOSS: And these are the exhibit
9 pages?

10 MS. GAFKEN: Yes. I was just trying to
11 clarify that in my own head.

12 BY MS. GAFKEN:

13 Q. By the 22 I am referring to the page number
14 that appears in the top right-hand corner.

15 A. I only have -- I see. Thank you.

16 Q. So, and actually starting on page 21, so
17 pages 21 and 22.

18 A. Yes.

19 Q. There is a discussion there regarding
20 stranded costs, is that correct?

21 A. Let's see. I am trying to make sure I'm on
22 your page. There is three page numbers on here.

23 Q. Right.

24 A. It starts on, of the report itself, it's
25 page 18, right, in the center?

0171

1 Q. That's correct.

2 A. Right. So they have a discussion of their
3 views on costs, yes, of stranded costs.

4 Q. Is it true that the Hittle report analyzed
5 stranded costs in terms of generation facilities?

6 A. They were using what I would call, yes, the
7 current definition of stranded costs, as far as I can
8 tell. It's not my report, so.

9 Q. Well, if we turn to your report that's
10 inUtiliPoint Exhibit RCB-6CX.

11 A. Right.

12 Q. And if we look at page 20, and thankfully
13 this page only has one page number.

14 A. I try to keep my report simple.

15 Q. Well, it looks like the page number is again
16 up at the top right in the corner.

17 A. There you go, yes.

18 Q. But it's section 2.6, Stranded Costs.

19 A. Correct.

20 Q. The UtiliPoint report analyzed stranded
21 costs in broader terms looking at generation,
22 transmission and distribution, is that correct?

23 A. Here again, this part where we begin a
24 discussion here, we are talking about the FERC formula
25 for stranded costs, which is the -- it pretty much

0172

1 boils down to the generation component in rates. FERC
2 preferred to use these types of calculations.

3 Q. But if you look down towards the bottom of
4 the page, that's the three sentences from the bottom
5 that begins, "Stranded costs are calculated," do you
6 see that sentence?

7 A. Yes, got it.

8 Q. Okay. So, in that sentence the UtiliPoint
9 report talks about stranded costs associated with
10 generation, transmission and distribution assets,
11 correct?

12 A. Correct.

13 Q. If you could turn to page 4 of Exhibit
14 RCB-6CX, so the UtiliPoint report, page 4, and that's
15 exhibit page number 4, your Qualifications page.

16 A. Thank you. Yes.

17 Q. In the second paragraph, three sentences in,
18 there is a sentence that reads, "During the past seven
19 years, he has directed ten feasibility reports on
20 municipal takeover attempts across the United States."
21 The "he" in that sentence is you, correct?

22 A. Me, right.

23 Q. And this is from 2008, looking back seven
24 years?

25 A. Correct.

0173

1 Q. In the past six years how many feasibility
2 reports have you conducted?

3 A. I'm trying to think. Actually, maybe two or
4 three. I am trying to -- I had a lot and it's hard
5 for me to remember at this point. But as far as
6 reports ever used like the Jefferson County one, I
7 believe it was -- it's two or three.

8 Q. Okay. So, less than in the seven years from
9 2008, is that --

10 A. Yes.

11 MS. GAFKEN: Okay. Thank you. I have no
12 further questions.

13 JUDGE MOSS: Thank you, Ms. Gafken.
14 Anything from the bench?

15 COMMISSIONER GOLTZ: Just one quick
16 question. Following up on what Mr. Trotter said in
17 your Exhibit RCB-4, in your testimony on page 17, you
18 say, Exhibit -- at the very top, lines 1 through --
19 starting line 1, "Exhibit RCB-4 provides an analysis I
20 prepared of utilities I am aware of forming since
21 1973." So what's the basis of that number? What
22 information did you have that gave you that awareness?

23 THE WITNESS: I've been --

24 COMMISSIONER GOLTZ: It makes it sound like
25 it was -- 40 was kind of it, but you obviously missed

0174

1 a couple, and so I don't know if this is a floor or a
2 ceiling.

3 THE WITNESS: The -- I've been involved with
4 the issue for over 15 years now, and have records on
5 most utility formations.

6 COMMISSIONER GOLTZ: Records meaning what?

7 THE WITNESS: Like the actual, you know, did
8 the utility form and when. And there is two ways to
9 look at the information. It's hard to track because
10 it's there is over 3200 utilities, electric utilities
11 in the United States. But we do have a couple of
12 sources of information. You have the media, you have
13 the cases you are involved with, and the American
14 Public Power Association for Municipal-Owned Electric
15 Systems publishes a directory, and in that directory
16 on some utilities, not all, they give a birth date.

17 So, taking that combination of information
18 together, is how I came up with the list, and then
19 researched each formation in terms of its history,
20 tried to look for whether it was a voluntary sale, or
21 did it involve some threat of condemnation.

22 So, there is many, many small utilities out
23 there. If you look at the list, for example, you will
24 find I believe 20 something of these are Alaskan
25 communities that formed in the last couple of

0175

1 decades. They maybe have a hundred customers, right?
2 They don't put a news release out, you know, on those,
3 so I'm sure there is some out there.

4 But generally speaking, there is a very rare
5 event in the industry. It's not necessarily rare to
6 look at it, but it is rare to take it to where
7 Jefferson County is, where they actually formed a
8 utility through that process. So, the cases where
9 they were sort of in a condemnation or a hostile
10 approach is where I tend to focus, if I want to also
11 illustrate where I had knowledge, where there were
12 other ones that formed through other means.

13 COMMISSIONER GOLTZ: And in the course of
14 researching these, this number, I gather you must have
15 looked at a record for each one of these of some sort?

16 THE WITNESS: Yeah, I did my best, yeah.

17 COMMISSIONER GOLTZ: But you didn't -- you
18 did not go the next step and ascertain how any gain
19 was allocated?

20 THE WITNESS: Well, to me it kind of goes
21 back to the other testimony. Each of these are unique
22 cases, and I'm sure are determined on their unique
23 features. And so the purpose of my testimony, my
24 background is engineering and the valuation concepts
25 involved. And so what I'm trying to present is more

0176

1 that perspective for your consideration of policy, you
2 know, that what is applicable here, why, you know, why
3 from my perspective, when I do a calculation I look at
4 the value and the money involved here, where does that
5 analysis kind of, you know, come from, if absent all
6 other factors of law, legal considerations, whatever
7 your statutes are --

8 COMMISSIONER GOLTZ: So are you saying you
9 didn't look for how gain was allocated, or you looked
10 and you didn't report it?

11 THE WITNESS: Well, it wasn't material to my
12 testimony.

13 COMMISSIONER GOLTZ: I understand.

14 THE WITNESS: Some of them, you know, I have
15 some knowledge of. I was involved in at this case so
16 I am not trying to testify to those cases and what
17 happened.

18 COMMISSIONER GOLTZ: So you didn't look for
19 it or you looked for it and you didn't report it?

20 THE WITNESS: I didn't look for it for
21 purposes of this, no.

22 COMMISSIONER JONES: Mr. Bellemare, good
23 afternoon.

24 THE WITNESS: Good afternoon.

25 COMMISSIONER JONES: You were the primary

0177

1 author of the UtiliPoint study, were you not?

2 THE WITNESS: Correct.

3 COMMISSIONER JONES: When was that submitted
4 to PSE and how did Mr. Karzmar use that in his
5 negotiation with JPUD?

6 THE WITNESS: My understanding is the PUD
7 might have used it more. I don't know how they -- how
8 it was used in negotiations. But the number came out
9 where I had suggested it would be. In here I said
10 without the transmission and substation assets, we
11 would have a number of about 77 million. If you end
12 up buying it, because that was a consideration, I said
13 it would be over a hundred million.

14 And actually, I feel like this report was
15 extremely accurate in its forecast, even though it was
16 a preliminary report. So, that was the guidance we
17 gave, that in our view, if you look at Jefferson
18 County, it would be about a hundred million dollars.
19 So I don't know how they used that exactly in
20 negotiating.

21 COMMISSIONER JONES: Your testimony RCB-1T
22 focuses heavily on the going concern issue, does it
23 not? You develop an expectation using a DCF formula
24 of what the value should be of the company on a net
25 present value basis over a long period of time.

0178

1 THE WITNESS: Well, when you start a
2 valuation you try to look at the floors of what the
3 expectation would be. So the minimum price, not
4 necessarily fair market price, but it's like what
5 would even get me interested.

6 And here I am making an assumption that the
7 proceeds would go back to the investors to the amount
8 I'm talking about. So in other words, I believe I
9 came up with a number of about 76 million in here.

10 COMMISSIONER JONES: You did.

11 THE WITNESS: And some of those are
12 transaction costs, 2 or 3 million, and the rest is an
13 analysis that if I were advising an investor of a
14 company to saying somebody walked in and said I want
15 to buy this thing from you, you know, where would I
16 start, so that to make me whole, make me interested --
17 not make me whole, but make me even interested in the
18 transaction, that's the kind of approach I'm using
19 here. And as an appraiser we are required to look at
20 three methods or approaches.

21 COMMISSIONER JONES: So which methods;
22 comparable sales?

23 THE WITNESS: Asset, which is cost plus
24 appreciation; and the income approach.

25 COMMISSIONER JONES: Right, the income

0179

1 approach.

2 THE WITNESS: And then our task is to
3 reconcile that into a fair market value.

4 COMMISSIONER JONES: Have you had a chance
5 to review Mr. Karzmar's testimony when they filed the
6 accounting petition, SSO-5?

7 THE WITNESS: I'll take a look at it. It
8 might be the one --

9 COMMISSIONER JONES: Please. And you may
10 have heard me this morning asking questions.

11 THE WITNESS: Yes.

12 COMMISSIONER JONES: But I think you know
13 that of the different valuation methods, income, comp,
14 comparable sales, market sales, the company landed on
15 the, what is called RCLD or RCNLD?

16 THE WITNESS: Right.

17 COMMISSIONER JONES: It's basically
18 reproduction cost minus accumulated depreciation,
19 right?

20 THE WITNESS: Correct.

21 COMMISSIONER JONES: That's where the
22 company landed. And that's where JPUD seemed to land,
23 too. They were both arguing over valuation based on
24 this method.

25 THE WITNESS: Well, as far as the fair

0180

1 market value determination.

2 COMMISSIONER JONES: Right. Could you turn
3 to page, let me see, in SSO-6, could you turn to page
4 16. Actually, it's 15 and 16. I think Mr. Trotter
5 may have referred to this earlier today.

6 THE WITNESS: I'm sorry.

7 MR. TROTTER: Mr. Jones, I'm sorry, do you
8 mean SSO-5?

9 COMMISSIONER JONES: SSO-5. What did I
10 say? 6? I apologize. SSO-5.

11 THE WITNESS: I've got it.

12 COMMISSIONER JONES: Turn to pages, let's
13 just go through pages 15, from line 10, to 16, page
14 11.

15 THE WITNESS: Uh-hum.

16 COMMISSIONER JONES: And this is no longer
17 confidential. But it cites your work, and it says
18 "UtiliPoint" -- on lines 15 and 16, that's your study,
19 right?

20 THE WITNESS: Right.

21 COMMISSIONER JONES: -- "included a \$15
22 million going concern value as part of its 77 million
23 all-in acquisition price," right?

24 THE WITNESS: In here they are referring to
25 the number without the transmission substation assets.

0181

1 COMMISSIONER JONES: Correct. And this
2 doesn't include the rights of way and the land values?

3 THE WITNESS: Correct.

4 COMMISSIONER JONES: Right?

5 THE WITNESS: Right.

6 COMMISSIONER JONES: And then, you are not a
7 lawyer, are you?

8 THE WITNESS: No. But sometimes I get
9 accused of being one, so.

10 COMMISSIONER JONES: So, you were not
11 involved in the company's deliberations on possibly
12 going to condemnation, going to a jury and --

13 THE WITNESS: No. I provided some
14 calculations in here, as you will see reference as far
15 as when they were negotiating.

16 COMMISSIONER JONES: But Mr. Karzmar goes on
17 to state that "PSE assumed it might be able to recover
18 going concern damages in the range of 15 to 20
19 million," right?

20 THE WITNESS: That's what it said here.

21 COMMISSIONER JONES: Okay. And then going
22 to the next page, what I'd like to end up and ask you
23 a question on, in line 7 to 11, so basically it says
24 that PSE and JPUD, even though they used reproduction
25 cost less depreciation methodologies, they agreed to

0182

1 disagree upon the distance and measure of going
2 concern damages. However, if you take the high JPUD
3 all-in number, RCNLD of 83 million, PSE arguably
4 recovered 20 million in going concern damages, which
5 is the upper end of our 15 to 20 million range by
6 agreeing to a purchase price of 103 million?

7 So my question to you is, if the company
8 through Mr. Karzmar negotiated an asset price like
9 this based on RCNLD and your study, the going concern
10 damages or the going concern value is already built
11 into it, isn't it?

12 THE WITNESS: I'm sorry, into which number?

13 COMMISSIONER JONES: Into these numbers?

14 THE WITNESS: Into the 103?

15 COMMISSIONER JONES: Yeah.

16 THE WITNESS: Well, we have to be careful
17 about definitions, I guess. What is going concern
18 damages? From a valuation perspective, going concern
19 to me is the value above the asset value. So, this
20 is --

21 COMMISSIONER JONES: It's above the asset
22 value? That's not what Mr. Karzmar and company said.

23 THE WITNESS: Right. There is a
24 different --

25 COMMISSIONER JONES: So you are saying

0183

1 something different than the company here. The
2 company agreed to this price.

3 THE WITNESS: Right. 103 million.

4 COMMISSIONER JONES: And going concern, the
5 way I read that, it's in there. The company did not
6 --

7 THE WITNESS: It's incorporated into that
8 number, right.

9 COMMISSIONER JONES: Right.

10 THE WITNESS: As even my testimony supports,
11 in that the going concern from -- of investors'
12 perspective of this business, has a value that's
13 related in my testimony here. This value was over and
14 above that. So, my thought process here is, the
15 shareholders would expect to receive roughly 76
16 million here as the starting point, and above that
17 point is where the deliberations begin as to what to
18 do with the remaining amount. So I think that's what
19 we are trying to talk about here.

20 COMMISSIONER JONES: I think that's your
21 testimony, but I don't think it's the company's
22 position. The company's position is reflected in the
23 ultimate negotiated settlement with JPUD in its
24 purchase price. The company did not, when they agreed
25 to 103 million, agree to calculate the valuation of

0184

1 the assets on either comparable sales or an income
2 approach. Your testimony in this case is based on an
3 income approach.

4 THE WITNESS: But that doesn't --

5 COMMISSIONER JONES: That goes over and
6 above, as I see it, the purchase price.

7 THE WITNESS: It doesn't invalidate the
8 income approach being used in terms of what we're
9 talking about today, which is, what is fair
10 compensation, you know, to the investors? Because
11 they've lost permanently 2.2 million a year, and any
12 growth associated with that.

13 COMMISSIONER JONES: I know.

14 THE WITNESS: Yeah.

15 COMMISSIONER JONES: So Mr. Karzmar
16 represented the company in the negotiations, right?
17 This is his testimony.

18 THE WITNESS: In terms of justifying the
19 fair market price, we have to be careful with that.
20 Again, that's -- and that fair market price has proven
21 to be pretty close to probably being accurate in that
22 Jefferson County today has rates that are slightly
23 higher than Puget Sound Energy.

24 COMMISSIONER JONES: I'm not asking about
25 that.

0185

1 THE WITNESS: Yeah, it was used to justify
2 the fair market price, which is --

3 COMMISSIONER JONES: We are talking about
4 valuation and what the company agreed to in the
5 context of the laws and policies of this state. The
6 laws and policies of this state allow a public utility
7 to form a district and to condemn property.

8 THE WITNESS: Right.

9 COMMISSIONER JONES: So, as part of the
10 company's calculation, as I read Mr. Karzmar and the
11 company in SSO-5, is that they took your study and
12 took your approaches, and then they looked at the
13 downside risk of litigation, cost of litigation,
14 condemnation, what they might get, what they might not
15 get. They took everything into account, and they even
16 took the going concern value, going concern damages
17 that you spent a lot of time in your testimony on.
18 And they said, this is a reasonable price and
19 reasonable risk. Isn't that fair to say?

20 THE WITNESS: I'm -- I don't want to read
21 into these words, because they are not my words. So,
22 I -- what it says here is they arguably recovered,
23 it's says arguably, \$20 million in going concern
24 damages.

25 COMMISSIONER JONES: Right.

0186

1 THE WITNESS: Right.

2 COMMISSIONER JONES: That's what it says.

3 THE WITNESS: Right.

4 COMMISSIONER JONES: Okay. Well, I rest my
5 case. No more questions.

6 JUDGE MOSS: Any redirect?

7 MR. QUEHRN: Just a couple questions, your
8 Honor.

9 REDIRECT EXAMINATION

10 BY MR. QUEHRN:

11 Q. Mr. Bellemare, I'd like to refer you back to
12 what I think was cross-examination Exhibit RCB-6CX,
13 which is the UtiliPoint study.

14 A. Yes, I've got it here.

15 Q. And I'd like to call your attention -- page
16 numbers are a challenge here, I think it's page number
17 15 at the top, and it would be section 2.4 of your
18 analysis.

19 A. Yes.

20 Q. And could you please review the statements
21 in your report, I think there were three relevant
22 portions of bottom two paragraphs, short paragraphs?

23 A. Right. When we did this report, we were
24 looking at a range of 0.5 to two and a half times
25 revenue as the range of going concern that you see in

0187

1 transactions. And so we used the low end of that, and
2 you have to remember the purpose of this report was
3 not to present a valuation. It was to really do a
4 test of the financial feasibility of pursuing the
5 formation of a utility.

6 Q. So if you would have taken the high end of
7 your parameters for measuring going concern damages,
8 what would that have been in this instance?

9 A. That would have been 70 million, yes.

10 Q. And do you characterize your analysis of
11 going concern damages in this particular report as
12 being aggressive or not aggressive, or --

13 A. I consider it conservatively low, as it says
14 here. Again, this was kind of a flunk test model,
15 where I'm trying to make low cost assumptions for what
16 I believe the outcome could be for Jefferson County,
17 and then incorporate the economics of that and test
18 feasibility. So yes, it's obviously in that range.

19 Q. Now I'd like to -- this is difficult, all of
20 us trying to speak for Mr. Karzmar, but I would like
21 to go back to his testimony, please. And in
22 particular this time, so this would be, I'm sorry,
23 it's exhibit -- I'm sorry, could someone help me with
24 the exhibit reference? SSO-5. Mr. Karzmar has a
25 further discussion of this 15 to \$20 million, and I'd

0188

1 like to take you to page 17 of his testimony, lines 5
2 through 12.

3 A. Okay.

4 MR. TROTTER: Excuse me, Counsel. Is the
5 page number in the upper right or the lower right?

6 MR. QUEHRN: I need to get the correct copy
7 of the exhibit. Just bear with me for a second,
8 please.

9 JUDGE MOSS: Just to be clear, the number in
10 the upper right of this exhibit is the exhibit number
11 page. And I believe based on your reference to line
12 numbers, you are probably looking at page 16 of the
13 exhibit, assuming we are talking about going concern
14 value.

15 MR. QUEHRN: I think we're close. Just
16 please bear with me. I get challenged electronically
17 because I give it one click and it goes more than one
18 page and it drives me crazy.

19 I think it's page 17. Thank you. Page 17
20 of 23.

21 JUDGE MOSS: Of the exhibit?

22 MR. QUEHRN: Of the exhibit.

23 JUDGE MOSS: All right.

24 BY MR. QUEHRN:

25 Q. And I'm referring then to the paragraph that

0189

1 begins, "Based upon the valuation analyses discussed
2 above." Have you found that?

3 A. Yes.

4 Q. Okay. So in that context, Mr. Karzmar is
5 again referring to the 15 to \$20 million conservative
6 characterization of going concern damages from your
7 report, correct?

8 A. Correct.

9 Q. And Mr. Karzmar states that "much of the
10 upside in PSE's high end number was embedded in
11 potential arguments in support of going concern
12 damages," correct?

13 A. Yes.

14 Q. Now, when you do a valuation, Mr. Bellemare,
15 and you do the income approach, is it characteristic
16 that there are assumptions and variables that
17 essentially are reflected in the income approach
18 analysis?

19 A. Yes, yes.

20 Q. And as was the case here, and I know you had
21 done some analysis, I think you did one on the PUD
22 numbers, you found quite a range, is that correct?

23 A. Correct.

24 Q. And I think that range was at least within
25 the upside here that Mr. Karzmar refers to as an

0190

1 upside of 136 million and the downside which was 58, I
2 believe.

3 A. Those were the ranges of value that were
4 being discussed.

5 Q. So, would you interpret Mr. Karzmar's
6 statements, since we are all doing that, as the upside
7 in this instance, and his conservative reliance on 15
8 to \$20 million was perhaps some concern of taking that
9 issue to a jury?

10 A. It says so right here.

11 Q. Have you ever testified before a jury?

12 A. A judge, not a jury.

13 Q. A judge.

14 A. They forfeited the jury rights in that case.

15 MR. QUEHRN: Thank you. No further
16 questions.

17 JUDGE MOSS: Okay.

18 COMMISSIONER DANNER: Can I ask a question?

19 JUDGE MOSS: Go right ahead.

20 COMMISSIONER DANNER: Are you aware of any
21 case where it has gone to a jury or through
22 condemnation or otherwise where the company did not
23 end up getting the net book value or something above
24 that?

25 THE WITNESS: The cases I'm aware of were

0191

1 all in excess of net book value.

2 COMMISSIONER DANNER: Are you aware of any
3 case where it has not been?

4 THE WITNESS: No. But I can understand
5 certain circumstances where that might be the case.

6 COMMISSIONER DANNER: Such as?

7 THE WITNESS: Such as, let's say, and I
8 don't know if it's a condemnation case, but some
9 circumstances that might be extreme, such as there is
10 a high cost, some investment is needed to serve an
11 area, and it might be better rather than for that
12 utility to incur that cost, that that area be changed
13 over to another utility.

14 And so, built into the price, even though
15 it's not exclusive because they didn't write the check
16 for it, is the value of some benefit that's not really
17 accounted for in directly by the check that was
18 written, or exchanged hands.

19 So, there can be circumstances where you
20 would get less than book value, you know. But there
21 is probably, to the point made earlier, there is
22 probably other circumstances involved in that
23 situation. Or it's just a bad ruling, you know.

24 COMMISSIONER DANNER: Because, I am getting
25 back to Dr. Levin's testimony, where he was saying

0192

1 there is a difference between the risk of doing
2 business and the risk of owning an asset.

3 THE WITNESS: Yes.

4 COMMISSIONER DANNER: And yet the risk of
5 owning an asset, everything I see is, the only risk is
6 how much of the upside you get. I'm not seeing the
7 downside yet. So it seems that the company is getting
8 a better end of the deal than the consumers in such a
9 scenario.

10 THE WITNESS: As has been talked about many
11 times here, we're a regulated business, right? In
12 exchange for that there are certain things that
13 occur. For example, the rate of return that is set,
14 is in this case was about 9.8, right. In other
15 industries you see more like 15 percent, right. So we
16 trade off certain things.

17 COMMISSIONER DANNER: Of course, there are
18 other industries that are considerably lower than
19 that, too.

20 THE WITNESS: Yes. They don't usually hang
21 around very long, you know. They usually have to
22 change their way of doing business. And I will give
23 you another example. We talk a lot about risk on the
24 negative side, but there is also risk on the other
25 side, like a rate-based generation asset, let's say

0193

1 it's producing power for 4 cents a kilowatt hour, but
2 the market price is 7 cents, as an example.

3 Well, the owner of that asset is forfeiting
4 those opportunities as well, because that has been
5 rate base dedicated to the customers, right? So we
6 have all kinds of issues in this industry, you know,
7 as far as how we, you know, what is fair, reasonable
8 and that Type of concept, so.

9 COMMISSIONER DANNER: But isn't it also part
10 of the regulatory compact that you get a certain
11 amount of stability because your risk is reduced, and
12 that means your reward is reduced as well?

13 THE WITNESS: And therefore, I exchange that
14 for a lower rate of return, yes. That's the nature of
15 how we solve this industry, because we are so capital
16 intensive, you know, the cost of capital is extremely
17 important. And the ability to raise that capital and
18 have confidence, you know, in the return of that
19 investment, and that's what I'm trying to point out
20 here.

21 A point was made earlier that, oh, they can
22 just take the proceeds and go buy other stock, let's
23 say somewhere else. Well, that's true, if you
24 dividend this out. Well, what are you going to pay
25 for that stock? You know, the equivalent, if I lose

0194

1 2.2 million a year in earnings and I want to replace
2 that investment, I can't replace it at net book
3 value. I have to go out on the market and buy stock
4 in some other utility, and that's going to be at the
5 cost I tried to represent in my testimony.

6 The PE multiples are 18, 2.2 million times
7 18 is, you know, almost \$40 million. And why would I
8 do that? There have to be incentives so I get some
9 premium, 20 percent or so. That's the nature of my
10 testimony. The investor's perspective from a
11 valuation lens like I have, in order to at least make
12 me interested in this transaction, that's what I need
13 to recoup.

14 And I think that's what I'm trying to
15 communicate here through this testimony. And
16 municipalization is a very rare event. That's the
17 other point. I don't think, in my view it's really
18 built into the ROE. We can debate that forever,
19 right, but when I look at the rarity of the issue, and
20 having lived it, it's a very rare event, you know, to
21 have a utility form.

22 And in Washington, I don't see it, you know,
23 there is a larger portion of load here served by
24 public utilities. We have to remember, BPA tier 1
25 power, that inexpensive power that Jefferson County

0195

1 got, they are only setting aside 250 megawatts more of
2 that for newly formed utilities.

3 Jefferson County already bit into that by 30
4 megawatts. I think 50 megawatts is for tribes. I
5 think there is only about 150 megawatts of this left.
6 And then everything else is pretty much at market
7 price. So as far as power goes.

8 And even if you can get it, look at what's
9 happening in Jefferson County. Just as my report
10 predicted, they are not making any money. They
11 budgeted a loss for this year. Their bills are now
12 higher than Puget Sound Energy. Slightly, but if you
13 do that for residential credit as proposed, the gap
14 will get even bigger. They just announced a cost of
15 service study because they don't even know what their
16 costs are. They said in the paper.

17 So I don't see this as perceived as a normal
18 risk of business, even though there are a few
19 instances where they form. But if you weren't able to
20 get a good price like you did here, I think it's
21 reasonable for investors to expect to get more than
22 net book value in this area.

23 COMMISSIONER DANNER: But this gets back to
24 my original point, is, it seems that they have. I'm
25 just not aware of any place where they have gotten

0196

1 less than net book value in any of these proceedings.

2 If it's condemnation, fair market value --

3 THE WITNESS: Net book value isn't
4 sufficient in and of itself because you haven't
5 compensated before entirely for the loss of that
6 future earnings. That's a difference between like an
7 asset to me, where there is no customers involved, I'm
8 just selling the power plant, you know. I still have
9 the same number of customers after that event so it
10 has a different economic profile than here, where I
11 lost a service territory. I have lost those customers
12 permanently. I have no way to really make up for it.
13 My earnings in the future are forever damaged.

14 You asked the right question earlier. Did
15 Puget Sound Energy's capital budget go up because of
16 Jefferson County? No. I mean, we have the same
17 capital needs. Actually, they are less because
18 Jefferson County left. So, there seems to be in this
19 case adequate compensation provided at that price to
20 go beyond net book value because net book value only
21 returns what's left of what you invested, not what the
22 real value of those earnings are. Does that make
23 sense?

24 COMMISSIONER DANNER: Yeah. I mean, we have
25 to sort out what the responsibility is because it's a

0197

1 different -- it's a different atmosphere. I mean,
2 this is basically it's a monopoly. It's headed by the
3 government. There is all of the signals, even though
4 it's a rare event are there that there is a
5 possibility. So these are all things that we have to
6 deliberate on.

7 THE WITNESS: Absolutely. I understand.

8 COMMISSIONER DANNER: All right. Thank you.

9 JUDGE MOSS: Anything further?

10 MR. QUEHRN: No, your Honor.

11 JUDGE MOSS: Just one quick question,
12 Mr. Bellemare.

13 THE WITNESS: Sure.

14 JUDGE MOSS: When looking at the rarity of
15 the occurrence of this type of an event, I was
16 wondering if you looked at a different -- another type
17 of event we haven't talked about, which is when cities
18 or towns or other municipalities, when they annex
19 territory and they have their own utility already, I
20 would think it would be fairly commonplace for them to
21 take over the distribution assets and add them to
22 their own utility system, or maybe I'm wrong about
23 that. I was just wondering if you looked into that at
24 all?

25 THE WITNESS: It's not, from my -- I don't

0198

1 have the data on how many of those things occur, but
2 I've been around the industry for almost 30 years
3 involved in a lot of these situations, and it's a rare
4 event in and of itself.

5 Oftentimes what you see there also in other
6 states, sometimes even in territorial agreements, are
7 formulas that say -- that's why we put the range, 0.5
8 to two and a half times revenue for going concern,
9 because oftentimes those, they have more of a
10 formulaic approach in that they say, you will pay
11 replacement costs less depreciation, plus going
12 concern, sometimes 10 years of revenue, and any
13 separation damages. So Jefferson County is a unique
14 thing in that it was its own essential electric
15 island.

16 Most of the situations I get into we have a
17 much more complicated situation, where we have assets
18 that are going to be stranded, or have to build
19 duplicate facilities in order to separate the system.
20 Fortunately we didn't have that in that case. So even
21 then it's a rare event. It goes back to almost -- the
22 point I was making earlier where you see maybe
23 something that the original cost appreciation number
24 is actually below. That would be in a situation where
25 it's just cheaper to serve, you know, from another

0199

1 utility.

2 Or I've seen it become an emotional issue.

3 I want to grab territory, you know. I don't care if
4 it costs me that much. I'll do it because I want to
5 grow. And so, yeah, it happens. But it's driven for
6 a variety of reasons in their own cases are unique and
7 oftentimes governed by some state statute and/or a
8 territorial agreement between the utilities.

9 JUDGE MOSS: Right. And those wouldn't
10 necessarily show up as a hostile situation then.

11 THE WITNESS: They are normally not. As far
12 as I know, they are normally not hostile, you know.
13 What can be somewhat hostile is an annexation, let's
14 say, you know, where you are taking territory from
15 somebody else in that sense. You know, it depends on
16 the state. I am not familiar with Washington, but,
17 you know, you see these kind of scenarios, usually
18 involving a few customers. They are not of the size
19 and scale we see in terms of this.

20 JUDGE MOSS: Thank you very much. All
21 right. With that I believe we have completed your
22 cross-examination and other testimony. We will let
23 you step down. I'm sorry, are you done with
24 redirect?

25 MR. QUEHRN: Yes.

0200

1 JUDGE MOSS: I'm sorry, I just had a follow-
2 up question. Who wants to follow up on my questions?

3 THE WITNESS: Do we have a question?

4 JUDGE MOSS: No. You're finished. We are
5 just having a little private chat, a publicly private
6 chat.

7 Now, Mr. Gorman is next. Are you on the
8 phone, Mr. Gorman?

9 MR. GORMAN: Yes, I am.

10 JUDGE MOSS: Okay, great. And we can hear
11 you clearly, which is good.

12 I think, you have at least witnessed me do
13 this before, if you haven't participated in it
14 personally, so you know we go through the formality of
15 giving you the oath. And I on my end at least will go
16 through the formality of rising and raising my right
17 hand, and if that solemnity is something that concerns
18 you, you may do the same thing on your end, or if you
19 don't, I'll never know.

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

23 THE WITNESS: I do.

24 JUDGE MOSS: Thank you, sir. Your exhibits
25 have been stipulated, your prefiled exhibits

0201

1 stipulated into the record. The cross exhibits have
2 not.

3 Counsel, do you see any need to inquire of
4 Mr. Gorman, or should we just go straight into the
5 cross?

6 DIRECT EXAMINATION

7 BY MR. PEPPLER:

8 Q. I'll just ask whether Mr. Gorman has any
9 corrections to that testimony.

10 A. I do not.

11 MR. PEPPLER: He is available for cross-
12 examination.

13 JUDGE MOSS: Great. Before we do that,
14 Mr. Gorman, I apologize. At one point I neglected
15 with our previous witness, Ms. Gafken, I don't recall
16 that you offered your exhibits.

17 MS. GAFKEN: Thank you for that. And
18 actually, I think it goes back to Mr. Piliaris as
19 well, there are four exhibits there that I don't have
20 marked that I offered them, but I would like to offer
21 those four exhibits as well as the two for
22 Mr. Bellemare.

23 JUDGE MOSS: Anticipating there won't be any
24 objections, and there are apparently are not, so those
25 six exhibits then will be admitted.

0202

1 (Exhibits JAP-16CX, JAP-17CX, JAP-18CX,
2 JAP-19CX, RCB-5CX, RCB-6CX were admitted.)

3 MS. GAFKEN: Thank you.

4 JUDGE MOSS: Counsel, if you check, if you
5 notice at the end of the day there are any others, be
6 sure to address whether they should be part of that
7 record.

8 So, with that, Mr. Gorman is available for
9 cross-examination, and I believe the company has
10 indicated approximately 15 minutes. We'll see where
11 that goes.

12 MR. QUEHRN: Thank you, your Honor. I
13 actually have, in the interest of time and efficiency
14 as a procedural question here, I would like to have
15 the relatively few cross-examination exhibits entered
16 into the record, if that's acceptable to counsel. But
17 I don't feel compelled to engage in further cross-
18 examination at this point.

19 JUDGE MOSS: All right. Well, are there
20 objections to any of the proposed cross-examination
21 exhibits for Mr. Gorman?

22 MR. PEPPLER: No objection.

23 JUDGE MOSS: Apparently there is no
24 objection, and so we can admit 4CX through 9CX for
25 Mr. Gorman.

0203

1 (Exhibits MPG-4CX, MPG-5CX, MPG-6CX,
2 MPG-7CX, MPG-8CX and MPG-9CX were admitted.)

3 JUDGE MOSS: And with that, Mr. Gorman -- is
4 there anything from the bench for Mr. Gorman?

5 COMMISSIONER JONES: A couple.

6 JUDGE MOSS: Okay. Commissioner Jones has a
7 couple of questions for you, so it won't be completely
8 anticlimactic for you to appear here today,
9 Mr. Gorman.

10 COMMISSIONER JONES: Good afternoon,
11 Mr. Gorman.

12 THE WITNESS: Good afternoon.

13 COMMISSIONER JONES: A couple of questions.
14 On page 3 of your testimony -- do you have your
15 testimony in front of you?

16 THE WITNESS: I do.

17 COMMISSIONER JONES: Okay. On lines 23
18 through 25 you come up with this calculation of what
19 you refer to as gross gain. And the way I understand
20 that is basically the sales proceeds minus the
21 original cost of the investment, is that correct? And
22 transaction -- and some transaction costs.

23 THE WITNESS: The gross gain would be the
24 difference between the sales transaction and the net
25 investment and transaction costs. Essentially it

0204

1 makes the company whole for their outstanding
2 investment, characterizes the rest as gains, and from
3 that I separated into the portion that is accumulated
4 depreciation and then gain in excess of the original
5 investment cost, original gross investment cost of the
6 asset.

7 COMMISSIONER JONES: So, this is a big
8 picture question, just why do you prefer this method
9 as opposed to the method that Mr. Dittmer for public
10 counsel and the Company uses in which they develop net
11 book value, add in certain costs to get a gain of 60
12 million, and then the difference between the gross
13 proceeds and the 60 million is their calculation. You
14 have different methodologies that arrive at the same
15 number except for the Company's. Three of the parties
16 are fairly close; the company is not close. But why,
17 why do you prefer this methodology as opposed to an
18 NBV, a net book value type of methodology?

19 THE WITNESS: Well, I was examining how to
20 take the sales in excess of the unrecovered costs to
21 the company, how to best develop a way of allocating
22 that between customers and shareholders, and in doing
23 so, recognizing the standard of risk versus reward and
24 benefit versus gain.

25 Towards that objective, the risk and reward

0205

1 was assessed based on the company's need to make
2 investments in utility plant equipment and offer
3 utility service. Their risk of fully recovering that
4 investment, part of the investment had been recovered
5 through customer charges already, so that the risk of
6 recovering costs which have already been recovered is
7 essentially non-existent.

8 So I developed an allocation of a part of a
9 gain based on taking away the gross gain, the amount
10 which was paid for through depreciation charges or
11 depreciation expense charges. The customers that were
12 booked at accumulated depreciation and decided that
13 entirely through customers.

14 Then I looked at the gain in excess of the
15 original gross plant investment and prescribed the
16 method that I believe properly recognizes the risks
17 and rewards of investing in a utility plant and
18 equipment based on regulatory procedures and
19 accounting mechanisms and regulatory process. And
20 based on that portion of the gain, I recommended 90
21 percent being allocated.

22 COMMISSIONER JONES: Right.

23 THE WITNESS: And 10 percent --

24 COMMISSIONER JONES: And I'll get to that in
25 a minute. Okay. My second line of questioning is on

0206

1 the ROE. were you able to listen to the recent
2 exchange with Mr. Bellemare on how much if any risk,
3 upward risk or downward risk is built into the ROE for
4 the risks of municipalization in condemnation?

5 THE WITNESS: Yes.

6 COMMISSIONER JONES: And what's your
7 position on that? Your position appears to be that
8 some level of risk in terms of basis points is built
9 into the ROE already, right?

10 THE WITNESS: There is -- the ROE reflects
11 the total investment risk of the company, and the risk
12 of investing in a utility company is based on whether
13 or not you will receive your expected return on that
14 investment. That's the bottom line assessment of all
15 the risk that a utility and a utility investor
16 shoulders when they decide to make that investment.

17 So, when we measure the return on equity for
18 a utility, it is the return investors demand in order
19 to commit their capital to the utility to allow it to
20 invest in utility plant and equipment.

21 One of these risks is that the utility will
22 be required to either retire equipment early, retire
23 the plant early, or it will be damaged or become
24 obsolete and would be required to be written off
25 sooner than the original expected life of the asset.

0207

1 That's an ongoing business risk to the company.

2 COMMISSIONER JONES: Right.

3 THE WITNESS: So the question then is, is
4 there regulatory mechanism, is there accounting
5 mechanism to mitigate that cost recovery risk to the
6 utility. And I believe that there are. And that
7 while that risk reduces an investor's risk, it doesn't
8 make the risk go away. It simply transfers the risk
9 from the investors to the customers, through either
10 the regulatory mechanisms or the accounting mechanisms
11 that mitigate that investor risk.

12 COMMISSIONER JONES: So you are basically
13 equating, and I've read your testimony and the
14 company's rebuttal of your testimony on this point,
15 but you are basically equating accelerated retirement
16 of useful plant for service with a condemnation
17 proceeding, or some sort of municipal taking of that
18 property, are you not?

19 THE WITNESS: Well, not exactly. I mean,
20 what I'm trying to do is describe whether or not
21 investors take all the risk of making investments
22 devoted to regulated services, or whether or not there
23 is an allocation of that investment risk between
24 investors and customers.

25 Early plant retirement and other factors

0208

1 that cause a utility to terminate the -- an asset
2 operation earlier than its expected useful life
3 results in the utility not being allowed to include
4 that cost in its cost of service over the expected
5 useful life. So then I examined whether or not the
6 utility is exposed to not recovering the full
7 investment in that equipment.

8 And in making that examination I considered
9 other instances where an asset is either retired early
10 because of obsolescence, again, or damage to the
11 equipment, either through natural or other means. And
12 based on that assessment, I concluded that investors
13 don't assume all the risk of a utility making an
14 investment in plant and equipment, that that risk is
15 largely transferred to customers of the utility
16 because of the accounting mechanisms.

17 And I found that in this instance, that risk
18 is very similar to terminating utility plant and
19 equipment operations in the event of an --

20 COMMISSIONER JONES: Okay. And then finally
21 my last question is, why 10 percent of the allocated
22 gain? On page 16 of your testimony, line 11, you
23 state you've made a 10 percent adjustment in favor of
24 the company in my proposed allocation, but there is
25 very little backup of how you landed on 10.

0209

1 The only thing in your testimony I can find
2 is on page 15, lines 8 and 9, you state, customers
3 bear, quote, "the vast majority of risks and burdens
4 associated with PSA sales of JPUD assets." So "vast
5 majority" to me means something, you know, 85, 90, 95
6 percent. But I'd like a little more precision, if you
7 can give it to me, on how you calculated based on this
8 risk/benefit and burden --benefit follows burden,
9 specifically, what, what weight you gave to specific
10 risks transferred to customers that -- where you
11 landed on 10 percent of the net gain?

12 THE WITNESS: It was largely a judgment
13 call. And in reaching that judgment, again, I looked
14 at how much of the original investment cost had
15 already been recovered by the company, by rates paid
16 by customers that allowed for recovery appreciation
17 expense. I considered the risk to customers of
18 providing the company full cost recovery, of other
19 instances where an asset's life is terminated due to
20 events beyond the company's control or within the
21 company's control, recognizing then that the customers
22 do take significant amount of asset cost recovery
23 risk.

24 A 10 percent sharing I thought provided some
25 incentive for the company to try to maximize its sale

0210

1 proceeds price. 10 percent of the proceeds provides
2 roughly a 10 percent on the net book value of the
3 asset, after full cost recovery of the transaction
4 cost, which is in line with the rate of return they
5 would have otherwise earned on it on an annual basis,
6 if they would have continued to own and operate those
7 assets and depreciated them over their expected useful
8 life.

9 COMMISSIONER JONES: So in your calculation,
10 the bottom line number that you have in the allocation
11 of the appreciation amount is about \$3 million, is it
12 not?

13 THE WITNESS: Yes, that's right. That's
14 shown in my table 1 on page 5.

15 COMMISSIONER JONES: Table 1 on page 5. And
16 that is opposed to staff's -- staff and public counsel
17 come up with different amounts, do they not, a little
18 bit higher than yours?

19 THE WITNESS: That's right, yes.

20 COMMISSIONER JONES: Okay. Well, thank
21 you. Those are all my questions.

22 JUDGE MOSS: All right. Anything,
23 Mr. Pepple, for Mr. Gorman after that?

24 MR. PEPPLER: No.

25 JUDGE MOSS: Okay. Well, thank you for

0211

1 being with us today, Mr. Gorman. That will release
2 you from the stand.

3 THE WITNESS: Thank you. Appreciate it very
4 much.

5 JUDGE MOSS: We have two more witnesses for
6 whom cross has been indicated, Mr. Dittmer and
7 Mr. Keating. Do you have cross of these witnesses?

8 MR. QUEHRN: I will have questions for
9 Mr. Keating. I would also be willing to do the same
10 thing with Mr. Dittmer that I did for Mr. Gorman.
11 It's just offer up the cross-examination exhibits and
12 not ask questions.

13 JUDGE MOSS: All right. Does the bench have
14 questions for Mr. Dittmer? Yes, no? Want to think
15 about it?

16 I tell you what, Mr. Dittmer, stay with us
17 through our 10-minute break and we will resolve this
18 question afterwards. Let's take our afternoon break
19 and be back at 3:15.

20 MR. TROTTER: Your Honor, before we go off
21 the record, I neglected to move into the record the
22 Exhibits MRM-76C through 10 -- excuse me, MRM-7CX
23 through 10CX, so I move them in.

24 JUDGE MOSS: All right. Any objections?
25 Apparently not, so those will be admitted.

0212

1 (Exhibits MRM-7CX, MRM-8CX, MRM-9CX and
2 MRM-19CX were admitted.)

3 (Short recess.)

4 JUDGE MOSS: All right. Let's go back on
5 the record.

6 JAMES DITTMER,
7 having been duly sworn was called as a witness herein,
8 and was examined and testified as follows:

9 THE WITNESS: I do.

10 JUDGE MOSS: Please be seated.

11 Ms. Gafken, go ahead.

12 DIRECT EXAMINATION

13 BY MS. GAFKEN:

14 Q. Please state your name for the record.

15 A. James R. Dittmer.

16 Q. And who is your employer and what is your
17 position?

18 A. My employer is UtiliTech, Inc., and I am a
19 senior consultant with that firm. And UtiliTech, Inc.
20 was in turn hired by public counsel for this
21 litigation.

22 Q. Mr. Dittmer, your testimony and exhibits
23 that were prefiled were earlier admitted into the
24 record. Do you have any changes or corrections to
25 those?

0213

1 A. I do not.

2 Q. And do you have in front of you copies of
3 cross exhibits that were sent in by PSE?

4 A. I do.

5 MS. GAFKEN: Mr. Dittmer is ready for cross.

6 JUDGE MOSS: Okay. I have confirmed during
7 the break that there are no objections to the
8 admission by stipulation of the cross exhibits
9 designated by PSE which consist of 4CX through 9CX, I
10 believe. And those would be admitted as marked.

11 (Exhibits JRD-4CX, JRD-5CX, JRD-6CX,
12 JRD-7CX, JRD-8CX, JRD-9CX were admitted.)

13 JUDGE MOSS: I believe we have questions
14 from the bench.

15 COMMISSIONER DANNER: I guess I'll start.
16 You've heard various suggestions on how the gains
17 would be allocated if we are going to go that
18 approach, and you've come up with a 5 percent/95
19 percent allocation. Could you tell me in your own
20 words the basis for that and why you would take a
21 different position than some of the other parties?

22 THE WITNESS: Well, first of all, other than
23 the company, we are very close, although the other two
24 parties are very close. The reason I take extreme
25 exception to the company's position is a combination

0214

1 of things. Probably the biggest concern or biggest
2 weighing factor is the harm that I believe remaining
3 customers will experience as a result of loss of
4 sale. I do believe there were stranded costs as was
5 pointed out to be probable in the original UtiliPoint
6 study.

7 I would admit that it's not an exact
8 science, a precise science, but there is little doubt
9 during the first four or five years following the loss
10 of the load that there will be stranded costs on the
11 production side, the power supply cost side.

12 I understand there is confusion and
13 different views on the delivery side, but I submit
14 that there is some stranded costs that will be borne
15 certainly after this current rate plan is in effect
16 for Puget. So that's the primary reason I think the
17 majority of the gain should go to customers.

18 I also talk about, as do ICNU and staff,
19 that there is a risk follows reward, basically the
20 regulatory compact, that I think the utilities are
21 fairly well protected from any of the business risks
22 that other non-regulated companies, you know, are not
23 protected from. So, I don't believe the shareholders
24 have the right to that much of the gain, if any of the
25 gain in this case, because they are -- they have a

0215

1 very good chance to earn their authorized rate of
2 return or certainly avoid punitive losses, as
3 Commission such as yourself frequently, regularly,
4 provide for recovery of costs that other companies
5 would have -- non-regulated companies would have to
6 absorb.

7 As far as the 5 percent going to the
8 utility, the primary reason for that is just to make
9 sure there is an incentive for them to maximize the
10 price in the future, and, you know, to give some
11 weight to prior Commission precedent in the Centralia
12 case of some gain going to the shareholders.

13 COMMISSIONER DANNER: So, this dichotomy of
14 the risk of doing business versus the risk of
15 ownership, do you agree with that assessment, and do
16 you see that there is risk of ownership that's
17 different than the risk of --

18 THE WITNESS: I didn't really raise that in
19 my testimony. I just look at it as a relatively risk-
20 free operation. I understand there is arguments about
21 business risk and ownership risk, and I haven't delved
22 into that argument. I just at a higher level think
23 that utilities are fairly, fairly well taken care of
24 as far as large exposure to risk of write-offs of
25 plant.

0216

1 COMMISSIONER GOLTZ: So to maybe follow up a
2 little bit, I heard sort of two different things. One
3 is you allocate 95 percent and 5 percent based on an
4 allocation of the risks. The other thing is, well,
5 it's a hundred percent to the rate payers, but we need
6 to have an incentive payment of something so we will
7 throw in 5 percent. Is that, is the latter, kind of,
8 that's what I glean from your testimony.

9 THE WITNESS: Yes. I do think that there
10 should be some incentive, or it's reasonable to give
11 some incentive to the utility to maximize that price,
12 although I also say, I think utilities have an
13 obligation to work hard for the rate payers, not just
14 for their shareholders.

15 COMMISSIONER GOLTZ: And would they have
16 incentive even if it was a hundred percent/zero, would
17 they still -- would they have no incentive or would
18 they have some incentive anyway?

19 THE WITNESS: Well, incentive or
20 obligation. I mean, I am of the camp that believes
21 that utility management should work very hard to lower
22 the long-term costs for its customers. And do they
23 need an incentive to do that? There is a lot of
24 theories about arguments about that they do, incentive
25 comp and other arenas, but, you know, I will

0217

1 acknowledge that, you know, giving them some incentive
2 should in theory push them to work harder.

3 COMMISSIONER GOLTZ: And so, assume that's
4 correct, and we were to agree with that, that in
5 general the gain goes to the rate payers, with the
6 exception of incentive payment, incentive allocation,
7 what principles do we look to to define what that
8 incentive allocation would be? I mean, there is 10,
9 there is 5, more than that? But is there a principle
10 we look at, or do we just kind of pick a small number
11 or a middle sized number and do it?

12 THE WITNESS: Noticeably absent from my
13 testimony is the formula on how I came to the 5
14 percent. There are components that I discuss that
15 it's difficult to say, okay, this, I'm giving 75
16 percent, I'm going to multiply that times, you know,
17 30 million. I didn't go through that calculation.

18 There is some judgment call in this. And
19 I'm sorry if I'm disappointing you, but I don't have
20 any more precise than that to offer.

21 COMMISSIONER DANNER: Okay, I'm sorry, but
22 of course that's why we are asking the question. Some
23 of the other incentive suggestions that we've had
24 though do have some bases. Did you review those? Did
25 you have any thoughts on those, or it's just one is as

0218

1 good as the other and it's really throwing something
2 at the wall and seeing what sticks?

3 THE WITNESS: The other -- you mean the
4 other splits, you mean?

5 COMMISSIONER DANNER: Yes. For example, I
6 mean, Mr. Keating hasn't testified yet, but in his
7 testimony he basis it on some analogies. Do you --

8 THE WITNESS: Well, I think it's an end game
9 that I have. I mean, in the end we are very close,
10 and I would not -- I would not -- I am very
11 comfortable making my recommendation to you. But it
12 is not the hill to die on, to say that my allocation
13 is better than Mr. Keating's or Mr. Gorman's, because
14 they are all very close. And there is some judgment
15 in it. It's just not precise in my mind.

16 COMMISSIONER DANNER: Well, we have to find
17 a rational basis for what we're doing?

18 THE WITNESS: Then use mine. Then use mine.

19 COMMISSIONER DANNER: Thanks.

20 JUDGE MOSS: Expert testimony.

21 COMMISSIONER JONES: So you make your
22 calculation on the gain on sale of about 50, roughly
23 \$60 million, it's a similar calculation that the
24 company does, right?

25 THE WITNESS: Yes.

0219

1 COMMISSIONER JONES: So you take the
2 proceeds minus net book value, add in some transaction
3 costs, and then you come up with 60 million. And then
4 you allocate 5 percent to the shareholders and 95
5 percent to the rate payers, that's roughly it, right?

6 THE WITNESS: Correct.

7 COMMISSIONER JONES: Okay. So why is your
8 methodology, or does it even matter, why is your
9 methodology better or worse than what staff and ICNU
10 use where they come up with this concept of gross gain
11 and appreciation?

12 THE WITNESS: Well, I don't know if they are
13 better. The results are very much in the ballpark.

14 COMMISSIONER JONES: Right.

15 THE WITNESS: I mean, the reason that I went
16 through the math that I did, number one, that's the
17 way I've seen it done more often with Washington, you
18 know, I am aware of the Centralia calculation and the
19 reasoning and so forth.

20 But just in my other experience, there
21 aren't many gains out there. It isn't like we've got
22 dozens and dozens I can talk to you about. There are
23 a few, and that's the way I've most often seen it
24 done.

25 But beyond that, you know, I am aware of the

0220

1 company argument that accumulated depreciation, if
2 anybody paid for it, it was the departing customers.
3 And I give some weight to that. I think there is a
4 counter to that also, but that went to my reasoning to
5 just go right to the net gain above book value, the
6 way I've seen it done in other jurisdictions.

7 COMMISSIONER JONES: And the net gain that
8 you calculate, or the allocated gain to the company is
9 roughly in line with Mr. Gorman's, right? Yours is
10 2.998 million, his is 3.002 million, right, something
11 like that?

12 THE WITNESS: Yes.

13 COMMISSIONER JONES: They are very --

14 THE WITNESS: Someone has laid them out very
15 nicely for it us. They are very much in the
16 ballpark. They were close enough. It was not
17 something to get that concerned about.

18 COMMISSIONER JONES: And then you spent a
19 lot of time in your testimony in JRD-1T on the harm
20 analysis, right?

21 THE WITNESS: Yes.

22 COMMISSIONER JONES: Okay. And so you state
23 that in the initial years on the stranded cost issue
24 there are going to be net net harm to the rate payers,
25 but it's going to even out, or it's going to shift

0221

1 over time, and it's very difficult to determine over a
2 five to 20 year period where it's going to end up,
3 right?

4 THE WITNESS: Well, particularly on the
5 power supply costs.

6 COMMISSIONER JONES: I am talking mainly on
7 NPC, not power costs now or power supply.

8 THE WITNESS: Okay. I didn't --

9 COMMISSIONER JONES: So, the question is,
10 when do you think -- I think in your testimony you say
11 several years of harm could easily be demonstrated,
12 but over a longer period of time it will shift. Can
13 you give us an idea of when your best guess is? Is it
14 four, five, six years?

15 THE WITNESS: Well, I think it's --

16 COMMISSIONER JONES: I think it's in one of
17 your exhibits?

18 THE WITNESS: JRD-4, the first four years,
19 2014 through 2017, there are 10 plus million dollars
20 worth of harm.

21 COMMISSIONER JONES: Right.

22 THE WITNESS: Then we jump into 2018, into a
23 gain situation. And it kind of flips back and forth
24 in the years after that. Now, that was based, just
25 based on the company's base case.

0222

1 COMMISSIONER JONES: Right.

2 THE WITNESS: What I state is, and I firmly
3 believe this, the front year harm, they are much more
4 knowable and much more precise than the out year
5 gains. And that's applicable to any study, any
6 company, it's not unique to this situation or Puget.
7 So, I think Puget has made the argument in the past,
8 you pay more attention to the front end of these long-
9 term studies because they are more knowable.

10 But the other thing, I mean, that has become
11 a little more obvious to me since this testimony was
12 prepared, and I talk about it in the testimony, that
13 this, these results are very dependent upon when you
14 assume that next power plant comes in. At least
15 that's what it looks like to me when I looked at their
16 output.

17 What drives their savings is them being able
18 to delay that next power plant. And what I talk about
19 in the testimony, if the load forecast is too
20 optimistic, then these savings calculations are
21 probably too optimistic from the company's camp.

22 And what I've learned since is they are
23 lowering their forecast. They expect to lower their
24 forecast. So that tells me that I have a concern
25 about that out year savings when I wrote this. I have

0223

1 a much bigger concern now, because I think those
2 savings are going to be less, or evaporate or become
3 negative when the new load forecast comes through.

4 COMMISSIONER JONES: So as the load forecast
5 goes down, the anticipated savings in column E here in
6 this exhibit will be the net benefits, if you will,
7 will go down as well?

8 THE WITNESS: Go down, pushed down, which
9 that the same impact.

10 COMMISSIONER JONES: Push down.

11 THE WITNESS: Yeah. And of course, benefit
12 down the road, further down the road the more it gets
13 discounted, net present value, it becomes less and
14 less, smaller and smaller dollars, the mass of net
15 present value.

16 COMMISSIONER JONES: Right. Then finally on
17 the crediting mechanism, you advocate, I think, for a
18 bill credit over four years of the company's
19 authorized rate of return, right?

20 THE WITNESS: I certainly am okay with
21 that. I think the main concern is that the funds get
22 returned with interest, you know. Whether it's bill
23 credit or the rates, but as long as there is a
24 carrying cost applied to the unreturned balance.

25 COMMISSIONER JONES: Okay. And you would

0224

1 prefer that as opposed to a lump sum method?

2 THE WITNESS: I think that's a policy call.

3 On a net present value basis it shouldn't matter that
4 much.

5 COMMISSIONER JONES: It should not. You are
6 an economist, though, right?

7 THE WITNESS: I am an accountant.

8 COMMISSIONER JONES. You are an accountant,
9 okay. And you love these net present value
10 calculations?

11 THE WITNESS: I put up with them. I don't
12 really love them. I live with them.

13 COMMISSIONER JONES: Okay. That's all I
14 have.

15 JUDGE MOSS: All right. Anything from
16 public counsel?

17 MS. GAFKEN: I just have one clarification
18 question.

19 JUDGE MOSS: Sure.

20 FURTHER DIRECT EXAMINATION

21 BY MS. GAFKEN:

22 Q. Mr. Dittmer, in response to a question from
23 Commissioner Jones you mentioned PSE's position about
24 departing customers and their relationship with
25 depreciation, but you also indicated there was a

0225

1 counter, but you didn't say what the counter was.

2 Would you elaborate on that, please?

3 A. Well, number one, you know, the company
4 makes the argument that the depreciation, if anybody
5 paid for it, it was the departing customers. Well, I
6 understand that argument. I considered that
7 argument. But one thing is for sure, the shareholders
8 didn't pay for that accumulated depreciation because
9 there was either, you know, departing customers or
10 remaining customers, number one.

11 Secondly, I mean, just if you think about
12 this was a high cost area, there seems to be no
13 dispute about that. The Jefferson County rates were
14 to some extent subsidized, because you have average
15 rates across the system, and rural customers pay the
16 same as Metro customers. It wasn't by design, I don't
17 mean subsidized in a bad, negative way, it's just the
18 way the math works. They were getting a little better
19 deal than what their true cost to serve them was.

20 And as I state in testimony, on a fully
21 allocated cost basis they were not paying their full
22 weight. So who was paying that? The remain
23 customers. So when you think about those type of
24 equity arguments, I think that the depreciation
25 reserve should be considered as having been paid for

0226

1 in a round about way by the remaining customers.

2 Q. And prior to the sale, who bore the risk of
3 loss with respect to those assets? By "those assets"
4 I mean the Jefferson County assets.

5 A. The rate payers in general. I mean, all the
6 rate payers.

7 MS. GAFKEN: Okay. That's all I have.

8 JUDGE MOSS: All right. Nothing further,
9 Mr. Dittmer. We appreciate you being here today, and
10 Hope you have a pleasant flight home tomorrow.

11 Mr. Keating.

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

15 THE WITNESS: I do.

16 JUDGE MOSS: Please be seated.

17 DIRECT EXAMINATION

18 BY MR. TROTTER:

19 Q. Please state your name and spell your last
20 name.

21 A. Edward Keating, it's K-E-A-T-I-N-G.

22 Q. And are you the same Edward Keating who
23 prepared and filed testimony in this docket that has
24 been admitted as EJK-1T through EJK-8?

25 A. I am.

0227

1 MR. TROTTER: The witness is available for
2 cross.

3 JUDGE MOSS: Thank you very much.

4 All right, this will be the company's cross.

5 MR. QUEHRN: Thank you, your Honor.

6 CROSS-EXAMINATION

7 BY MR. QUEHRN:

8 Q. Good afternoon, Mr. Keating.

9 A. Good afternoon.

10 Q. I'd like to begin by having you refer to
11 page 8 of your testimony, please. I think I want to
12 look at lines 9 through 11. Now, is it your
13 testimony, as you state here that -- your testimony is
14 that a hundred percent of the accumulated depreciation
15 should be allocated to the customers, correct?

16 A. That amount equivalent to the accumulated
17 depreciation that's recorded on the company's books.

18 Q. Now, Mr. Marcellia was asked to state his
19 favorite definition of "depreciation." I don't think
20 I'm going to ask you that. I am going to try a
21 different approach. Is it a fair statement to say
22 that paying a depreciation expense, the customers are
23 essentially paying for a portion of the asset that has
24 been used or consumed in service?

25 We can go to a definition. I'm just looking

0228

1 for a general --

2 A. An accounting definition of "depreciation,"
3 I would accept that.

4 Q. Do you think the Jefferson County customers,
5 PSE's former customers, paid any portion of the
6 accumulated depreciation that we have accounted to the
7 Jefferson County assets?

8 A. Rate payers just pay, you know, rates are
9 set on a system-wide basis. So, some of the rates
10 that were paid might have gone to that. It's not
11 really line by line item. I don't know if we track it
12 that way, but --

13 Q. But you would concede that perhaps some of
14 it was --

15 A. Some of it might have flown that way.

16 Q. Okay. Now, in connection with your analysis
17 of accumulated depreciation, your conclusion, did you
18 try to make any attempt to determine what portion of
19 this accumulated depreciation might have been paid by
20 former customers?

21 A. No. Like I said in my testimony, I defer to
22 Mr. Piliaris' testimony.

23 Q. I want to change focus here for a moment and
24 now I'd like to take you, please, to page 20 of your
25 testimony.

0229

1 A. Okay.

2 Q. Line 14, you are asked the question, "Which
3 of these decisions did Staff find most useful in this
4 case," referring to a series of prior decisions by the
5 Commission. And if I'm correctly understanding your
6 testimony, I think you were saying that the Centralia
7 decision was the most useful of the referenced
8 precedents, is that correct?

9 A. The Centralia decision provided valuable
10 guidance as to how to break up the proceeds. That's
11 what I meant by that, correct.

12 Q. Now, to your reading of the Centralia
13 decision, was the Commission called upon in that case
14 to address a sale of an asset under threat of
15 condemnation?

16 A. Not that I am aware of.

17 Q. Okay. And in the Centralia case, was the
18 Commission called upon to address a loss of service
19 territory?

20 A. Not that I am aware of.

21 Q. And in that case was the Commission called
22 upon to address loss of customers?

23 A. No.

24 Q. Do you know in that case, was the question
25 before the Commission a question whether or not they

0230

1 should approve the asset transfer?

2 A. I believe, I believe that was part of the
3 filing.

4 Q. Okay. Now, Mr. Keating, specific to the
5 case before us, I have some questions for you. Is it
6 your understanding that the sale of the assets, the
7 Jefferson County assets to JPUD, to Jefferson County
8 Public Utility District, involved the sale of assets
9 to a governmental entity under threat of condemnation?

10 A. Yes.

11 Q. And is it your understanding that the sale
12 of assets to JPUD, as I will refer to them, actually
13 involved the entirety of Puget's distribution system
14 in Jefferson County?

15 A. In Jefferson County, yes.

16 Q. Jefferson County. And is it your
17 understanding that the assets that were sold, that the
18 transmission and distribution assets that were sold
19 were assets that were rate based prior to the sale?

20 A. Yes.

21 Q. And finally, is it your understanding that
22 when this sale closed and JPUD took possession and
23 ownership of PSE's assets, that PSE was relieved of
24 its public service obligations in that service area?

25 A. Yes.

0231

1 Q. Just shifting focus again, Mr. Keating, is
2 it your understanding that as a consequence of the
3 sale of the Jefferson County service area, let me --
4 sorry, let me rephrase the question.

5 Is it your understanding that PSE lost the
6 Jefferson County load as a consequence of the sale of
7 the service area?

8 A. Yes. They will no longer be serving that
9 load, yes.

10 Q. Are you aware of any fact or circumstance or
11 would offer any thought in terms of why that might be
12 some sort of temporary or short-term circumstance,
13 going to get it back?

14 A. The load from Jefferson County customers?
15 You will not get that back.

16 Q. Now, is it also your understanding that PSE
17 lost approximately, I don't have the exact number, but
18 approximately 18,000 customers when it sold the
19 Jefferson County service territory?

20 A. Yes.

21 Q. Now, had PSE not lost these customers, we
22 still had them, would it be reasonable to assume that
23 we would receive revenues from these customers?

24 A. You would be receiving, yes, the revenues
25 from those customers based on the rate base.

0232

1 Q. So, is it a fair correlation to say that in
2 this instance, the loss of customers also attributed
3 to a loss of revenues from those customers?

4 A. You will no longer receive revenues from
5 Jefferson County customers.

6 Q. Finally, I was going to ask you some
7 questions about the home loan analogy, but I think
8 someone else is planning to do that. Let me just go
9 one other place. I want to go all the way back to
10 near the end of your testimony, page 35, and when you
11 make an observation some of the other witnesses made,
12 let me see if I can find an exact reference here of
13 lines 14 through 16, on page 35. And actually, let's,
14 please take a look at lines 13 through 16.

15 A. Okay.

16 Q. Now, it's Staff's position that the amount
17 of the gain, the amount of the \$60 million gain to be
18 shared in this case with -- I'm sorry, to be allocated
19 in this instance to shareholders is 7.5 million, is
20 that correct?

21 A. Correct.

22 Q. And you analogize this to a standard fee
23 that maybe a broker would get in connection with
24 negotiating a deal, is that correct?

25 A. That was one of the analogies used, yes.

0233

1 Q. So, would a fee be sort of an incentive to
2 do this, is that the meaning behind this, or did you
3 have some other sense of why we should get this fee?

4 A. Well, this was under the incentive section.
5 I outlined a few reasons, actually in the Centralia
6 order, the majority talked about an incentive. The
7 dissent, Hempstead also talked about incentive and
8 mentioned a brokers fee. And like I said, real estate
9 sales you generate about 6 percent as the transaction
10 fee, or the broker's fee when you sell property.

11 Q. Okay. So let me ask you a hypothetical
12 question here. And you can assume this is a regulated
13 business or a non-regulated business. For purposes of
14 this question I'm not sure it matters.

15 If you had a business that was generating
16 approximately \$30 million a year in annual revenues,
17 would you -- in your view would you be incented to
18 sell that business for \$7.5 million?

19 A. If you were generating 30 million net
20 income, gross revenues, doesn't make a difference to
21 me. Net income?

22 Q. Net income.

23 A. Was that what Jefferson County was netting?

24 Q. I'm just saying -- that's a hypothetical.

25 A. I don't want to compare the two because

0234

1 that's makes a big difference in my mind. Let's say,
2 if, \$10 million, I mean, that's --

3 Q. I'm sorry. Let's go back to gross
4 revenues. We can -- so you if had a business that in
5 terms of gross revenues was generating \$30 million a
6 year, I assume your answer is going to be it depends,
7 but would you be incented to sell that business for
8 \$7.5 million?

9 A. I see, okay, I see what you mean. You are
10 assuming that you get back in the asset value as well,
11 correct? You are not selling the entire business with
12 the assets for 7.5 million, you are selling the
13 assets, getting your full net book back plus an extra
14 7.5 million, correct?

15 Q. I am selling the whole business, lock, stock
16 and barrel.

17 A. For \$7.5 million?

18 Q. No. Would I be incented -- I understand
19 your question.

20 A. I want to make sure I understood yours. I
21 didn't mean to ask you a question.

22 Q. Let me ask the question differently. I'm
23 trying to understand how a business that generates
24 annual revenues in the neighborhood of \$30 million a
25 year, how one would be -- what would incent someone to

0235

1 sell that for \$7.5 million if that's all they got
2 above their investment?

3 A. For an unregulated business, probably
4 nothing. For a regulated business or one that is
5 condemned, there is no choice in the matter. And an
6 incentive is there is something above and beyond that
7 technically in a regulated industry isn't necessarily
8 mandatory.

9 So, in the private world, unregulated world,
10 I would agree with you. I would probably -- there is
11 too many variables. I don't know what your net income
12 is, I don't know what the asset side is. I can't
13 really answer that. But I understand your point, I
14 do. And that's why I think you need to distinguish
15 between regulated and unregulated, and condemnation
16 versus non-condemnation.

17 MR. QUEHRN: Okay. Thank you, I have no
18 further questions.

19 JUDGE MOSS: Thank you. Anything from the
20 bench for Mr. Keating?

21 COMMISSIONER JONES: A couple.

22 Mr. Keating, hello.

23 THE WITNESS: You are forgetting about me.

24 COMMISSIONER JONES: No, I'm not forgetting
25 about you. So, this whole issue, and I think counsel

0236

1 just addressed questions to you on what the business
2 is worth, 18,000 customers, this much revenue on a
3 going concern basis, what do you think of that
4 argument?

5 THE WITNESS: I understand where counsel is
6 trying to go, but I don't particularly agree with it
7 in this case.

8 COMMISSIONER JONES: Why not?

9 THE WITNESS: Let me tell you why. The net
10 book value of the assets, for rate base rate of return
11 regulation you earn your return on rate base, net book
12 value of the assets, that's how the utility earns its
13 money, if you will. Its margin, its profit.

14 In this instance, the 46.7 million is the
15 net book value that they were earning a return on.
16 And if you look at the company's capital structure, 48
17 percent, only 22 and a half, .5 million of that is
18 actual investor equity, wouldn't you agree, because
19 that's their capital structure.

20 So, Staff's proposal is actually giving them
21 7.5 million on top of the 22.5 million, which is a 33
22 percent return on investment, which is pretty good in
23 my opinion. If you look at it from that point of
24 view, shareholder investment is 22 and a half million,
25 Staff's proposal gives them that 22 and a half million

0237

1 back plus another 7.5 million, that's a 33 percent
2 return. So I think that's pretty good incentive. And
3 I think that's a pretty good return.

4 I'm not sure if I answered your question.

5 COMMISSIONER JONES: I get a sense you are
6 just getting going.

7 THE WITNESS: I started going too fast. I
8 need to slow down.

9 COMMISSIONER JONES: Well, you probably
10 heard my exchange today, I forget, with Mr. Bellemare
11 and Mr. Marcelia about Karzmar's testimony in SSO,
12 what is it 6 or 5, and the way that price was
13 calculated. The gross proceeds price I think at the
14 end of the day there, there was consideration of
15 litigation risk of condemnation.

16 THE WITNESS: Correct.

17 COMMISSIONER JONES: You do agree that there
18 is a risk of condemnation in this state?

19 THE WITNESS: I do.

20 COMMISSIONER JONES: Okay. So you are
21 taking that into account?

22 THE WITNESS: I am.

23 COMMISSIONER JONES: Okay. And so there is
24 litigation risk, condemnation risk, and on the other
25 hand it appears to me that the company did a pretty

0238

1 good job in negotiating a price, a certain price above
2 net book value. Net book is what?

3 THE WITNESS: 46.

4 COMMISSIONER JONES: Is there any
5 disagreement among the parties on net book value of
6 46?

7 THE WITNESS: As far as I know, there is no
8 disagreement on any of the numbers.

9 COMMISSIONER JONES: Is there any
10 disagreement among the parties about the gain of
11 roughly 59 or \$60 million?

12 THE WITNESS: No.

13 COMMISSIONER JONES: Okay. So we are just
14 disagreeing about issues like who gets the accumulated
15 depreciation and who gets, in your definition the,
16 quote, "appreciation," or in Mr. Dittmer's, the net
17 gain, above that, right? That's what we're arguing
18 about today.

19 THE WITNESS: That's what we are arguing
20 about, the allocation of the proceeds, or as the
21 company says, the allocation of the accounting term
22 net gain, which is anything above net book value.

23 COMMISSIONER JONES: How did you land -- I
24 think in your testimony you refer to Hermiston?

25 THE WITNESS: Correct.

0239

1 COMMISSIONER JONES: The Oregon Public
2 counsel -- the Oregon Commission decision on Hermiston
3 that allocated 95 percent to rate payers, 5 percent to
4 the Company, right?

5 THE WITNESS: Correct.

6 COMMISSIONER JONES: You also refer to
7 Centralia. You say there is a range of zero to 50
8 percent in terms of allocation to shareholders,
9 right? So who is at zero, who is at 50?

10 THE WITNESS: Okay. In my -- yeah, I was
11 talking in my case history, just a few of the examples
12 of this Commission. We have the Centralia was at --

13 COMMISSIONER JONES: What page are you on?

14 THE WITNESS: Page 19 of my testimony.

15 COMMISSIONER JONES: Okay.

16 THE WITNESS: Starting on page, or excuse
17 me, line 12.

18 COMMISSIONER JONES: Okay.

19 THE WITNESS: I just laid out a few of the
20 past sales, asset sales.

21 COMMISSIONER JONES: So can we just go
22 through those six one by one, and just clarify for me
23 the allocation of the gain between shareholders and
24 rate payers.

25 THE WITNESS: Sure. In WUTC versus Avista

0240

1 Corporation, PacifiCorp and Puget Sound Energy,
2 commonly referred to as the Centralia docket, the
3 sharing was 50/50 of the appreciation.

4 COMMISSIONER JONES: Okay.

5 THE WITNESS: Appreciation, which in this
6 case would come out to 25 percent, which is my
7 proposal.

8 COMMISSIONER JONES: Okay.

9 THE WITNESS: Qwest Corporation, docket
10 120128, that was a settlement. It came out to 50/50
11 of the appreciation as well, which is equivalent to
12 the proposal I have of.

13 COMMISSIONER JONES: Okay.

14 THE WITNESS: The Colstrip, sale of the
15 Colstrip plant which the Commission ruled on, however
16 the company never sold, was a hundred percent of the
17 gain to rate payers.

18 COMMISSIONER JONES: So that was the one
19 where the company shareholders get zero, rate payers
20 get a hundred percent.

21 THE WITNESS: Correct.

22 COMMISSIONER JONES: Okay.

23 THE WITNESS: Another, WUTC versus Puget
24 Sound Power & Light, Cause Number 85-53, the
25 Commission allocated all of the gain from the sale of

0241

1 surplus, non-appreciable property to rate payers, a
2 hundred percent to rate payers of the gain, zero to
3 the shareholders.

4 COMMISSIONER JONES: And in that case, just
5 to be fair, there was no depreciable property in that
6 case?

7 THE WITNESS: Right.

8 COMMISSIONER JONES: It was just
9 undepreciated land.

10 THE WITNESS: Right. Rate payers still got
11 all the gain, correct.

12 The other one, WUTC versus Puget Sound Power
13 & Light, Third Supplemental Order, 89-2688, a hundred
14 percent to rate payers, again, of the gain.

15 The other one, Washington versus -- excuse
16 me, WUTC versus Washington Water Power, 87-1533, a
17 hundred percent of the gain to rate payers.

18 COMMISSIONER JONES: Okay.

19 THE WITNESS: So there is a range there of
20 between 50 percent to a hundred percent, or excuse me,
21 zero percent to a hundred percent of the gain. And --

22 COMMISSIONER JONES: So in your assessing of
23 the these various cases, these precedents, did you
24 weight them in any particular order? Centralia was
25 obviously there was a dissent of Hempstead, there was

0242

1 a majority decision. I think these others were
2 unanimous. But tell me how you went about weighting
3 these various decisions, because you would agree that
4 these are unique circumstances with a condemnation,
5 correct?

6 THE WITNESS: Correct, correct. I didn't
7 necessarily weight them. The 50 -- the last two on
8 the list, meaning the most recent, both had an
9 allocation methodology that staff is proposing in this
10 case where they recognized what we are calling
11 appreciation, accumulated depreciation, and net book.
12 So staff did, or I should say I did use, maybe weight
13 those more than the others only because they were more
14 recent, the last orders regarding sales of assets.

15 COMMISSIONER JONES: So, recent decisions of
16 the commissions carried weight with you?

17 THE WITNESS: They did.

18 COMMISSIONER JONES: Okay. What about this
19 idea of, quote, "the incentive," which is kind of an
20 ill defined term, but Mr. Gorman or ICNU public
21 counsel and you seem to be a bit apart. One is at 5
22 percent, one is at 10, one is at 25 percent. So you
23 appear to be willing to offer the company management
24 more of a, quote, "incentive" to negotiate a good
25 deal. That's the way I see it.

0243

1 THE WITNESS: Yes.

2 COMMISSIONER JONES: What's your response?

3 THE WITNESS: Yes, we did come in, or I,
4 let's say I came in higher than the other parties. I
5 believe that Mr. Dittmer and Mr. Gorman are really
6 close. Mr. Gorman seemed more -- his 10 percent was
7 more along the lines of what I would term an
8 appreciation, I believe I'm right on that.

9 And so, Mr. Dittmer's, if you split up the
10 proceeds as Staff has proposed, his would be about a
11 90/10, it would be about a 10 percent, we are calling
12 it appreciation.

13 So we are about 15 percent above, excuse me,
14 15 percentage points higher on the appreciation scale
15 than Mr. Dittmer and Mr. Gorman.

16 COMMISSIONER JONES: Now you are confusing
17 me.

18 THE WITNESS: I figured I was.

19 COMMISSIONER JONES: Numerators and
20 denominators. And please don't use the home sales
21 analogy if you don't have to. But when you deal with
22 percentages, let's just talk about gross numbers.

23 THE WITNESS: Okay.

24 COMMISSIONER JONES: The way I read it is,
25 the ICNU proposal would give the company share of the

0244

1 net gain 3 million; public counsel would give them
2 2.998 million; Staff proposal, you would give them 7.5
3 million.

4 THE WITNESS: Correct.

5 COMMISSIONER JONES: Is that correct?

6 THE WITNESS: That is absolutely correct.

7 COMMISSIONER JONES: So there is quite a
8 difference between ICNU, public counsel, right around
9 3, and you at 7.5.

10 THE WITNESS: Right.

11 COMMISSIONER JONES: More than double?

12 THE WITNESS: Well, yeah. Like if you look
13 at it the way we are looking at it from appreciation,
14 meaning anything net book value plus accumulated
15 appreciation, the remainder is called appreciation, we
16 are at 25 percent. They are both approximately 10
17 percent.

18 COMMISSIONER JONES: Okay.

19 THE WITNESS: So we are 150 percent -- I
20 will stop the percentages. We are 150 percent above
21 them if that makes any sense. You're right.

22 And we arrived at that, like I wrote in my
23 testimony, by finding a mid range between historical
24 orders from this Commission between 0 and 50 percent.
25 We hit 25 right in the middle. A broker's fee is

0245

1 approximately 6 percent. We came in at 7 percent.
2 And that's really, it was just judgment. And like I
3 wrote, staff thought they did a very good job of
4 negotiating.

5 COMMISSIONER JONES: Okay.

6 COMMISSIONER DANNER: So, do you give any
7 weight to the fact this does involve an unwilling
8 seller? You are saying that because they are not
9 burdened with the risk of losing their investment,
10 that they are made whole, it's okay. So, the fact
11 that you've got questions about whether this is, you
12 know, a sale under threat of condemnation, is that
13 relevant in your mind?

14 THE WITNESS: We weighed that, but it just
15 ended up not being -- I guess just from a regulatory
16 perspective we looked at it as the sale of an asset
17 and the transfer of the funds and who they go to. We
18 just based it on rate of return regulation,
19 risk/reward.

20 COMMISSIONER DANNER: I mean, you can --
21 where there is a voluntary sale obviously the company
22 has made a decision that there are other places where
23 it would rather spend it is money. In this case, this
24 is where it wants to spend its money, but it can't.
25 Is that --

0246

1 THE WITNESS: It's true. We wrote in here,
2 they are an unwilling seller. There is something to
3 be said for that. I didn't necessarily use that in my
4 analysis or my quantifying the gain, though.

5 COMMISSIONER DANNER: Okay.

6 COMMISSIONER JONES: So, if we were to
7 assume an investor-owned utility doing business in the
8 state of Washington, all within one county, and that
9 county formed a PUD, take over the entire system, so
10 there is nothing left, there is no remaining rate
11 payers, the same principle applies? Net book value is
12 what they get, that's it, say you?

13 THE WITNESS: If there is no remaining rate
14 payers, the company is gone, is that what you are
15 saying?

16 COMMISSIONER JONES: So, under the
17 condemnation statutes, they would be required to pay
18 net book value -- pardon me, net market value.

19 THE WITNESS: Fair market value. Correct.

20 COMMISSIONER JONES: And so, then I assume
21 net book value is 10 and market value is 20. Whatever
22 numbers in those you want. The entire sale goes at
23 20, there is no remaining rate payers. What happens;
24 does the company get it all?

25 THE WITNESS: The shareholders keep it all.

0247

1 COMMISSIONER JONES: Shareholders keep it
2 all. If they -- change the facts a little bit, so
3 there is a little tiny community, the utility losses
4 99 percent of its service territory and they are
5 serving a portion of southeast Olympia.

6 JUDGE MOSS: Your house.

7 COMMISSIONER GOLTZ: Maybe Dave's, too, the
8 chairman as well. The rate payers get all of it?

9 THE WITNESS: Yes. And let me explain why.
10 In this instance, what the company is doing is
11 shedding some of its distribution territory. What's
12 remaining is the fixed production plant. The
13 remaining customers, there is now less customers to
14 contribute to the same amount of fixed production
15 costs. In your instance, if there was a hundred
16 million dollars of fixed production costs and there
17 was a million customers previously, everyone paid a
18 hundred dollars. And now there is only a hundred
19 customers?

20 COMMISSIONER GOLTZ: Yeah.

21 THE WITNESS: They are all now paying a
22 million dollars. So they would need to get any gain
23 on that to compensate for them for the extreme harm
24 that will happen, in the instance they are just
25 selling their distribution system as is the case here

0248

1 in Jefferson County.

2 COMMISSIONER GOLTZ: But it would be
3 different if they are selling generation and
4 everything else?

5 THE WITNESS: If they are selling generation
6 they are not necessarily losing customers, or are you
7 saying they are selling generation and customers?

8 COMMISSIONER GOLTZ: Getting rid of the
9 whole system. In the first hypothetical they are
10 selling the whole system.

11 THE WITNESS: I understand.

12 COMMISSIONER GOLTZ: Everything except for
13 about a hundred customers left, and I'm not saying
14 they are keeping all their generation for all those
15 customers. I am saying they are getting rid of a
16 proportional amount of that too. It seems to me at
17 some point that there is a potential for some unfair
18 benefit to the remaining customers --

19 THE WITNESS: There could be.

20 COMMISSIONER GOLTZ: -- if the customers are
21 sufficiently few and the departing customers are
22 sufficiently large.

23 THE WITNESS: There could be if what you are
24 saying, they sell off an equivalent amount of
25 generation along with the distribution, and it came

0249

1 out to equal, I would agree with you there.

2 How, how you would determine the equities of
3 that I don't know right now without having it in front
4 of me. But I would not necessarily disagree with what
5 you are saying.

6 Harm, as Dr. Levin spoke of, you could try
7 and attempt to calculate a harm or benefit.

8 COMMISSIONER GOLTZ: I have nothing else.

9 COMMISSIONER JONES: Mr. Keating, is there
10 anything you heard today from the other witnesses,
11 Mr. Piliaris, Mr. Bellemare, Mr. Levin, that would
12 change your testimony, your harm analysis, where you
13 conclude, I think in EJK, let's just go to EJK-6, just
14 so I understand that, if you could just walk me
15 through that one more time. This is the summary of
16 harm to rate payers, and you break it into fixed
17 production cost, ERF and decoupling.

18 THE WITNESS: Correct.

19 COMMISSIONER JONES: So just run through
20 that again. Fixed production costs is what other
21 witnesses have referred to as stranded costs. It's
22 basically the fixed cost in the distribution system
23 divided by a fewer number of customers, 16,000 less
24 customers, right?

25 THE WITNESS: Fixed costs of the remaining

0250

1 production plant.

2 COMMISSIONER JONES: Production plant.

3 THE WITNESS: Correct. Right. And then
4 what we -- yeah, with the less, with 18,000 less
5 customers, and we used Mr. Piliaris' load estimates
6 for the next five years.

7 COMMISSIONER JONES: Right.

8 THE WITNESS: And then it's the incremental
9 amount that the remaining rate payers will have to pay
10 due to that loss of those customers.

11 COMMISSIONER JONES: And the ERF, expedited
12 rate filing number I think I get.

13 And decoupling is the RPC, the revenue per
14 customer changes, right? And why is that?

15 THE WITNESS: Mr. Mickelson did the analysis
16 on the ERF decoupling. I put it in my testimony
17 because it flowed better. I am hesitant to answer
18 some of those questions.

19 COMMISSIONER JONES: I will call him on
20 that. But the cumulative harm, you still stand by
21 that over five years, a cumulative harm to the
22 remaining rate payers is \$53 million?

23 THE WITNESS: On a nominal basis?

24 COMMISSIONER JONES: Nominal.

25 THE WITNESS: Yes. Estimate of, because

0251

1 nothing is perfectly known, but that's the high
2 probability of happening, the Staff's opinion, yes.

3 COMMISSIONER JONES: And you haven't heard
4 anything today from Mr. Piliaris that would make you
5 change your opinion, or the Company witnesses?

6 There has been a lot of discussion today
7 about we know more in the short-term, three, four five
8 years; it's difficult to figure out what comes out in
9 the longer term?

10 THE WITNESS: That's why I used the short-
11 term.

12 COMMISSIONER JONES: That's why you used
13 just five years?

14 THE WITNESS: Correct. The long-term is
15 just too speculative. And the analysis done, in my
16 opinion, to show the benefit, net present valuing it
17 back is an investment decision. Usually that type of
18 analysis when you are making an investment, you net
19 present value back expected cash flows to determine
20 whether or not you should make that investment. It's
21 a before the fact calculation. This an after the fact
22 calculation, and it's not an investment. It's not a
23 resource acquisition.

24 So, and it's also known to be wrong, so
25 there was no reason in Staff's mind to use that. It

0252

1 wasn't necessarily whether it was a harm or a
2 benefit. It was just in Staff's opinion, in my
3 opinion, too speculative to use to determine the
4 allocation of over a hundred million dollars in
5 proceeds. That is why I stayed away from that
6 particular analysis and went with the more shorter
7 term higher probability known estimates of you have
8 less customers, you have the same fixed costs, you
9 know exactly the extra amount you are going to have to
10 pay. There is the harm.

11 COMMISSIONER JONES: And then finally on the
12 reinvestment of the proceeds from the net gain here,
13 on page 17 of your testimony, lines 7 and 8, tell me
14 when you are there.

15 THE WITNESS: Okay. 7 and 8?

16 COMMISSIONER JONES: Yeah.

17 THE WITNESS: Yes.

18 COMMISSIONER JONES: So, what you say there
19 in sub 2, you say "PSE" --

20 THE WITNESS: -- "reinvests the proceeds" --

21 COMMISSIONER JONES: -- "in other similar
22 capital projects, as it plans."

23 THE WITNESS: Correct.

24 COMMISSIONER JONES: Did you hear the
25 exchange today with Mr. Marcelia? He was kind of

0253

1 saying, no, we can't spend incremental above the Capex
2 budget. We can't spend any more money because we are
3 limited.

4 So, do you buy that argument, or do you
5 stand -- I assume you are standing by your statement
6 here that they can take the proceeds, invest it in
7 rate base, earn a return of and a return on, and it
8 doesn't harm the Company. Is that what you remember
9 saying?

10 THE WITNESS: Yes. I believe that they are
11 doing that, because -- for the tax treatment. I think
12 they were taking -- they are reinvesting the
13 proceeds. I'm not sure that's what Mr. Marcellia said.

14 COMMISSIONER JONES: Well, what did you hear
15 him say? Is it consistent with your -- I guess all I
16 need to know is, is it consistent with your testimony
17 here, what you heard him say today?

18 THE WITNESS: I did hear something, I guess
19 I misunderstood. I'm not sure what he was talking
20 about when he said he couldn't reinvest that. I
21 missed that part. I contend that you can reinvest
22 those proceeds in similar capital projects, earn your
23 rate of return, because that's how the company earns
24 their profits is their rate of return.

25 So if you just turn around and reinvest that

0254

1 in another asset, which they are already planning on
2 doing, then they are going to get their rate of
3 return. There is no actually loss of income. What I
4 think Mr. Marcellia was talking about was there is no
5 incremental income because they would have continued
6 to have Jefferson County and do this at the same
7 time. In my mind that's not relevant, though. There
8 is no loss to investors.

9 However, I've also said, though, there is a
10 gain on the asset where we just increased the value
11 of -- the equity value of that asset by 33 percent.
12 So instead of getting the ROE on the 22 and a half
13 million, now getting the ROE on 30 million, or you can
14 return that back to the shareholders, it depends on
15 what the board decides.

16 COMMISSIONER JONES: That's all I have.
17 Thank you.

18 JUDGE MOSS: Mr. Trotter?

19 MR. TROTTER: Mr. Keating, you were asked
20 some questions by Company counsel regarding a
21 hypothetical company that earned \$30 million in
22 revenue. Would that company incented to sell for 7
23 and a half million?

24 I want you to assume that company had \$60
25 million in expenses. Would that be -- change your

0255

1 mind about --

2 THE WITNESS: I would be incentivized in a
3 heartbeat to sell for that.

4 MR. TROTTER: And under any scenario, would
5 the answer depend on your alternatives, alternative
6 use of the proceeds of sale?

7 THE WITNESS: Of the alternative use.

8 MR. TROTTER: You have a choice to keep the
9 business going and not sell, right?

10 THE WITNESS: Correct.

11 MR. TROTTER: Then you have a choice to take
12 the money and invest it elsewhere, right?

13 THE WITNESS: Right.

14 MR. TROTTER: Would you go through that
15 analysis to compare the two scenarios and see which
16 one you would be better off under, or not?

17 THE WITNESS: In the \$60 million loss
18 scenario?

19 MR. TROTTER: No. Just hypothetically, if
20 you are selling the company --

21 THE WITNESS: Yes, yes.

22 MR. TROTTER: Okay. You were asked some
23 questions about Centralia. Was that project owned a
24 hundred percent by the IOUs?

25 THE WITNESS: No.

0256

1 MR. TROTTER: Who are the other owners?

2 THE WITNESS: PUDs, I believe.

3 MR. TROTTER: Were there several or just
4 one?

5 THE WITNESS: I'm not sure about that.

6 MR. TROTTER: Is it your understanding that
7 some of the owners of that plant did not want to go
8 forward with certain environmental costs and other
9 things?

10 THE WITNESS: Yes.

11 MR. TROTTER: You were asked questions from
12 Company counsel about, and you answered that the
13 Company will not get back the load of -- that it was
14 serving at Jefferson County, do you recall that?

15 THE WITNESS: Yes. It will not ever have --
16 those Jefferson County customers, it will not get
17 their load back.

18 MR. TROTTER: Did those customers provide
19 contribution to production assets of the company when
20 they were Puget customers?

21 THE WITNESS: Yes.

22 MR. TROTTER: Are those contributions lost?
23 They are not going get -- are they going to get those
24 back?

25 THE WITNESS: Yes. That's the whole point

0257

1 of the fixed cost. There is now less customers, so
2 the remaining rate payers have to pay the incremental
3 more for the same amount of fixed costs, correct.

4 MR. TROTTER: Did PSE sell any production
5 assets in this deal?

6 THE WITNESS: No.

7 MR. TROTTER: And approximately how many
8 customers did they have in Jefferson County?

9 THE WITNESS: 18,000.

10 MR. TROTTER: And do you know approximately
11 how many they have in the entire system?

12 THE WITNESS: A million, approximately.

13 MR. TROTTER: So, are we -- we are close to
14 the point where we might just have a few customers
15 left over and who gets the gain?

16 THE WITNESS: Nowhere near.

17 COMMISSIONER GOLTZ: That was a good
18 hypothetical, wasn't it?

19 THE WITNESS: Home loan?

20 MR. TROTTER: That's all I have. Thank
21 you.

22 JUDGE MOSS: Mercifully we are staying away
23 from that.

24 All right, Mr. Keating, I believe that
25 completes your examination. Thank you for your time

0258

1 on the stand. You may step down.

2 Now, we have Mr. Mickelson left. Nobody has
3 indicated cross. Are there questions from the bench?
4 I am seeing heads shaking to the negative.

5 Mr. Mickelson, it appears that you have
6 mercifully escaped the stand, or perhaps you were
7 looking forward to being on the stand. In any event,
8 your prefiled exhibits were stipulated in. There were
9 no cross exhibits, which brings me to the question,
10 Mr. Quehrn, did you want to do anything with the cross
11 exhibits you identified for Mr. Keating?

12 MR. QUEHRN: Thank you, your Honor, for
13 reminding me. I would actually, if there is no
14 objection from Mr. Trotter, ask that they be
15 stipulated to the record.

16 MR. TROTTER: That's fine.

17 JUDGE MOSS: All right. Mr. Trotter is
18 feeling a sense of comity today. We will have those
19 in the record as marked.

20 (Exhibits EJK-9X, EJK-10X, EJK-11X, EJK-12X,
21 EJK-13X, EJK-14X, EJK-15X, EJK-16X, EJK-17X, EJK-18X,
22 EJK-19X, EJK-20X, EJK-21X, EJK-22X, EJK-23X were
23 admitted.)

24 JUDGE MOSS: Well, that brings us to the
25 conclusion of the evidentiary hearing insofar as the

0259

1 business I plan to conduct.

2 Do counsel have anything else they wish to
3 take up with me on the bench today?

4 Then I would like to thank you all for a
5 very professional presentation from all parties. I
6 think counsel all did a great job today, and I
7 appreciate it very much.

8 We will look forward to your briefs. Is
9 everybody happy with the current schedule on briefs?
10 Well, happy.

11 MR. QUEHRN: Satisfied.

12 JUDGE MOSS: All right. That's fine.

13 COMMISSIONER GOLTZ: There are a couple of
14 things I hope the parties could address. One is we
15 didn't hear any witness from the Company talk about
16 the relative percentages of an appropriate incentive
17 payment if we were to go that way, so I would like to
18 hear what the various parties think about that and the
19 testimony we had today.

20 I would also like to hear from the other
21 parties, the non-company parties, about the
22 distinction between the risk of owning an asset and
23 the risk of operating a business, if there is really a
24 distinction there.

25 And then I would like to hear from the

0260

1 Company if they are really arguing for the rule that I
2 heard Dr. Levin articulate, that the utility takes the
3 loss if the sale is at less than net book value, and
4 in sort of maybe a broader context than just a sale
5 for a -- a sale to a PUD, for example, if there is a
6 stranded generation asset such as a nuclear plant that
7 becomes non-economic and its net book value, its worth
8 is now less than net book value. I would like to know
9 if the rule that Dr. Levin is articulating is really
10 the position that the Company wants in that broader
11 context.

12 JUDGE MOSS: So, I think these are probably
13 the best handled in the form of bench requests.

14 COMMISSIONER GOLTZ: No. I would just like
15 to see the briefs on that. I don't need to a bench
16 request.

17 JUDGE MOSS: Are you comfortable addressing
18 these issues on brief? All right.

19 MR. TROTTER: Certainly, your Honor.

20 JUDGE MOSS: All right. Well, we will just
21 handle it that way then and I won't try to reduce
22 these to bench requests. All right.

23 Nothing further? Once again, thank you all
24 very much. And we are adjourned.

25 (Proceedings were concluded at 4:15 p.m.)

0261

1

C E R T I F I C A T E

2

3 STATE OF WASHINGTON)

)

4 COUNTY OF KING)

5

6 I, Leslie M. Sherman, a Certified Shorthand
7 Reporter in and for the State of Washington, do hereby
8 certify that the foregoing transcript taken on May 21,
9 2014, is true and accurate to the best of my
10 knowledge, skill and ability.

11

12

13

14

15

Leslie M. Sherman, CSR

16

17

18

19

20

21

22

23

24

