BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Proposal by PUGET SOUND POWER & LIGHT COMPANY to Transfer Revenues from PRAM Rates to General Rates.	DOCKET NO. UE-951270
In the Matter of the Application of PUGET SOUND POWER & LIGHT and WASHINGTON NATURAL GAS COMPANY For an Order Authorizing the Merger of WASHINGTON ENERGY COMPANY and WASHINGTON NATURAL GAS COMPANY with and into PUGET SOUND POWER & LIGHT COMPANY, and Authorizing the Issuance of Securities, Assumption of Obligations, Adoption of Tariffs, and Authorizations in Connection Therewith.	DOCKET NO. UE-960195 VOLUME 10 Pages 1055 - 1260

A hearing in the above matter was held on November 4, 1996, at 9:40 a.m. at 1300 South Evergreen Park Drive Southwest, Olympia, Washington before Chairman SHARON L. NELSON, Commissioners RICHARD HEMSTAD and WILLIAM R. GILLIS, and Administrative Law Judges MARJORIE R. SCHAER and JON PRUSIA.

Cheryl Macdonald, CSR
Court Reporter

The parties were present as follows:

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION STAFF, by ROBERT CEDARBAUM, Assistant Attorney General, 1400 South Evergreen Park Drive Southwest, Olympia, Washington 98504.

FOR THE PUBLIC, ROBERT F. MANIFOLD, Assistant Attorney General, 900 Fourth Avenue, Suite 2000, Seattle, Washington 98164.

PUGET SOUND POWER & LIGHT COMPANY, by JAMES M. VAN NOSTRAND, Attorney at Law, 411 - 108th Avenue NE, Bellevue, Washington 98004.

WASHINGTON NATURAL GAS COMPANY, by MATTHEW R. HARRIS, Attorney at Law, 6100 Columbia Center, 701 Fifth Avenue, Seattle, Washington 98104.

NORTHWEST INDUSTRIAL GAS USERS, by EDWARD FINKLEA, Attorney at Law, 101 SW Main, Suite 1100, Portland, Oregon 97204.

INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES, by CLYDE H. MACIVER, Attorney at Law, 601 Union Street, 4400 Two Union Square, Seattle, Washington 98101.

SEATTLE STEAM COMPANY, by FREDERICK O. FREDERICKSON, Attorney at Law, 33rd Floor, 1420 Fifth Avenue, Seattle, Washington 98101.

WASHINGTON PUD ASSOCIATION, by JOEL MERKEL, Attorney at Law, 1910 One Union Square, 600 University Street, Seattle, Washington 98101.

PUD NO. 1 OF SNOHOMISH COUNTY, by ERIC E. FREEDMAN, Associate General Counsel, 2320 California Street, Everett, Washington 98201.

BONNEVILLE POWER ADMINISTRATION, by JON D. WRIGHT, Attorney at Law, Routing LQ, P.O. Box 3621, Portland, Oregon 97208.

NATURAL RESOURCES DEFENSE COUNCIL and NORTHWEST CONSERVATION ACT COALITION, by DEBRA SMITH, Attorney at Law, 401 North Last Chance Gulch, Helena, Montana 59601.

I N D E X

P R O C E E D I N G S

JUDGE SCHAER: Let's be on the record. The hearing will come to order. This is a hearing before the Utilities and Transportation Commission for the purpose of presentation and cross-examination of the direct case of the Commission staff, public counsel and intervenors and the rebuttal case of the joint applicants in docket No. UE-951270, which is a proposal by Puget Sound Power and Light Company seeking approval to transfer revenues from PRAM rates to general rates, and docket No. UE-960195 which is the application of Puget Sound Power and Light Company and Washington Natural Gas Company for an order authorizing the merger of Washington Energy Company and Washington Natural Gas Company with and into Puget Sound Power and Light Company and authorizing the issuance of securities, assumption of obligations, adoption of tariffs, and authorizations in connection therewith.

The hearing is being held before Chairman Sharon Nelson, Commissioner Richard Hemstad and Commissioner William Gillis. My name is Marjorie Schaer. John Prusia and I are the administrative law judges assigned to these proceedings.

This hearing was set by a notice of hearing and today's date is November 4, 1996. We are in the Commission's hearing room in Olympia, Washington. Let's begin by taking appearances starting with the join applicants, please.

MR. VAN NOSTRAND: On behalf of applicant, Puget Sound Power and Light Company, James M. Van Nostrand.

MR. HARRIS: On behalf of Washington Natural Gas, Matthew Harris.

JUDGE SCHAER: Next for Commission staff, please.

MR. CEDARBAUM: Robert Cedarbaum, Assistant Attorney General representing the Commission staff.

JUDGE SCHAER: Public counsel.

MR. MANIFOLD: Robert Manifold, Assistant Attorney General appearing as public counsel.

JUDGE SCHAER: And then for the intervenors starting with Mr. Finklea.

MR. FINKLEA: Edward Finklea representing the Northwest Industrial Gas Users.

MR. MACIVER: Clyde H. MacIver representing ICNU, Industrial Customers of Northwest Utilities.

MR. FREDERICKSON: Fred Frederickson representing Seattle Steam Company.

MR. WRIGHT: John D. Wright representing

Bonneville Power Administration.

MS. SMITH: Deborah Smith representing Natural Resources Defense Council and Northwest Conservation Act Coalition.

MR. FREEDMAN: Eric Freedman representing Public Utility District No. 1 of Snohomish County.

MR. MERKEL: Joel Merkel representing the Washington PUD Association.

MR. ELLSWORTH: Lynn Ellsworth representing IBEW Local 77.

JUDGE SCHAER: Thank you. Are there any preliminary matters before we begin taking testimony? Mr. Van Nostrand.

MR. VAN NOSTRAND: I believe you wanted us to indicate on the record, in response to the twelfth supplemental order the applicants do find the conditions acceptable and we are willing to proceed on that basis.

JUDGE SCHAER: Thank you. And Mr. Manifold, had you determined whether you wanted judicial notice taken or whether you were going to make that order an exhibit?

MR. MANIFOLD: We're happy to work with that either way. It may be more convenient for the parties if we make it an exhibit and we will have copies made. We do not have them at the moment, though. Since it does relate to the first witness's testimony if we could, as you wish, perhaps reserve a number for it and we will distribute copies to everybody as soon as possible.

JUDGE SCHAER: Let's do that. I'm going to ask everyone here to make a real point of using the microphones and speaking directly into the microphones. Commission has a conference bridge set up and we have a surprisingly large number of people who dial into that bridge and listen to the hearings who are going to want to hear what's said in this room.

We are also being filmed by TVW today and they can pick up the sound if the microphones are used and then provide the public service programming regarding this hearing to the public. So there are microphones at the tables around the room, and I am going to ask you to make a particular note to try to use them.

Would you like to call your first witness, Mr. Cedarbaum.

MR. CEDARBAUM: Thank you, Your Honor. Staff calls Ms. Dixie Linnenbrink.

Whereupon,

DIXIE LINNENBRINK,

having been first duly sworn, was called as a witness herein and was examined and testified as follows:
MR. CEDARBAUM: I don't think we've given numbers to her testimony and exhibits yet.
JUDGE SCHAER: Would you like me to do that now?
MR. CEDARBAUM: Please.
JUDGE SCHAER: Marked for identification as Exhibit T-78 the testimony of Dixie Linnenbrink. That is a nine-page document. I'm going to mark for identification as Exhibit 79 Exhibit DLL-1 the title of Exhibit of Dixie Linnenbrink and title at the top Staff Conditions for Merger Approval. It's a cover sheet and then a one-page document.
Then I'm going to go ahead and mark for identification the exhibits that have been distributed by the parties. As Exhibit No. 80 I'm going to mark staff response to PSE data request No. 1. It's a one-page document. As Exhibit 81 I'm going to mark staff response to PSE data request No. 2, another one-page document. As Exhibit 83 I'm going to mark staff response to PSE data request No. 3 another one page document -- excuse me, that should be Exhibit 82, and as Exhibit 83, a letter to William Vittitoe from Vicki Elliott dated September 25, 1996 regarding Commission

complaint and statistics.

As Exhibit 84 for identification document entitled cost shifting example, a two-page document. As Exhibit 85 for identification document entitled staff response to public counsel data request No. 8.

(Marked Exhibits T-78, 79 - 85.)

JUDGE SCHAER: Are there any other exhibits that any party is wishing to offer through Ms. Linnenbrink?

Please proceed.

DIRECT EXAMINATION

BY MR. CEDARBAUM:

Q. Would you please state your name and spell your last name?

A. Yes. Dixie Linnenbrink, L I N N E N B R I N K.

Q. And by whom are you employed, Ms. Linnenbrink and in what capacity?

A. I'm employed by the Washington Utilities and Transportation Commission as director of regulatory services division.

Q. Directing your attention to what's been marked for identification as Exhibit T-78, is that your direct testimony in this proceeding?

A. Yes, it is.

Q. And this was prepared by you or under your supervision and direction?

A. Yes, it was.

Q. It is true and correct to the best of your knowledge and belief?

A. Yes.

Q. Do you have any corrections to make?

A. Yes, I do have two. On page 5, line 3, there was a formatting error and I just need to note that doesn't indicate the beginning of a new paragraph. That's a continuation of a previous line. And then on page 8 of my testimony line 3 towards the end there is the number 58 percent of the savings. That number should be changed to 54 percent of the savings.

Q. Those are all the corrections necessary?

A. Yes.

Q. Directing your attention to what's been marked for identification as Exhibit 79, do you recognize that as the exhibit that is referenced in your direct testimony?

A. Yes, it is.

Q. And this Exhibit 79 was prepared by you or under your supervision and direction?

A. Yes, it was.

Q. And it's true and correct to the best of your knowledge and belief?

A. Yes.

MR. CEDARBAUM: Your Honor, I would offer Exhibits T-78 and 79 and make the witness available for cross-examination.

JUDGE SCHAER: Any objections?

MR. HARRIS: No, Your Honor.

JUDGE SCHAER: Exhibits T-78 and 79 are admitted.

(Admitted Exhibits T-78 and 79.)

JUDGE SCHAER: Mr. Harris, did you have questions for this witness?

MR. HARRIS: Yes, Your Honor.

CROSS-EXAMINATION

BY MR. HARRIS:

Q. Good morning, Ms. Linnenbrink. I'm Matthew Harris representing Washington Natural Gas.

A. Good morning.

Q. I have a few questions for you. First of all, it's our understanding that you are the staff policy witness with overall responsibility for the case; is that correct?

A. That's correct.

Q. Now, as you know, a dispute has arisen about whether staff's proposal is for a $103 million electric rate cut or a $75 million electric rate cut; is that correct?

A. That's correct.

Q. And you understand that we've analyzed the mechanics of your plan, at least as we understand it, and reached the conclusion that the proposed electric rate cuts are $103 million?

A. I understand that that's your position, yes.

Q. You're aware of our analysis?

A. Right.

Q. And you disagree with it?

A. Yes, I do.

Q. And your position is in fact that the cut is $75 million?

A. That's correct, as sponsored by staff witness Roland Martin.

Q. Is it true that at some point during the development of staff's case the proposed cut in electric rates in staff's plan was in fact $103 million?

A. Yes. We did look at that scenario.

Q. And ultimately decided that that was not the scenario that you would propose?

A. That's correct.

Q. And why is that?

A. We looked at it from the standpoint and asked Dr. Lurito to evaluate that, and then went ahead and recommended the $74 million number as a result of the financial indices.

Q. So your recommendation, the change from 103 to 75 million was a result of advice that you received from Dr. Lurito. Is that fair?

A. As a result of his analysis, yes.

Q. What did his analysis show?

A. I don't recall. I believe that's the subject of a data request, though, but -- do you want me to look up the number?

Q. No, that's fine. I just want your recollection at this time. Did Dr. Lurito reach the conclusion that PSE would not be financially viable if the cuts were $103 million?

MR. CEDARBAUM: Your Honor, I guess I will object at this point only for purposes of indicating that this may be beyond the scope of this witness's testimony. The specs of Dr. Lurito's analysis of that scenario that Ms. Linnenbrink is being asked about can be asked of him, but I suppose general questions about that would be fine.

JUDGE SCHAER: I'm going to allow the witness to inform us of whether or not she's able to answer that question or whether she would prefer to refer the answer to Dr. Lurito who I believe is on the stand later today.

A. Well, I would like Dr. Lurito to answer it also, but I would note that in conversations that I had he never indicated that that scenario would definitely make them not financially viable.

Q. Thank you. I have just a few more questions on this subject. Did Dr. Lurito suggest the $75 million number or is that a number that your staff came up with?

A. That was a number that staff came up with.

Q. And then Dr. Lurito tested the $75 million number and you were satisfied with the results that he came up with?

A. That's correct.

Q. And in Dr. Lurito's analyses, is it your understanding that he assumed 100 percent achievement of stretch goals?

A. Yes. We had those numbers in our exhibits.

Q. Now, there's been some confusion about whether stretch goals are in fact forecasts or are something else, targets or goals. Was there anybody on staff with the assignment of determining the likelihood of achieving stretch goals?

A. We did not look at the numbers since that number was soft to begin with. I think even the company acknowledged that there weren't specific programs where you could for instance go in and analyze data that would say, okay, this is one of the things we're going to achieve and it has X dollar amount. So, no, I would say there was no one that attempted to go through and say, well, here are some things that could be done in that category and here's a dollar amount.

Q. And you talked about staff. You didn't ask any of the outside consultants including Dr. Lurito to perform such an analysis either, did you?

A. No. We relied on the company numbers.

Q. The test that is suggested in staff's testimony for analyzing whether the proposed rate plans are appropriate or not talks in terms of financial viability?

A. Correct.

Q. You mentioned that test in your testimony, too?

A. Right.

Q. What was the source of that test?

A. The source of the test or how did we determine?

Q. No. The source of the test itself, not how you applied the test. Was that a test that was developed by staff or someone else?

A. We asked I think generically in our contract with Dr. Lurito to evaluate the various financial indices, and so I guess that would indicate that that was our test.

Q. Did you ask him specifically, test the results of our different rate plans and tell us whether the company is going to be financially viable or were you not that specific?

A. I don't believe we were that specific. I believe our contract just asked that he evaluate the results of our rate plan under different financial tests.

Q. Are you aware of any instance in which this Commission has applied this financial viability test?

A. Well, I think financial viability is something that's looked at in every rate case, so, yes, I would say the Commission has looked at that.

Q. And used it as a method for setting rates?

A. No, I don't believe we've done that. Typically the case has been a traditional test year, the review of known and measurable changes, and of course the problem is in this case we are going out in the future, so the old rules don't apply.

Q. So the test that you're proposing at least is a different test?

A. Correct.

Q. I want to ask you about the service quality proposal of staff. Is that simply an adoption of public counsel's service quality proposal? Staff does not propose modifications to it, does it?

A. I believe there is a couple of differences between staff's proposal and public counsel's, but in large part, yes, staff is supporting public counsel's testimony.

Q. And for those differences we should ask Ms. Stephens?

A. That would be good.

Q. One of the assumptions underlying staff's case overall is that the market is moving towards competition. Is that fair?

A. Yes, that's fair.

Q. Staff's view is that that move is happening now and will continue?

A. Correct.

Q. And one of your goals was to determine how to better position PSE for competition?

A. That's right.

Q. And under this new competitive regime there would be presumably more choice for customers?

A. Presumably, yes.

Q. And in a market characterized by more choice service quality will become more important?

A. Correct.

Q. And the market presumably will punish poor service?

A. Going back to that other, presuming that there will be more choice, in fact, yes, presumably, the market would be able to move.

Q. Do you have before you what's been marked for identification as Exhibit 80?

A. Yes, I do.

Q. Could you identify that for me, please.

A. This is staff's response to your data request No. 1.

Q. Was that prepared by you or under your direction?

A. Yes, it was.

Q. Does it appear to be a complete and

accurate?

A. Yes.

MR. HARRIS: We would offer Exhibit 80 at this time.

JUDGE SCHAER: Any objection?

MR. CEDARBAUM: No objection.

JUDGE SCHAER: The document is admitted.

(Admitted Exhibit 80.)

Q. You also have before you what's been premarked for identification as Exhibit 81?

A. Yes, I do.

Q. Can you identify that, please?

A. Yes. This is staff's response or my response to your data request No. 2.

Q. Prepared by you or under your direction and control?

A. Yes, it was.

Q. Does it appear to be complete and accurate?

A. Yes, it does.

MR. HARRIS: We would offer Exhibit 81.

MR. CEDARBAUM: No objection.

JUDGE SCHAER: That document is admitted.

(Admitted Exhibit 81.)

Q. Do you have before you what's been marked for identification as Exhibit 82?

A. Yes, I do.
Q. Would you identify that, please.
A. Yes. That's my response to your data request No. 3.
Q. Again, prepared by you or under your direction?
A. Yes, it was.
Q. And again, complete and accurate?
A. Yes.
MR. HARRIS: We would offer Exhibit 82.
MR. CEDARBAUM: No objection.
JUDGE SCHAER: That document is admitted.
(Admitted Exhibit 82.)
Q. Finally, we have what's been marked for identification as Exhibit 83. Do you have that before you?
A. Yes, I do.
Q. A letter from a Ms. Vicki Elliott to Mr. William Vittitoe. Have you seen that letter before?
A. No, I had not.
Q. Could you take a moment and review it?
A. I read through it while we were waiting, yes.
Q. Do you have any reason to believe that that is not a true and accurate copy of the letter sent to

Mr. Vittitoe?

MR. CEDARBAUM: Your Honor, I guess I will object. I don't know how the witness can answer that question. She didn't prepare it. She hasn't seen it until this morning. I don't see how she can then be asked whether she could accept it as a a true and correct copy.

MR. HARRIS: Your Honor, it was a letter that was sent to Mr. Vittitoe. We're just looking for a way that makes sense to put the letter into evidence and she's the chief or the head witness for staff. We're not going to be calling Vicki Elliott, obviously, as a witness, and it seemed to make sense to us to offer the letter through Ms. Linnenbrink.

JUDGE SCHAER: Well, I think the objection right now, Mr. Harris, is to the question of whether she can testify that this is a true and accurate copy of the letter, and I am going to sustain that objection.

MR. HARRIS: I would offer the same question again, make it subject to check.

MR. CEDARBAUM: Well, first of all, I guess part of my problem with this exhibit is that she wasn't the one who authored it and hasn't seen it. It was addressed to Mr. Vittitoe. I suppose he could then be the one to -- we could admit it through him at that time since he received it, and secondly, because it goes to information that is not really the focus of the staff case on service quality, and so attaching it to this witness's testimony seems to me to be inappropriate, but if we want to wait until Mr. Vittitoe is on the stand that's fine.

MR. HARRIS: We're happy to put it in through Mr. Vittitoe if you prefer that.

MR. MANIFOLD: That assumes that it should not have been part of Mr. Vittitoe's rebuttal testimony. The document appears to be dated September 25 which was well before his rebuttal testimony was submitted. If it was to be introduced through Mr. Vittitoe it should have been part of his rebuttal testimony. I just didn't want to waive that now.

JUDGE SCHAER: Well, I'm going to sustain the objection to the question just asked of this witness and I am going to encourage parties to look at this letter and decide if you can agree to some method by which it could be admitted, and if not then I will deal with any objection through Mr. Vittitoe at that time.

MR. HARRIS: Okay. The only thing we would add to that is we may then possibly attempt to offer it through other witnesses, other staff witnesses if issues arise that this letter is responsive to, and with that I have no further questions for this witness.

JUDGE SCHAER: Mr. Manifold, did you have questions for this witness.

MR. MANIFOLD: I do.

CROSS-EXAMINATION

BY MR. MANIFOLD:

Q. First of all, I hope you will forgive me peering over my glasses but I've reached that point I need them for reading but not for seeing. I would like to, first of all, highlight and be clear about the differences between some of the parties' cases in this case. The staff case would reduce both electric and gas tariff rates for the entire five-year period; is that correct?

A. That's correct.

Q. And is it your understanding that the public counsel proposal would hold current rates or PRAM-related rates unchanged for this period?

A. That's my understanding.

Q. Do you have an understanding as to the probable direction of the BPA residential exchange?

A. I understand that that's under consideration right now and that BPA has proposed cuts in it, which would have a detrimental impact to Puget customers.

Q. Under the staff proposal how would that impact customers? I mean, how would a cut in the BPA residential exchange to Puget be passed through to customers?

A. Under staff's case I would characterize that as a flow-through type item. The schedule would change and the result would be an increase to customers.

Q. And is it your understanding, or if you prefer would you accept subject to check, that the effect of that if the BPA credit went to zero, as BPA has proposed, would be approximately an 18 percent increase for those customers who receive the benefit of that?

A. Since it's speculation I would accept that. I don't know what I would do under a subject to check to confirm or not confirm that.

Q. Well, is it your understanding that BPA has proposed eliminating the credit entirely?

MR. WRIGHT: I would object to this because she's already testified that it's not even subject to check, and so I don't know how we can accept this as testimony on the exchange and the level of cuts and the meaning of cuts, and if it can't be verified how can it be introduced as testimony.

JUDGE SCHAER: I haven't heard the entire question, so I'm going to ask you to repeat the question, Mr. Manifold, and I believe you were indicating in the question how you believed it could be checked and perhaps you're asking that she check something. I'm not certain at this point.

Q. Would you accept subject to your check that the current residential rate for Puget Power is approximately 5.97 cents?

A. I would accept that subject to check.

Q. And would you accept subject to check that the amount of the schedule 94 exchange credit is approximately 1.085 cents?

A. If you give me a second I think I can look at that number in a staff exhibit. Did you say 5.97?

Q. I said 5.97, yes.

A. I was referring to Jim Miernyk's exhibit which shows that for residential customer Puget Power's average kilowatt hour is 7.02 and then with the BPA exchange it would be 5.94.

Q. Fine. So the current rate paid by

customers is 5.94 cents?
A. Right.
Q. And the amount of the current schedule 94 credit is the difference between that and 7.02? He shows it on his exhibit as .01085 cents -- dollars?
A. That's correct, yes.
Q. So if the schedule 94 credit went away -- was zeroed out, would you accept subject to your check that that would be an increase of approximately 18 percent in the rates actually paid by residential and other customers who -- well, by residential customers?
A. I would accept that subject to check.
Q. Is it your understanding that under the public counsel proposal any changes in schedule 94 would be the responsibility of Puget and would not be flowed through to customers?
A. That's my understanding of your testimony.
Q. So under the staff proposal, residential schedule 7 rates might decline by 2 percent or so in response to the DSM tracker proposed by Mr. Martin, but bills might also increase by up to 18 percent if the BPA exchange credit were eliminated?
A. I think under staff's proposal the DSM amounts closer to 1 percent than 2 percent. And with that change, yes, I would accept that.

Q. Would you agree, then, that residential customers would likely be worse off under the staff proposal than the public counsel proposal while other customer classes, those not receiving the BPA exchange, would be better off under the staff proposal than the public counsel?

A. Not necessarily because I think staff's proposal is an immediate 1 percent based on what we know today. Now, if your scenario plays out and the BPA exchange in fact does go away then I would agree that, yes, in fact your scenario would have lower rates than would staff's proposal.

Q. When you say immediate 1 percent, is that to be applied upon merger or is that 1 percent to be averaged over the five years?

A. That's a five-year average number. It's varying percentages during that time frame.

Q. So, my understanding is that on the gas side the staff proposal is an immediate decrease in margin by I think 2 percent?

A. 2 percent to the margin which sunsets 50 percent of the cost of service. That would equate approximately to 1 percent, too, roughly.

Q. And on the gas side that would be under staff proposal that would be accomplished immediately whereas on the electric side I had understood that the 1 percent would be phased in over the five years?

A. There's an impact in each year.

Q. That has a cumulative effect of 1 percent on the electric side?

A. It has an average effect of 1 percent.

Q. Would you agree that Puget by its participation in the BPA ratemaking process and its participation at FERC and Congress and elsewhere is in a position to influence the future of the residential exchange program?

MR. WRIGHT: Your Honor, I object. I don't see how the witness is qualified -- John Wright, Bonneville Power Administration. I don't see how the witness is qualified to answer a question about a legislative matter before Congress, and I also believe that the testimony relating to the residential exchange is beyond the scope of the witness's direct testimony.

JUDGE SCHAER: Mr. Manifold.

MR. MANIFOLD: This is the only question I have on that particular area, and I don't intend to go into any detail. It seems to me it's a fairly straightforward proposition as the head of the staff if she knows what Puget's position is regarding the

ability to influence the BPA credit.
JUDGE SCHAER: To the extent that she has knowledge I will allow her to answer.
A. I would be more comfortable in saying they have an opportunity to participate than making any judgment about what kind of influence they can have.
Q. So they have an opportunity to participate in the processes that determine the result?
A. Correct.
Q. I have a series of questions on the general subject of cost shifting. You're obviously aware that in the schedule 48 the issue of cost shifting and the company, Commission, staff, everybody's commitment was that costs will not be shifted, as I recall?
A. That's my recollection also.
MR. MANIFOLD: Your Honor, it would be our intent -- first of all, regarding the order in schedule 48 I personally don't really care whether we mark it as an exhibit or not. I gather it may be more convenient for the bench and other parties to mark it. I do not have copies now but I can later today. This would be I think the appropriate time to deal with the admissibility of it. I imagine it was not a contested matter but I thought I would bring it up now.
JUDGE SCHAER: Well, I think it would be

more convenient to have that marked. And so for identification let's give it No. 86.

(Marked Exhibit 86.)

JUDGE SCHAER: Do you have a date for the order, Mr. Manifold?

MR. MANIFOLD: That would be the Commission order approving schedule 48 with conditions in docket No. UE-960696 bearing a service date of October 31, 1996. We'll undertake to have copies three-hole punched and made for as many as are needed.

JUDGE SCHAER: Did you want to offer that at this point?

MR. MANIFOLD: I would like to offer that.

JUDGE SCHAER: Is there any objection to entry of that order into the record?

That document is admitted and we will expect to receive copies from you during the day today.

(Admitted Exhibit 86.)

Q. Could you define your concept of cost shifting, and actually I have a series of questions and it may be easier for you to take them in one lump, which is to define cost shifting and to define benefit shifting and to distinguish if any what the difference is between them?

A. Okay. Cost shifting to me implies that you would take the costs that are no longer being recovered from one ratepayer and increase other ratepayers' rates by that equivalent amount, whereas benefit sharing to me argues that you have savings or your rate reductions and that would argue for all ratepayers' rates should decline a comparable amount.

Q. Since a decrease in -- benefits as we've used them in this general discussion on schedule 48, benefits really is a term for reduction in costs, is it not?

A. Yes, I think that's a fair characterization of it.

Q. So, under normal circumstances a reduction in costs that we call benefits would simply be different costs after the reduction took place?

A. You would have different costs to the company as a total, correct.

Q. Does staff's proposal in this case eliminate all cost shifting?

A. I believe that staff's case does not contain any cost shifting. I think the distinction is I distinguish between cost shifting and benefit sharing.

Q. Would you please elaborate on that

distinction because you must have read my next question.

A. Cost shifting, and it goes back to that, would mean that other ratepayers' rates would need to go up because you still had those costs, and since our proposal doesn't include an increase to other ratepayers to account for those costs, I don't believe we're cost shifting.

Q. Would you agree with the statement that the staff case shares the benefits in a way other than would normally be the case under traditional ratemaking?

A. If you use the premise that all ratepayers are captive then you would just spread all costs on an analysis, then I would agree that, yes, that would be true.

Q. At page 9 of your testimony, lines 3 and 4, you say that staff's rate plan prevent cost shifting and provides for sharing benefits to the greatest extent possible without placing PSE in financial jeopardy. I was caught by the phrase "to the greatest extent possible." That implies to me that it's not to the total amount but to the extent possible with a constraint of financial jeopardy. Is that an accurate understanding?

A. That's -- yes, that would be correct.

Q. Does that mean that if you had a different view of financial jeopardy then the benefit sharing or the cost shifting might be different?

A. If we had a different view about perhaps you could have a lower resulting -- the various financial tests then, yes, we could have given more benefits to the residential ratepayers, or I'm not sure if there was a second part to your question.

Q. I think that answers it. So there's, as Mr. Harris was asking you earlier, the way that you would prevent cost shifting and there's the way that staff would share benefits and then a condition on how you would prefer to do all that is the staff's view of financial viability which, in this instance, limited the extent to which you could accomplish what you would have otherwise sought to do?

A. Correct.

Q. At page 8 of your testimony along in the line where you made the typographical change, 54 percent of the savings and then on line 6, 42 percent of the savings comes up to 96 percent of the savings. Is there another part of the savings that ought to be -- why don't those total 100?

A. The other party in this would be the

shareholders and they would have the remaining percentage.

Q. Which we would estimate at 4 percent?

A. That's correct.

Q. If large customers of Puget were not threatening to leave Puget's system and thereby obtaining price concessions, would the staff's recommendation for costs and benefits sharing have been different?

A. Yes. If we weren't faced with that situation I think we would probably do more of an across-the-board sort of sharing.

Q. What is the end date of the staff rate plan? Is it through the end of the calendar year 2001?

A. I believe that's right.

Q. When could rates be changed and/or when could the company file for different rates under that scenario?

A. Well, they can offer, under their proposal and our acceptance, they could offer different services, so they could file therein, but as far as just an overall change, we were asking for them to file a cost of service and rate design revenue requirements at the end of that period, so I think you

would want that filing to come in early in 2001.
Q. So the expectation would be a filing early in 2001 with the result to be made effective after the end of the five years, say in January of 2002?
A. Correct.
Q. I would like to go through with you a hypothetical.
MR. MANIFOLD: Your Honor, I would like to have marked as the exhibit -- well, you have marked as Exhibit 84 some data for a hypothetical which I would like to go through with the witness, and I guess we can wait and deal with admitting the exhibit at the end of the questions.
Q. Ms. Linnenbrink, I would like to have you assume, for the purposes of a hypothetical to explore the cost shifting issue, a utility, an electric utility with a total load of 2,000 megawatts with an average cost of power of 40 mills per kilowatt hour and the assumption for purposes of simplicity that all classes pay equally. Like you to further assume that there's a growth in all classes of 25 percent load growth and that the incremental cost of power to serve that load growth is 20 mills per kilowatt hour.
A. All right.
Q. Under that hypothetical -- and what has

been marked as Exhibit 84 is basically calculations to assist in the numerical aspects of this hypothetical -- post-growth the total load of the utility would be 2,500 megawatts. Is that correct?

A. That's correct.

Q. If the incremental cost of power was shared uniformly among all classes then all classes would be paying 36 mills per kilowatt hour on average for power?

A. Right.

Q. And this is basically because the new cheaper power has been shared uniformly among all customer classes?

A. Correct.

Q. Let's further assume a different scenario after the load growth occurred and that is that the utility designates some group of customers as core customers and some other group of customers as noncore. If the noncore customers are paying 20 mills and represent approximately -- represent 400 megawatts of the total load of -- let me start that one over again.

You see on what's been marked as Exhibit 84 a hypothetical breakdown of customer classes before growth with the large industrial class at 400 average megawatts? It's on page 1.

A. Right.

Q. Then after each class grows by 25 percent the next part of that page shows the amount of increased load each class would have and the price at 20 mills per kilowatt?

A. On the first page, yes.

Q. Yes. And turning to page 2 -- and I am trying to do this in a way that we don't have to go through each line, but if you want at any time to stop and do that, I'm pleased to do that. The top part of the second page that shows a total of 2500 megawatts shows an average cost of 36 mills per kilowatt hour. That would be the result in a scenario where all classes shared equally in the new lower cost power?

A. That's my understanding, yes. You're spreading both the growth and the cheaper cost of power in equal proportions to each customer class, yes.

Q. And then in the middle of the page, the set of numbers there, post-growth load and costs with low cost resources streamed to large industrial customers. In this scenario would you assume that the large industrial load of 500 average megawatts is given or provided the benefit of all of the -- all of its power at the new low incremental cost of resources of 20 mills and that the remaining customer classes are served at the old cost of 40 mills. That still results in a total average cost in general of 36 mills but it just distributes the prices differently among the customer classes?

A. That appears to be what that does, yes, that 20 mills goes to the large industrial and other rates stay the same.

Q. And would you accept that that's a rough approximation of what we're talking about in the schedule 48 scenario?

A. I think this is a scenario of unequal benefits sharing.

Q. And you would not call this cost shift but rather a benefit shift sharing?

A. I would not characterize it as a cost shifting because the rates to those other classes stay the same.

Q. Would you be willing to accept subject to your check the calculations on the lower half of that page which contrast the difference in revenues from each class under the two different scenarios?

A. I would accept that subject to check. It appears correct.

MR. MANIFOLD: Your Honor, I would move for the admission of Exhibit 84 to demonstrate the hypothetical that we've just been through.

JUDGE SCHAER: Any objection? That document is admitted.

(Admitted Exhibit 84.)

Q. Do you have before you what's been marked as Exhibit 85?

A. I do.

Q. Is that a true and correct copy of a staff response to public counsel data request No. 8?

A. Yes, it is.

Q. Is it accurate to the best of your knowledge?

A. Yes.

MR. MANIFOLD: Your Honor, I would move for admission of Exhibit 85.

JUDGE SCHAER: Any objection?

MR. CEDARBAUM: Yes, Your Honor, I would object on the basis of relevance. This document concerns what appears to be hundreds of utilities not regulated by this Commission under standards of regulation that I have no idea apply especially given the fact that we're involved with a rate plan in this case as opposed to traditional regulation, so I just don't see the relevance to this document in this proceeding.

JUDGE SCHAER: Mr. Manifold.

MR. MANIFOLD: Yes. At page 5 of the witness's testimony, line 18 she testifies regarding the payoff ratio of Puget, and this report shows the payout ratios for a variety of other IOUs. Those are on page 2 -- the third page in which in the upper right-hand corner has a page No. 5. The seventh column over has a dividend payout ratio. That's the sixth column over of numbers.

MR. CEDARBAUM: Your Honor, again, there are all kinds of data on these pages that other witnesses on staff and other parties talk about, but they're not talking about these utilities, so again, I don't see the relevance of this document in our proceeding.

JUDGE SCHAER: Well, Mr. Manifold, other than this column on the first page numbered 5, is there anything else in this exhibit that ties into Ms. Linnenbrink's testimony?

MR. MANIFOLD: I may have misspoken. There's both electric and gas in this not just electric. No. It's mainly related to the staff's proposed -- proposal as it relates to the company's payout ratio and a chart which shows what payout ratios of other electric utilities are.

JUDGE SCHAER: So you're interested in the electric utilities page and not the gas company page?

MR. MANIFOLD: Well, I'm interested in the payout ratio column on each of the pages. I'm sorry, I still think that Puget is an electric utility. I realize that post-merger they will be more than that if that occurs. For instance, on page -- the fifth page in which is numbered 7 at the upper right-hand side has combination electric and gas companies dividend payouts.

JUDGE SCHAER: Well, I'm inclined to let in those two pages but not the rest of this document. Does having this not complete cause problems for anyone else? So we have the first page of this document which has the request and response; second page, which is the cover sheet of the document from which these are taken; the third page which is numbered 5 has a column says dividend payout. The next sheet also numbered 5 I'm going to remove from the document. Next one is numbered 7 has a column for dividend payout and then the rest of the document I'm going to remove and I will allow those two pages and the covers to be admitted.

MR. MANIFOLD: Your Honor, I'm advised that these include data for two different time periods and in addition to the two pages you've indicated there are comparable pages for the following year that have the same sort of page numbers and I can tell you where they are.

MR. HARRIS: There's actually three time periods.

MR. MANIFOLD: Well, we would request that the comparable pages be in there for each of the time periods.

JUDGE SCHAER: Mr. Manifold, if I gave you until after lunch could you get a revised version of this made that has just those pages in it.

MR. MANIFOLD: We would be happy to.

JUDGE SCHAER: Why don't we not admit any of this at this point. I will make the ruling that that revised will be admitted as Exhibit 85, and please be prepared to distribute those after lunch.

MR. MANIFOLD: Yes, I will do that.

(Admitted Exhibit 85.)

JUDGE SCHAER: Do you have any further questions for this witness?

MR. MANIFOLD: Yes, I do.

Q. Just a couple. Mr. Miernyk's testimony, as

I read it, says that this is the case to address the company's -- Puget's -- above market PURPA resources. Could you as the lead witness indicate where, and if that is correct, where and how that's handled in the staff case? And that's at Mr. Miernyk's page 11, I believe.

MR. CEDARBAUM: Do you have a line number so we can focus in on that testimony?

MR. MANIFOLD: Line 2 on page 11. The sentence actually starts on page 10 and reads, "Since the upward rate pressure resulting from Puget's resource acquisitions is a contributing cause for special rate arrangements with large use customers, it is appropriate to address those resource acquisitions in this proceeding."

Q. It's in his testimony so I can ask him that too, but my real question is where is it in the staff case. I thought I ought to start with you.

A. I believe it's in the staff case under the lost revenue category and that's what he's referring to.

Q. Could you expand on that?

A. It relates back to the earlier discussion in his testimony about uneconomic power costs where the larger customers are refusing to pay or seeking alternatives to the price of Puget's contracts and as a result of that then we've quantified lost revenues, which is the difference between the former tariff schedule, or, I guess, it's still the current tariff schedule, and what customers would pay under schedule 48 and those lost revenues.

Q. And that's that plus the potential -- the lost revenues from the other special contracts is estimated to be a cumulative $121 million over the five years?

A. Right.

Q. That's a company estimate; is that correct?

A. Yes. The company provided us that number, my understanding.

Q. Finally at page 3 of your testimony, line 5 you refer to the commitments made by the applicant to mitigate cost pressures what has been sometimes called the power stretch goals. Is it your opinion that the -- is it your opinion that absent a merger Puget Power would be pursuing these savings on its own?

A. That would be my belief, yes.

Q. Is it your belief that if there were a merger and no rate plan Puget would still be pursuing -- the combined utility would be pursuing those savings?

A. I would think they would need to. I think Puget has a problem with their prices relative to prices of other providers and, yes, they need to address that, so I think that's going to have to take place regardless of the corporate form.

Q. At pages 3 and 4 of your testimony, is it my understanding that staff has identified cost savings in addition to those presented by the company in its case? And those are contained in the testimony of Messrs. Martin and Schooley.

A. I would characterize those more as adjustments to the merger savings that the company put forward rather than a thorough search for what else might be out there and then the DSM adjustment, the disputed $74 million or $103 million. That is a number that's comparable to what the schedule 48 customers are receiving.

Q. Is it your understanding that those adjustments are not included in the data on which public counsel's case was presented since they presented at the same time?

A. These numbers, staff adjustments, are not included in public counsel's case, is that the question?

Q. Yes.

A. I think there were -- oh, the similarity was I think we both removed the impact of the 1996 cost pressures, but I believe that's the only overlay between public counsel and staff. Otherwise, we approached it vastly different.

Q. And specifically Mr. Martin, Mr. Schooley make adjustments for gains on sales of real estate and costs to achieve the merger, labor costs savings, facility savings and revenue-related tax savings?

A. Correct.

Q. Are you aware that there are certain savings that are presented by Mr. Lazar in his testimony regarding meter reading, billing, et cetera?

A. I am.

Q. And those are savings which are not included in the staff case?

A. They were not included as adjustments to the merger savings per se, but I think they're a cost that you could characterize as in the stretch the best practices are a capture of those numbers.

Q. Am I correct that staff has not attempted to identify any particular level of stranded costs which Puget would face in a competitive market environment in the context of this case?

A. That's correct. Staff would like to see those costs mitigated before we start doing any quantification and didn't perceive that this was the appropriate place to do that. I think it would be premature.

Q. You're aware of the testimony by public counsel's Mr. Marcus in this proceeding where he does seek to identify an estimate of Puget's above market costs?

A. I am aware of that, yes.

Q. Has staff attempted any similar analysis? I take it the answer would be no?

A. No, we did not.

Q. To the extent that there are what would in the future be considered stranded costs on Puget's system, those costs are currently being recovered in rates today or some of those costs are currently being recovered in rates today?

A. I guess I would say those costs are not stranded at this point. Is that what you're asking?

Q. Well, what I'm asking is that discussion regarding stranded cost there seems to be a belief that stranded costs are something that exist out there in the future. To the extent that those are costs that the utility has and has included in its rate base and are above market then they're being collected from ratepayers today, even though they haven't yet been identified as, quote, stranded because competitive conditions have not occurred for at least most customers?

A. I would agree that, yes, there may be some costs today in rates which, down the road, could be stranded because of customers leaving the system or seeking alternatives and so we have not quantified those at this point in addition, though I would say they are not stranded until there's no way to mitigate them either.

Q. What would the staff position be regarding the responsibility of special contract customers for any costs that wind up being identified as stranded costs down the road?

A. I would refer to in schedule 48 I believe there was an explicit acknowledgement that schedule 48 did not exempt those customers from a future determination of stranded costs, if any, so they wish be responsible also.

Q. What I don't understand about that is that if the current concessions to special contract customers are made necessary because of the allegations regarding those customers' alternatives, what is it that will be different in the future that will allow some additional costs to be charged to those customers?

A. Well, I think it relates more to a hope that those costs will be lost because the company will have gone out and accomplished the savings, so you're mitigating a number.

Q. And mitigating it to zero?

A. That would be lovely.

Q. Well, the question is, if the mitigation doesn't go to zero, if there is some amount of stranded costs five years from now, how is it -- my understanding of your previous answer is that it would be staff's view that those stranded costs, if indeed there are some five years from now, would be the responsibility of all ratepayers whether they're on special contracts or otherwise, but I also understand the staff position to be that the current offering of special contract prices is the most that one can obtain from those customers because of their competitive alternatives, and what I don't understand is taking those two positions together what will be different in five years. And most people seem to think it will be a more competitive industry that will allow the company to extract its stranded costs from customers who currently are not paying anything more

than their special contract rates?
A. Well, without having the answer for how will we treat those, I think the point I wanted to make is those industrial customers or all customers should be considered as a part of any stranded cost recovery without making any determination about what that is and what is the spread between customers, shareholders or anything else.
Q. If it could be shown or if one believed that it would not be possible to charge any of those stranded costs to those industrial customers, would that change your view about what those customers should be paying now?
A. Would you repeat that?
Q. If one believed that in the future it would not in fact be possible to charge stranded costs to those industrial customers because of market conditions, or any other reasons, would that change your view of how benefits should be shared in this case?
A. If we could not charge those customers, I mean, I think that's the issue we've addressed so I hate to make you repeat it again but I think I've still missed your point.
Q. Okay, I will try it again. Let's do it as

a hypothetical. Let's assume that in the future, one is unable to charge -- let's assume in the future there's been some mitigation of the uneconomic power costs of the utility or other cost savings but that there still remains some stranded costs on the Puget system, and let's assume a more competitive environment arises so it is in your view relevant to figure out what stranded costs are.

Let's further assume that at that time the large industrial customers have even more choices than they do today and so it is practically impossible to charge those industrial customers any of, quote, their share of the stranded costs. Given that hypothetical, would that change your view of what costs those industrial customers ought to be paying between now and that future date?

A. I think the situation we're faced with right now is schedule 48 retains these customers, and probably the most common way of dealing with stranded costs would be then, quote, the wires charge, so some customers presumably at least, or at least the majority, would be still there. The ones you wouldn't have would be the ones that self-generate or go on to another system because of proximity.

MR. MANIFOLD: Thank you. I have no other questions.

JUDGE SCHAER: Let's take our morning recess at this time. Let's be off the record until 11:10.

(Recess.)

JUDGE SCHAER: Let's be back on the record after our morning recess. I have been getting requests from the back of the room where people are unable to hear what's going on that people do use the microphones, and I will point out that on counsel table between Mr. Wright and Ms. Smith there is now a cordless microphone so that if the row of intervenors, as they go through want to use that to respond you can just pass it along if you like. And we've also moved another microphone down from the bench so that hopefully there's one available to you, but I would greatly appreciate the courtesy of everyone trying to speak directly into the microphone so that they may be heard.

JUDGE SCHAER: Mr. Finklea, did you have any questions for this witness?

MR. FINKLEA: No questions.

JUDGE SCHAER: Mr. MacIver.

MR. MACIVER: Yes, I have a few, Your Honor.

JUDGE SCHAER: Would you please look on the bottom of that microphone and turn it on, sir.

CROSS-EXAMINATION

BY MR. MACIVER:

Q. Public counsel asked you a number of questions which were premised on his assumption that schedule 48 customers receive price concessions solely on the basis of a threat to leave the system. Do you agree?

A. Yes. I think that's a fair characterization of the questions.

Q. Is it not true that schedule 48 established what is called a noncore class of customers?

A. That's correct also.

Q. Would you describe, please, the difference between a noncore customer class and a core customer class in terms of riskiness to the customer?

A. Under the noncore they take the risk of the market and also reliability, assuring that the power will be there and the company will no longer plan resources to serve this particular customer class.

Q. Does that reduce in any way the company's resource costs to serve that customer?

A. Today?

Q. Today or however or in the future.

A. I would say in the future, but to the extent that the company has already committed or acquired resources to serve these customers that will take additional steps on behalf of the company to mitigate those.

Q. Does it affect the company's long-range planning for resource costs having a class of noncore customers?

A. Yes, it would. They would no longer be planning for these customers.

Q. So, in other words, a noncore customer takes risks in two basic ways, one, the availability of power, and two, the price of power?

A. I agree with that.

Q. Would you turn to Exhibit 84, please, which is public counsel's hypothetical.

A. Yes, I have it in front of me.

Q. This hypothetical does not represent the impacts on all customers of allocation of low cost resources, does it? The full impact on customers under the hypothetical? My question is confusing you. Would it be a more illustrative exhibit if it had another column added for fixed costs? In other words, does this exhibit show the impact on other customers

if large industrial customers left the system?
A. No. This exhibit does not demonstrate that and what might happen as a result of that.
Q. Because large industrial customers do pay a portion of fixed costs, do they not?
A. Yes, they do.
Q. And if they left the system they would also leave those fixed costs to be picked up by other customer classes, would they not?
A. That's correct.
MR. MACIVER: I have no further questions.
JUDGE SCHAER: Thank you. Mr. Frederickson, did you have questions for this witness?
MR. FREDERICKSON: No, I don't, Your Honor.
JUDGE SCHAER: Mr. Wright, did you have questions?
MR. WRIGHT: I had not intended to ask questions, but since the witness testified regarding the exchange program I would ask Your Honor's indulgence to take about five minutes.
JUDGE SCHAER: Certainly. Please proceed.
MR. WRIGHT: First I would like to renew my objection to the admission of the testimony. I would move to strike this witness's testimony regarding the exchange for three reasons. First, it seems to me

that the testimony is beyond the scope of the witness's direct testimony or at best it's very tangential to that testimony. At the outset of this proceeding, Your Honor attempted to limit the scope of the issues that the parties would address. Bonneville has been limited to addressing the residential exchange issues. We prepared for cross-examination by proposing to examine those witnesses whose testimony has a direct bearing on the exchange. I'm a little bit concerned that possibly any witness could suddenly become an expert on the exchange program now with the result that we could get bogged down in a lot of testimony that's not particularly helpful to the Commission in making a decision here.

I would also add that the nature of this particular testimony was highly speculative by the witness's own admission and in that respect it's also not particularly helpful to a final determination of this case, and it seems to me that in the interests of efficiency that this type of testimony should be stricken and so I would move to strike the testimony relating to the exchange program.

JUDGE SCHAER: I'm going to rule consistently with my previous ruling, that the testimony is admissible. Ms. Linnenbrink is testifying as the policy witness for the Commission staff in this proceeding, and to the extent that parties with different proposals want to explore with her her understanding of something like the exchange and the decision that staff made to treat the exchange as they do in their proposal, I think that that is appropriately within the scope of her testimony, and I believe that her testimony sponsors an overview of the other witnesses' testimony.

To the extent that she referred to Mr. Miernyk's testimony to bring in numbers that responded to the question as the question was narrowed, I believe that that was also appropriate testimony and something that Bonneville knew was within the scope of staff's case at least through the testimony of Mr. Miernyk. So, please proceed with your questions.

MR. WRIGHT: Thank you.

CROSS-EXAMINATION

BY MR. WRIGHT:

Q. Ms. Linnenbrink, I want to limit my questions to your testimony on the exchange program. Could you describe your experience and level of knowledge with the exchange program?

A. I would characterize that as pretty

limited. I mean, it's a very general knowledge. I have not ever participated in any exchange hearing.

Q. How familiar are you with the terms of section 5C of the Northwest Power Act that created the program?

A. Generally familiar, but I have not spent a lot of time with it.

Q. How would you characterize your specific knowledge regarding the 1984 ASC methodology that's used to calculate a participating utility's ASC?

A. Very limited.

Q. And are you aware of the comprehensive regional review that's now taking place?

A. Yes, I am aware of that.

Q. Do you know whether the residential exchange is a subject of that review?

A. Yes, it is.

Q. Do you know if any recommendations has been made to end the program in that process?

A. No, I do not. I don't know the answer to that.

Q. How much knowledge do you have regarding the level of exchange benefits that Puget will receive in fiscal year 1997?

A. I believe those are proposed. For 1997?

Q. Fiscal year 1997.
A. I don't know the answer to that off the top of my head?
MR. WRIGHT: I don't have any further questions. Thank you.
JUDGE SCHAER: Ms. Smith, did you have any questions?
MS. SMITH: Your Honor, I didn't indicate that I had any questions for Ms. Linnenbrink, but I would like to ask just a couple of questions on the record to determine whether she or Mr. Martin is the correct person or another staff witness is the correct person to whom I should ask my questions concerning Dr. Power's testimony. Shouldn't take very long.
JUDGE SCHAER: Please proceed.

CROSS-EXAMINATION

BY MS. SMITH:
Q. Morning, Ms. Linnenbrink. My name is Debbie Smith and I'm a lawyer representing Natural Resources Defense Council and Northwest Conservation Act Coalition in these proceedings. Have you had an opportunity or are you aware that NRDC and NCAC introduced testimony in this docket?
A. Yes, I am.

Q. And are you aware that that testimony was presented by Dr. Thomas Power?

A. Yes, I am.

Q. Have you had an opportunity to review that testimony?

A. I did read through that testimony, yes.

Q. In particular I am curious if you have had an opportunity to review his proposal for using a revenue cap mechanism with regard to recovery of fixed costs for Puget's or PSE's distribution and transmission system?

A. I have not spent any time on that subject matter and, as you indicated, questioned me as to who that should be referred to, that should probably go to Frank Maglietti.

Q. Any other witnesses to whom I should ask these questions?

A. No, I don't think so. I think Frank would be your person.

Q. Is there anything in your testimony that would relate to a revenue cap mechanism with regard to PSE's recovery of its fixed costs for its transmission and distribution systems?

A. No, not in my direct testimony.

MS. SMITH: Thank you. No further

questions.

JUDGE SCHAER: Mr. Freedman.

MR. FREEDMAN: No questions.

JUDGE SCHAER: Mr. Merkel.

MR. MERKEL: I have no questions.

JUDGE SCHAER: Mr. Ellsworth.

MR. ELLSWORTH: No questions.

JUDGE SCHAER: Commissioners, do you have questions of this witness.

CHAIRMAN NELSON: I will pass.

EXAMINATION

BY COMMISSIONER HEMSTAD:

Q. Ms. Linnenbrink, in your testimony, I believe you take the position that the merger must provide positive customer benefits if it is to meet the public interest standard. Is that correct?

A. That's correct.

Q. Other witnesses, and I believe including Mr. Lurito, on behalf of the staff talked about the test being that no party would be worse off under the proposed merger than they are currently or that they would be no worse off. Is there a difference between those two descriptions?

A. I believe there is, yes. I think that no person or group being any worse off would be the absolute minimum standard, so to speak. You wouldn't want anyone to be harmed by the merger. In staff's case this was largely driven, though, by Puget's high cost of power right now and also the schedule 48 introduced items that wouldn't necessarily have been present in other merger cases. So we felt like we needed benefits for all customers.

Q. Well, is there an inconsistency between the positive benefit standard and staff witness Mr. Lurito's no worse off standard?

A. I don't believe there is. I think he was describing the absolute minimum.

COMMISSIONER HEMSTAD: That's all I have.

EXAMINATION

BY COMMISSIONER GILLIS:

Q. Ms. Linnenbrink, in the staff's rate plan do you make any assumptions about whether or not customers of the merged company would have an opportunity to choose energy supply from alternative companies over that time period ending 2001?

A. Not explicitly. I mean, I think that is the driver for why staff would like to see the costs come down for everyone to place Puget in a more competitive position, but, no, we didn't try and go in and quantify what lost revenues might come about because of other programs.

Q. So you don't assume one way or the other whether or not the company would be -- remain the monopoly suppliers of the customers until 2001 over that sort of rate --

A. No, we didn't try and quantify what those impacts might be, but we do recognize that there is or we do believe there is going to be open access and other trials and that other customers having choice would just exacerbate the kind of situation we saw with schedule 48.

Q. Potentially the company could have open access prior to 2001 under your rate plan?

A. Yes.

Q. And if that were true, would that change any of the conditions that you've outlined for the merger? If that were to occur with some certainty, if you knew it were to occur say halfway through the period, would that alter the conditions that you suggest for the merger or are the conditions generic and appropriate regardless of whether or not the company would have a commitment to open -- full open access in the near term?

A. I don't think that would change our recommendations, no.

Q. You're familiar with the term stranded benefits in the electric industry restructuring literature?

A. Yes.

Q. Just to be clear, when you had a discussion with Mr. Manifold about benefit sharing or benefit shifting that was a different category of benefits. That was merger benefits, as I understand, as opposed to what --

A. That's what I was talking about was, yes, was the savings and not the benefits such as DSM programs, renewables, et cetera.

Q. Within the staff testimony, is there anyone that is addressing -- I know some of the testimony of Mr. Martin and I believe one other are addressing the accounting handling of DSM, but the concept of stranded benefits being whether or not they exist is a different question, but the concept of certain benefits that are within the bundled electric supply now may not be offered to customers in a competitive environment. Is that your understanding, the same as mine, on what a stranded benefit is?

A. Yes.

Q. Does anyone within the context of the testimony address the issue, that particular perspective on stranded benefits?

A. No, they don't address stranded benefits, and also for future DSM programs Frank Maglietti touches on that but says that decision shouldn't be made here. The programs should be evaluated before we come to a recommendation, so that would be done future risk.

Q. The question I'm wondering about, and maybe you can pass it on to Mr. Maglietti, is whether staff has an opinion of whether the merger has an impact one way or another on the exposure of customers to potential stranded benefits?

A. I don't think the merger has any more impact than they would have on a stand-alone basis.

COMMISSIONER GILLIS: Thank you.

EXAMINATION

BY JDUGE SCHAER:

Q. Ms. Linnenbrink, from your earlier testimony it appears that you believe that the rate plan proposed by staff would insure that costs associated with the contracts and schedule 48 recently approved would not be transferred to other customers or customer classes.

A. That's correct.

Q. Do you believe that the plan proposed by public counsel also insures this result?

A. It would also insure that by no increase.

Q. Is it possible, in your opinion, that still other rate plans could be designed to accomplish this protection?

A. Without having a specific plan in mind, yes, I think there could be others but you would need the no rate increase impact, I believe.

JUDGE SCHAER: Thank you. Is there any redirect for this witness?

MR. CEDARBAUM: Just a few questions.

REDIRECT EXAMINATION

BY MR. CEDARBAUM:

Q. Ms. Linnenbrink, you were asked questions by Mr. Harris about the dispute, apparently, between the staff and the company about whether the staff electric rate reduction was $75.5 million or the $103 million. Do you recall that?

A. Yes.

Q. Is it your understanding that the staff rate reduction is a $75.5 million rate reduction?

A. Yes.
Q. And that is the amount that is included in Mr. Martin's testimony?
A. Yes.
Q. And is that also the amount that Dr. Lurito modeled for his testimony?
A. Yes.
Q. Has staff had any discussions, to your knowledge, with the company to try to clarify for them that the staff electric rate reduction is the $75.5 million?
A. Yes, we have. It's my understanding Roland Martin has discussed that issue with John Story.
Q. Did he also provide documentation with Mr. story to help Mr. Story understand that clarification?
A. Yes, we responded.
MR. CEDARBAUM: Thank you. Those are all my questions.
JUDGE SCHAER: Thank you. Is there anything further for this witness?
MR. HARRIS: I have two or three questions, Your Honor.
JUDGE SCHAER: Please proceed.

RECROSS-EXAMINATION

BY MR. HARRIS:

Q. You were asked questions by Mr. Manifold about your calculations on the top of page 8 where you made a correction from 58 percent to 54 percent?

A. Yes.

Q. Could you explain how those calculations are made?

A. What I did was took the various -- all the various options out of Roland Martin's testimony, and that would include the amortization and the regulatory assets, the DSM, both the amortization and the DSM reduction, the gas rate reduction, and then put those in different categories of the customer classes and then compared those to the overall benefit number or savings number that was in staff's case, and calculated percentages, and that came up with the industrial customer class getting the 54 percent. I'm hedging here because I'm afraid I'm going to step into confidential numbers.

MR. HARRIS: That's all I have. Thank you.

JUDGE SCHAER: Thank you for your testimony. Let's go off the record for a moment to allow distribution for any exhibits for Dr. Lurito and allow Dr. Lurito to take the stand.

(Recess.)

JUDGE SCHAER: Let's be back on the record after a brief recess to allow the witness to take the stand. A number of documents have been distributed and let's start marking them for identification. I'm going to mark for identification as Exhibit T-87 the testimony of Richard Lurito. I'm going to mark for identification as Exhibit TS --

Is this top secret or confidential?

MR. CEDARBAUM: I believe this is top secret.

JUDGE SCHAER: -- TS Exhibit 88 Exhibit RJL-2. I'm going to mark for identification as Exhibit 89 Exhibit RJL-3, which is a summary of cases in which Dr. Lurito has testified. I'm going to mark for identification as Exhibit 90 the deposition of Dr. Lurito, and his Exhibit 91, did you want this marked as a group or individually?

MR. HARRIS: There's two exhibits in that group. If you throw the cover sheet away there's a one-page exhibit on top and then the rest of the package is grouped together as a single exhibit.

JUDGE SCHAER: As Exhibit 91 a one-page exhibit titled at the top 1992 WNG General Rate Case. As 92 for identification a copy of the order in UE-920840, service date of September 27th, 1993, and I believe that the cover sheet on this is incorrect. This should be UG --

MR. HARRIS: That's correct, Your Honor, it's UG.

JUDGE SCHAER: As Exhibit 93 for identification, a document with page numbered 13 at the top which says Public Counsel 22. As Exhibit 94 for identification, a document with a page No. 14 at the top entitled Public Counsel No. 23. And as Exhibit 95 for identification a document numbered page 15 at the top which is labeled Public Counsel 24.

(Marked Exhibits T-87, TS-88 and 89 - 95.)

JUDGE SCHAER: Are there any other exhibits for Dr. Lurito?

Whereupon,

RICHARD LURITO, PhD,

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

DIRECT EXAMINATION

BY MR. CEDARBAUM:

Q. Could you please state your full name and spell your last name.

A. My name is Richard J. Lurito, L U R I T O.

Q. And Dr. Lurito, you are president of

Commonwealth Consulting Group?

A. Yes.

Q. And you have been retained by the Commission staff in this proceeding to provide expert testimony?

A. Yes.

Q. Referring you to what's been marked for identification as Exhibit T-87, do you recognize this document as your direct testimony for staff in this proceeding?

A. Yes, I do.

Q. And your testimony was prepared by you or under your supervision and direction?

A. Yes, sir.

Q. And it's true and correct to the best of your knowledge and belief?

A. Yes.

Q. Referring you to what's been marked for identification as Exhibit TS-88, is that the exhibit that is referenced in your direct testimony?

A. Yes.

Q. And also Exhibit 89?

A. Yes.

Q. Both exhibits TS-88 and 89 were prepared by you or under your supervision?

A. Yes, they were.

Q. And they're both true and correct to the best of your knowledge and belief?

A. They are.

MR. CEDARBAUM: Thank you. Your Honor, I would offer Exhibits T-87, TS-88 and Exhibit 89.

JUDGE SCHAER: Any objection?

MR. HARRIS: No, Your Honor.

MR. CEDARBAUM: Witness is available for cross.

JUDGE SCHAER: Those documents are admitted and we will take our lunch recess at this time. Please return at 1:15. We're off the record.

(Admitted Exhibits T-87, TS-88 and 89.)

(Lunch recess taken at 11:50 a.m.)

AFTERNOON SESSION

1:15 p.m.

JUDGE SCHAER: Let's be back on the record after our lunch recess. Over the lunch hour I believe, Mr. Manifold, you had distributed copies of Exhibits 85 and 86. Is that correct?

MR. MANIFOLD: Yes. I think it was distributed for me.

JUDGE SCHAER: And Mr. Cedarbaum, have you had an opportunity to glance at 85 and see if those are the pages that you heard me rule could come in?

MR. CEDARBAUM: Let me just have a second now.

MR. MANIFOLD: In addition to -- specific to the things that were referenced we tried to copy just that part of the pages that were relevant.

MR. CEDARBAUM: It appears to be what you decided would be admitted.

JUDGE SCHAER: Well, then, the document that's now distributed marked at the beginning staff response to public counsel data request No. 8, which we now recognize as a partial response, is Exhibit 85 and has already been admitted. And the order in docket UE-960696 Commission, order approving schedule 48 with conditions, has already been admitted as

Exhibit 86. Mr. Harris, did you have questions for Dr. Lurito?

CROSS-EXAMINATION

BY MR. HARRIS:

Q. Good afternoon.
A. Good afternoon.
Q. Matthew Harris for Washington Natural Gas. Dr. Lurito, do you have a copy of what's been marked as Exhibit 90, which is an excerpt of your deposition transcript? If not I have a copy here I can hand you.
A. I'm sure I have it here somewhere.
Q. Just to speed things along, I will pass it up to you.
A. Thank you.
Q. Sure. Did you have a chance to review your transcript after the deposition?
A. You know, I don't think I did.
Q. Do you or counsel have any corrections you wish to make to the transcript?
MR. CEDARBAUM: If this is a complete, accurate version of the transcript that you indicated to us that you would offer into evidence, I don't have any objection to it.
MR. HARRIS: It is. At this time the joint

applicants would offer Exhibit 90.

JUDGE SCHAER: That document will be admitted.

(Admitted Exhibit 90.)

Q. Now, Dr. Lurito, it's our understanding that you were hired by staff to do the financial analyses in this case?

A. It's true.

Q. And at some point staff showed you various rate plans and we asked you some questions about those rate plans during your deposition and we have no intent of repeating those questions here, but I do have a few questions about the $103 million cut proposed and the $75 million cut proposed.

Were you shown at one point a plan that proposed a $103 million rate cut?

A. Thereabouts, yes.

Q. Did you review that plan?

A. Yes.

Q. Perform some sort of financial analysis on it?

A. Yes.

Q. Reach a conclusion about whether it would be appropriate or not?

A. Yes.

Q. And what was your conclusion?

A. My conclusion was while I didn't view it as inappropriate, I feel that the plan that staff is now recommending is more appropriate.

Q. Why is that?

A. Well, as you can imagine, these are matters of judgment. We're all in this room making judgments as best we can. And one of the things that I felt would be appropriate, and there are principles which tried to guide what I am doing -- and one of the principles is that investors should be fairly treated -- that the merger is something that can be in everyone's benefit if it's handle properly. Everyone can be made better off.

And what I was trying to do was to come up with a plan that I felt balanced the interests of investors and consumers fairly, would put investors in a position of earning at or near what one might consider to be a fair rate of return, would provide sufficient coverages, not to have bonds downgraded to a point to where they would no longer be investment grade, which would be below BBB, and which would also provide the company an ongoing opportunity to finance on reasonable terms, and, as I say, the number one consideration is to fairly apportion benefits amongst the interested parties, the parties that have interests here. Of course, the workers have interests, too, but what I was analyzing because I can't do much about that, I was analyzing it from the point of view of the ratepayers of both companies and the investors of both companies.

JUDGE SCHAER: Dr. Lurito, would you please pull your microphone a little bit closer to your mouth?

THE WITNESS: Is that any better, Your Honor?

JUDGE SCHAER: The people that are waving at me from the back --

THE WITNESS: Is this any better? I'm sorry.

JUDGE SCHAER: Thank you.

THE WITNESS: It's a lean problem here.

Q. So given the standard that you just described and the interests that you were balancing, did you reach the conclusion that the proposed $103 million would be unfair to the investors?

MR. CEDARBAUM: Object to the form of the question. There is no proposed $103 million rate reduction. There was a scenario Dr. Lurito considered but it is not the proposed staff rate reduction.

MR. HARRIS: Let me rephrase the question.

JUDGE SCHAER: Thank you.

Q. In reviewing the scenario that contained the $103 million cut, did you reach the conclusion that it would be unfair to investors?

A. No. I wouldn't say that it would be unfair. As I said before, we're talking judgments here, and my judgments have to do with what is more reasonable. There's a difference. It didn't have to be unfair if it's somewhat less reasonable. It's just because there's a line that one crosses, in my judgment, between what one would call unreasonable and reasonable. Once one gets into the reasonable zone, if you will, then what you talk about is more reasonable or less reasonable, and I was saying that I think that the one that staff ultimately proposed is more reasonable.

Q. Did staff come up with the $75 million number or was that your number?

A. No, I had nothing to do with selecting numbers. Staff provided me with plans, various of them, and asked me to analyze them, and I did that straightforwardly.

Q. So after you analyzed the scenario that included the $103 million electric rate decrease, you didn't then advise staff that a decrease any greater than $75 million would be unacceptable?

A. No, I never said that.

Q. You never said that? You never said anything like that?

A. No. What I said was, because they were providing plans that had different ways of accomplishing reductions, and they provided me a whole bunch of them I think at one time, three or four at one time so that it wasn't one at a time kind of thing, give me one, look at it and go to another one. I think I was provided four of them within two days and three of them I believe in one fell swoop, so it wasn't an iterative process. I had a bunch of them in front of me which I then analyzed.

Q. And in doing your different analyses, you always worked on the assumption that there would be 100 percent achievement of stretch goals; is that correct?

A. Yes. That was the assumption, which is the same assumption the company made.

Q. Well, wait one second. The same assumption that the company made where?

A. In its rating agency presentation.

Q. You had a copy of the rating agency

presentation?

A. Yes. I believe it was a data response or something in this case.

Q. And you saw the numbers listed down at the bottom of that rating agency presentation for stretch goals, correct?

A. It was my understanding that that plan had them in there, yes, and in fact we worked off of the rating agency presentation so whatever was in there was in there.

Q. So was it your assumption then based on your review of the rating agency presentation that the company was forecasting 100 percent achievement of stretch goals?

A. I don't know what their forecast was. I don't know. The numbers spoke for themselves. Staff took those as being the company's best estimate, and I think we discussed this on the deposition if I recall. I took them at their face value meaning it was my understanding that they were the company's, let me call it, best estimate, for lack of a better word, of what's going to happen.

Q. Now, would you have performed your analysis differently if your understanding had been instead that those were goals that management thought would be difficult to achieve and that in fact they were not management's best estimate of what would have happened or what would happen?

A. If I had known that going in, so to speak?

Q. Yes.

A. I don't know. The reason why I say that is I would have to know more, why is management saying that. In other words if they have a number -- it's always difficult for me to comprehend a situation where someone says I've got a number but it really isn't my best judgment. Then I say to myself, well, what is it?

Q. Well, let me refine the hypothetical a little bit.

A. I'm not trying to play games with you. I don't know what to do in that case.

Q. Sure. Let's assume that management does know what this number is and that it's a target for them, a goal, something that will be very difficult for them to achieve and they're not sure that they could ever achieve all of it. So it's not a forecast. It's instead something that they're going to stretch to achieve. They have no specific plan to achieve it. Now, that's a different assumption than the assumption you were working with when you did your financial analysis based on the rating presentation presentation, correct?

A. No. Because I don't have a view that it's like a person running a race, I can really run faster but I didn't. Well, you know, you never know about that statement. It seems to me that management is being paid to do its best. Now, its best means its best. We don't start putting ratings on best, it's 80 percent of best, 90 percent of best. It's either best or it isn't best. This management has an obligation to its investors and to ratepayers to do its best. I assume that was its best, doing its best.

Q. So is your testimony then -- I'm a little confused. Is your testimony that you wouldn't have done anything different if you had known that in fact the stretch goals were not forecast but were instead targets set at a level that management believed would be difficult or perhaps even impossible to achieve?

A. Well, impossibility is not a goal. A goal is something that's attainable. Granted with some level of human effort but is attainable. When we're talking about impossible that's not a goal.

Q. What if you had had an additional piece of information that management believed the most likely outcome or their best estimate of what would happen in the future is that a percentage, a relatively small percentage, of those stretch goals would actually be achieved. Would you then have revised your financial analysis?

MR. MANIFOLD: Your Honor --

Had you finished?

MR. HARRIS: I had finished.

MR. MANIFOLD: I would like to object to this question because it mischaracterizes the record. I think what the record reflects is that the record requisition to which the company responded was one in which the staff asked the company for its best estimate of what the future would hold, and it appears that the company is now trying through this witness to impugn their own data response.

MR. HARRIS: I don't believe that's a proper objection to the question. The question is just asking the witness how he would have performed the analysis differently without making specific assertions about what was in the rating agency presentation itself. And I don't believe that we made any representations about stretch goals being forecasts in responding to that data request.

JUDGE SCHAER: Well, perhaps it would help me if someone could tell me what the data request was that was responded to.

MR. HARRIS: Data request 38, I believe.

MR. CEDARBAUM: Your Honor, if I can interject. What data request 38 asked was to provide Puget, Washington Natural and NewCo, as we called it then, stand alone and merged financial forecasts for the rate stability period. That's what we asked for. We didn't ask for a rating agency presentation. What we got was a rating agency presentation.

MR. MANIFOLD: We have a copy of the data request and intended to make it an exhibit on a company witness. We would be happy to do that now if that would be of any assistance. We don't have copies yet. The objection really is a relevance one in that the evidence says one thing and the question puts as a supposition something other than what is currently the evidence in this case.

JUDGE SCHAER: Mr. Harris, what evidence are you going to have to support your hypothetical at some point in this proceeding?

MR. HARRIS: Mr. Torgerson's rebuttal testimony, which has been or has survived the motion to exclude it, addresses this issue directly and explains how these stretch goals are in fact not forecasts and are difficult to reach management targets designed to give management an incentive to strive to do the best and so on and so forth. It fits very well with the line of questioning that is going on right here.

MR. MANIFOLD: Your Honor, given that it's a hypothetical question based upon evidence which the company intends to produce later I would withdraw my objection as long as it's clear to the witness and to the record that that's the basis of the question rather than a representation of what's in the record now.

JUDGE SCHAER: Do you understand this to be a hypothetical question, Dr. Lurito?

THE WITNESS: I think I do.

JUDGE SCHAER: Please respond.

A. Well, the only way I can respond is that when I received the data request -- response, excuse me -- I thought the response spoke for itself. What was asked for was a forecast. This is what we got. Now, if it wasn't a forecast then it would seem to me at that point in time the company had an obligation to say to me or anybody else obviously at this time, by the way, when we use the word "forecast" we want you to know that it's not our best estimate. It's at the absolute outer limit of our management working 20 hours a day, et cetera, et cetera, and getting a lot of breaks. I didn't hear that. And even now that I hear it after the fact -- you have to pardon me for being a little suspicious -- I'm hearing it now after the fact that this wasn't a -- I don't want to say serious but it wasn't something that humanly could be reached. It was really calling for something pretty super human. I have trouble with that.

Q. I think I understand your answer. I still don't know if you would have performed the analysis any differently. Is your answer no, that you would not have?

A. No, that's not my answer. My answer is if that had been called to my attention at that point in time I would have inquired further. What I would have said then we need to have all the bases for all of their estimates, whatever they might be. Okay, probabilities, put on them, or some way of measuring how likely the outcomes are so that one could do kind of a little probability study and say, well, it looks likes savings between X and Y would have a 90 percent probability, between A and B would have a 70 percent probability, et cetera, et cetera. But that's what I would have done if I was aware of this ex ante.

Q. Now, when you were performing your analysis

you had already reviewed our opening case, correct?
A. I think so.
Q. And you were aware, weren't you, that the company had not relied on that data in its opening case, correct?
A. Yes, I am aware of that.
Q. And it had first been produced in response to this data request 38 that we were just talking about?
A. I believe that's a fair statement.
Q. And you had also reviewed the cross-examination of the company's case by that time?
A. Tell you the truth I don't know the answer is yes or no to that. I'm sure some of it, but I don't know that I had reviewed all of it.
Q. What about the cross-examination of Mr. Torgerson?
A. I believe I reviewed that.
Q. So you were aware, then, that Mr. Torgerson on cross-examination had pointed out that there were some aggressive assumptions built into those forecasts?
A. Yes, I remember the word.
Q. And you recall that he had pointed out they weren't done on a Commission basis?

A. He could well have said that. That does not leap to mind. I'm not saying he didn't say it, I just don't recall that, but the other statement, the aggressive I recall that.

Q. Were you aware that Mr. Torgerson produced what he thought were more accurate forecasts in response to record requisition 19?

A. More accurate?

Q. Yes.

A. I am not aware of that.

Q. The results or the data that was produced in response to record requisition 19 was supplied to you, wasn't it?

A. I think it was. I have a hard time with these record requisitions and exactly what was asked and what was in the answer, I'm sorry.

MR. CEDARBAUM: If you can provide him that then that would help to refresh his memory.

Q. Well, instead, if it's helpful, do you have your data request responses with you?

A. I think so.

Q. I will tell you, and maybe we can short-circuit this, in response to data request 34 which asks you to identify each and every data request response in these proceedings that have been provided to you, you listed record requisition 19.

A. Yes, I see it.

JUDGE SCHAER: Do you have a copy of that available, Mr. Harris?

MR. HARRIS: Sure.

JUDGE SCHAER: If you're going to ask the witness about whether it's more accurate I think it's appropriate to let him look at it.

MR. CEDARBAUM: What number was that again, Counsel?

MR. HARRIS: 34.

A. Yes, okay. I see the answers, et cetera, et cetera, yes.

Q. Do you recall that you had that information when you were doing your financial analysis?

A. Let's just say I did. I don't know, but I assume I did because I obviously had the answer.

Q. But you didn't rely on that information?

A. No, I didn't.

Q. Instead you relied on the rating agency presentation?

A. Absolutely.

Q. Were you concerned about relying on the rating agency presentation given Mr. Torgerson's testimony about it?

A. Well, you know --

MR. CEDARBAUM: Excuse me, which testimony?

MR. HARRIS: The testimony that we were discussing earlier where he discussed the aggressive assumptions and the nonCommission basis nature of it.

JUDGE SCHAER: Do you have the transcript of that available, Counsel?

MR. HARRIS: We can provide that.

JUDGE SCHAER: Please. I believe the witness had testified that he remembered one of the statements and not the other and I'm concerned that the record is going to be a mish-mash if we don't make sure that he knows what you're talking about.

MR. HARRIS: I would be happy to proceed at this point using only the aggressive assumptions part of it if that's the part the witness remembers. Just to keep things moving.

JUDGE SCHAER: All right.

A. Can I have the question again? I'm sorry.

Q. Sure. Given Mr. Torgerson's testimony about the aggressive assumptions underlying the rating agency presentation, did you have concerns about relying on that, doing your financial analysis?

A. Absolutely not, because the word aggressive doesn't mean impossible. Doesn't mean we can't do it.

It just says, hey, we're going to stretch management to do its best, best, best, and that's what it should be doing. They should be out there doing aggressive things.

Q. As part of your analysis of the rate plan proposed by staff, you calculate an average ROE over the five-year period?

A. I did.

Q. Do you have any opinion about the likelihood of the company achieving that?

A. No. When you say likelihood, that's obviously very, very difficult to say. The only thing I can say is that it's based upon obviously company's response to data requests and it's based upon the staff rate plan. I would hesitate to put probabilities on it. I wouldn't know how to do that because obviously we're in a very, very uncertain period. We have transitions, things are happening, so it's very difficult to say what the probability is. I just don't know how I would assess it.

Q. You say we're in a period of uncertainty and there are transitions. You're talking about the transition in the marketplace that is beginning right now?

A. I'm talking about that transition and what we're doing today. If there's a merger, if the Commission were to approve this merger we're going to obviously have a new different company, different ways of competing. We're going to have a company that is going to be facing a marketplace which is going to be changing downstream. We have a Commission that may be having to deal with issues that are not being dealt with yet or in this case that may affect the company. I had no idea what that might mean, so, yes, we're entering a period of transition and uncertain, there's no question, but I can't assess that. I wish I could, in terms of their earning a rate of return that I am recommending or that is implicit in staff's plan.

Q. Back to the subject of stretch goals. I asked you in your deposition about whether you had done any analysis of the likelihood of the company achieving the stretch goals and you said you had?

A. That's true.

Q. Since that time you haven't undertaken any such analysis, have you?

A. No, that's beyond the scope of my expertise.

Q. You've testified in many different rate proceedings, haven't you?

A. Yes, sir.

Q. You're familiar with the known and measurable standard?

A. Yes.

Q. Assume for a moment that the known and measurable standard were applied here. Would stretch goals qualify as known and measurable?

A. You mean if this were a traditional rate proceeding?

Q. Sure.

A. Where there's a test period and all that goes into that?

Q. All I'm asking, if the known and measurable standard were to be applied would stretch goals qualify?

A. Within the context of traditional ratemaking probably not, but then again maybe the merger savings that Mr. Flaherty has estimated wouldn't either. That's one of the problems in this case, and I think the Commission and all of us need to meet this. There's no sense hiding this under the rock. The truth of the matter is we have a merger; whether it's approved or not hinges crucially on the benefits that will inure from that merger. Now, even though we may sit there and say as accountants or as traditional ratemakings this is not a known and measurable, this is not on a Commission basis, unfortunately we have to deal with the realities here and the realities of this case is that the company has proposed a rate plan, which is certainly its prerogative. Staff has responded in kind. It's my understanding that the Commission basis has not really been met, and therefore what we are here asking ourselves is, how should the benefits and whatever these benefits might be, how should they be apportioned among the interested parties?

So the issue of whether they're known and measurable to me is a ratemaking issue but it is not an issue that needs to be dealt with when one asks the question should there or should there not be a merger. In my judgment the issue before the Commission is this. This merger is going to give investors an extremely valuable asset. That asset cannot -- the value of that asset is not easily quantifiable. Indeed no one in this case to my knowledge has quantified it, and that is that we are creating a company that's going to be better able to compete in a nonregulated world or deregulated world that we're moving toward, better than either WNG or Puget standing on its own. We are eliminating an existing competitor to Puget through this merger. And, just as importantly, we are creating an environment where a third party utility is not going to be able to come in and buy Washington Energy Company and compete with Puget in Puget's own service territory. We are here dealing with a situation where that avenue of competition has been foreclosed.

Now, I'm not saying therefore that I oppose the merger, and in fact Mr. Maglietti I think has done a wonderful job in his testimony of laying out all of the merger risks that investors can face. Even though those, in quotes, benefits -- and I alluded to them in my testimony -- that investors might be getting cannot be quantified doesn't mean they're not most significant. Therefore, to me the threshold question -- and to me this is a merger case, it's not a case about stranded costs. This is a merger case. And the question before this Commission is: How should potential benefits of the merger be apportioned and what apportioning balances in their judgment the interests of investors and ratepayers. That's the essence of staff's rate plan and we can't lose sight of that.

And staff has an answer to that question. Perhaps the Commission, obviously, may have a different answer, which is obviously their prerogative, but I think we cannot ignore that and if we take the so-called known and measurable items off the table then we ought to take them all off the table. Let's take Mr. Flaherty's savings, the power stretch, the best practices all off the table at which time what are we sitting here doing. The question begs an answer. The answer is they're on the table, let's talk about them as best we can. You can characterize them as aggressive, best estimate, whatever you want, but they're there. Let's talk about them. Let's get a balancing of the interests. That's what staff is trying to do, at least that's what I am trying to do to the best of my ability.

Q. Assume for a minute that there were no stretch goals, they hadn't been included in the rating agency presentation, they simply didn't exist. Would you still be recommending staff's rate plan?

A. That's like asking if pigs could fly how much would they charge to fly you from here to Chicago. This is a hypothetical we don't have to deal with because there's a reality on the table so that hypothetical doesn't fit reality. Let's talk reality. There are going to be savings. How much? Granted they might be debatable but there are.

Q. You're unwilling to answer the question?

A. As asked, absolutely.
Q. You can't form any judgment whether you would recommend approval of the rate plan with no stretch goals?
A. Let me put it to you this way. I would have some personally, not speaking for staff, I really don't want to.
Q. Just asking for your opinion.
A. In my opinion I would cast some real serious doubts on the size of the benefits that can be apportioned amongst the interested parties, and if we're down to a number that's represented by Mr. Flaherty's merger savings, assuming that, and I guess that's what you're asking me to assume, then I would have to say it would cause me to question the value given what it is investors are getting, what ratepayers may be giving up. It would make me question it, so I can't answer your question saying in my judgment sitting up here today I would be for it or against it or whatever. I would just say at this point, that's all I can say, that I would really have to question it.
Q. In your testimony you say that the analysis over the rate plan period should be made in the context of general principles that obtain in

nonregulated industries?

JUDGE SCHAER: Could you give us a page?

MR. HARRIS: Page 10, lines 2 through 4.

A. Yes. What I'm saying there is simply this. That in truth, the company chose to cast this case in its direct testimony in a rate plan context. It did not choose, as I understand it, what we used to call traditional regulation. Didn't put in a test year. Didn't do all the old usual things which I won't burden the record with. So I was analyzing their rate plan within that context, and what I am saying is that when one then comes up with criteria perhaps they needn't be as stringent as the criteria that might be otherwise be applied in a nonregulated environment. This isn't to say, and I think a fair reading of my testimony and certainly Mr. Story helping me out with respect to his response to data request 236, shows clearly that staff's rate plan gives investors every opportunity to earn a fair rate of return on their investment, and certainly would preserve the concept of investment grade ratings. So that in my judgment, even though I do not believe the Commission is under any obligation or any party is under any obligation to use the traditional regulatory standards, if you will, to measure the appropriateness of the rate plan, I believe the rate plan that staff proposes would meet even those most stringent criteria.

Q. So you do believe that investors are going to be given an opportunity to earn a fair return under staff's rate plan?

A. Yes, if investor's management goes out and is aggressive, in the words of Mr. Torgerson, it's better than being a shrinking violet. I mean, I assume they're going to go out there and be aggressive. Certainly investors expect them to be aggressive.

Q. And the fact that you've reached this conclusion that investors will be given an opportunity to earn a fair return, is that important in your opinion that staff's plan is appropriate?

A. No. What I'm saying is it's not a necessary or a sufficient condition. What I am saying is if the plan comes close to doing that -- and again this is a judgment -- in my judgment staff's rate plan comes very close to meeting most if not all of what we would call traditional standards. It doesn't have to. It just happens to.

Q. Just so I'm clear on this, it doesn't have to because a rate plan has been proposed?

A. Yes, that is not traditional regulation.

Q. Back to your suggestion about substituting nonregulated industry tests for traditional regulated industry tests. You agree, though, don't you, that the Commission will continue to have full regulatory authority over PSE during the rate plan period, don't you?

A. I assume so, yes, sir.

Q. And that the Commission will still have full authority over rates during that time period?

A. Well, I guess so, sure.

Q. Same is true for service quality?

A. I would hope so, yes.

Q. Auditing and reporting requirements?

A. That's my understanding that they haven't been waived.

Q. Back to the test. Again, you made a statement back in the 1992 gas case -- you can accept this subject to check but you stated, "it seems to me that the Commission's responsibility as regulators is to balance the interests of investors and consumers." Would you still agree?

A. Yes. It's a standard of the Permian Basin decision, yes.

Q. You also said, and again you can accept this subject to check, "that regulation should do what's necessary to give the company every reasonable opportunity to maintain its current bond rating." Do you still agree with that statement?

A. In the context of this case?

Q. Yes.

A. What I am saying there is that the standard is not as strict, in my judgment, doesn't have to be as strict. What I am saying is that staff's rate plan does, in my judgment, meet that test but I am simply saying it doesn't have to any more because this is not a traditional rate case.

Q. Finally in the '92 gas company case when asked why you would not recommend a situation where bond ratings would go too low you said in response -- and again you can accept this subject to check -- "because it's not fair to investors. The regulation is a balancing of interests, as I mentioned before. When that balancing is improperly done, when it's done on the side of investors or the side of ratepayers usually it's not good regulation." Still agree with that statement?

A. Sounds good to me.

Q. Does it apply in this case?

A. Yes, but with different criteria. The Commission can determine those criteria, but the balancing, I have no problem with that. That's proper.

Q. Now, have you had an opportunity to review Mr. Torgerson's rebuttal testimony in this case?

A. Very quickly.

Q. He draws some conclusions about future bond ratings. Are you familiar with those conclusions?

A. Yes. I think he doesn't think that the bonds will maintain their rating.

Q. You disagree with his conclusions?

A. Let me say that, yes, I disagree. However, events can intervene where it it looks like I'm right, so to speak, or he's right, but that's not really the right issue here. That's not the focus. This is not a contest on who is right and who is wrong. It's a contest of what is appropriate regulation and regulation has an obligation to do all it can, but none of us, as God, we don't walk on water or have 20/20 foresight. We do the best we can. But as a principle I have no problem with that.

Q. And it's your view, though, that the bond ratings -- if staff's rate plan is imposed that the bond ratings will not likely deteriorate, isn't it?

A. Well, based on Mr. Abram's testimony in rebuttal and from Mr. Story's response to our data request No. 236, I think even if one adjusts for purchased power -- talking about adjusting capital structure and coverages -- staff's rate plan results appear to support the contention that ratings will be maintained, yes.

Q. So it's fair to say that you and Mr. Torgerson disagree about future bond ratings for the company?

A. If Mr. Torgerson has made an adamant statement, they're going to go down -- I'm not sure he has, but if that's it then, yes, I disagree.

Q. You disagreed with Mr. Torgerson back in the 1992 gas company general rate case, didn't you?

A. We have a habit of disagreeing, yes.

Q. And in that case you testified in support of staff's case?

A. I did.

Q. You supported their recommendations and the recommendations included the significant rate decrease?

MR. CEDARBAUM: Your Honor, I guess I will object as a mischaracterization. Dr. Lurito testified on cost of capital in that case, and that was the extent of his testimony. The question was did Dr. Lurito support the staff recommendation in total, and

I just don't think that was the extent of his involvement.

Q. You're free to explain the extent of your involvement.

A. Thank you.

JUDGE SCHAER: Let me then -- so you're objecting to the form of the question?

MR. CEDARBAUM: Yes. If the form of the question is to the extent of Dr. Lurito's involvement in the case, which was cost of capital, I don't have any objection. It was not stated that way.

JUDGE SCHAER: Would you like to rephrase it?

MR. HARRIS: Sure.

Q. Why don't we start by having you explain what your involvement was in the '92 gas company general case?

A. As I recall it was to give overall rate of return testimony which obviously includes a determination of a appropriate capital structure, an appropriate cost of debt preferred and common equity capital.

Q. And then what will flow out of that determination eventually is a revenue requirement, correct?

A. It's a part of the revenue requirement, sure.

Q. Now, I would like to direct your attention to what's been marked for identification as Exhibit 91.

A. I have it, thank you.

Q. Summarizes some of the facts in the 1992 gas company general rate case. Line 1, company recommendation, 45 percent common equity. Was that your recommendation in that case?

A. No.

Q. That was the company's recommendation, correct?

A. Yes, I think that's what you asked.

Q. Yes.

A. Yes, it was the company's recommendation.

Q. And your recommendation is shown on staff's line and it was 41 percent?

A. Yes.

Q. And back to the ROE line, the company was asking for 12.25 percent?

A. Yes, sir.

Q. Your recommendation was 10.5 percent?

A. Yes.

Q. And with all the other adjustments company

was asking for a $14.8 million increase in revenue?
A. Yes.
Q. Staff's recommendation was a $24 million decrease in revenue?
A. I will accept that, sure.
Q. And when the order came out focusing just on common equity and ROE it adopted a position on common equity that was more favorable to the company than what you were recommending; is that correct?
A. I think you might have misspoke, but if not then I misheard, so try it once more.
Q. The order when it came out it implemented a 44 percent common equity ratio --
A. Yes, that's true.
Q. -- which was more favorable to the company than what you were recommending at 41 percent?
A. It's true.
Q. And it adopted your 10.5 percent ROE?
A. That's true.
Q. And it substituted a rate cut less than what was being recommended by staff?
A. I will accept that, yes.
Q. Now, during that case you gave testimony, and the testimony included the following, and you can accept this subject to check.

A. Sure.
Q. "First, I see no evidence, no empirical evidence whatsoever, to lead me to believe that the company would be downgraded if the Commission were to follow my recommendation." Will you accept that you gave that testimony subject to check?
A. Sure.
Q. "Second, I firmly believe that the recommendations I have made will not lead to that downgrading." Do you accept that subject to check?
A. Sure.
Q. "The case staff has put forward I believe is sufficient to allow the company to maintain its bond rating." Will you accept that subject to check?
A. Yes, and there I was referring, so to speak, to me as staff. I had no judgment about the rest of staff's case. That's beyond my expertise.
Q. Do you accept subject to check that Mr. Torgerson gave the following testimony. "First, implementation of the staff's recommendation would result in the downgrading of WNG"?
A. Yes, sure.
Q. That really is the heart of the disagreement that you had with Mr. Torgerson in that case, isn't it?

A. That's not all of it but certainly part of it.

Q. And also you can accept this subject to check that Mr. Torgerson testified "an unfavorable decision in this case creates great potential for a downgrading"?

A. I accept he said that.

Q. And after the order was issued were you aware that the company's senior debt was downgraded within 24 hours?

A. Yes.

Q. Do you follow Washington Natural at all? Were you aware that they applied for interim rate relief in 1995?

A. Yes, I understand that. I wasn't a part of that case but I understand that.

Q. And through a settlement they obtained relief?

A. That's my understanding.

MR. HARRIS: The joint applicants at this time would offer Exhibit 91 as a summary of the 1992 WNG rate case as it relates to Dr. Lurito and Mr. Torgerson.

JUDGE SCHAER: Any objection?

MR. CEDARBAUM: I don't object to the

exhibit. That's fine. I have no objection.

JUDGE SCHAER: That document is admitted.

(Admitted Exhibit 91.)

MR. HARRIS: I have no further questions.

MR. CEDARBAUM: What about 92?

MR. HARRIS: Given that 91 has been admitted and 92 is simply backup for 91, we see no reason to burden the record with it. If you would like to put it in --

MR. CEDARBAUM: No. I was just keeping track.

JUDGE SCHAER: So 92 has been withdrawn?

MR. HARRIS: Yes, Your Honor.

JUDGE SCHAER: Dr. Lurito, Commissioners are having trouble hearing you.

THE WITNESS: That's really unusual.

JUDGE SCHAER: For some reason your microphone has a little -- doesn't have the long arm to get it up to your mouth like some of the others do.

THE WITNESS: Is that better?

JUDGE SCHAER: Would you like to trade microphones with Mr. Harris and see if that helps?

THE WITNESS: It won't change the answers but if that helps.

JUDGE SCHAER: I just want to make sure

you're heard.

THE WITNESS: Is that better?

JUDGE SCHAER: You almost have to gargle with these things.

THE WITNESS: Thank you.

JUDGE SCHAER: Mr. Manifold, did you have questions for Dr. Lurito?

MR. MANIFOLD: I have a few.

CROSS-EXAMINATION

BY MR. MANIFOLD:

Q. Do you have before you what's been marked as Exhibits 93, 94 and 95 which are I believe your responses to public counsel data requests respectively 22, 23, 24?

A. Yes, I'm sure I do. Yes, I do.

Q. Each of which is one page?

A. Yes, thank you.

Q. Were those the answers you provided and are they true and correct to the best of your knowledge?

A. They are.

MR. MANIFOLD: Your Honor, move for admission of Exhibits 93, 94 and 95.

MR. CEDARBAUM: No objection.

JUDGE SCHAER: Those documents are

admitted.

(Admitted Exhibits 93, 94 and 95.)

Q. Were the input assumptions to your analysis such as the restating adjustments referred to in your response to another public counsel data request provided to you by staff?

A. Yes.

Q. If those assumptions were to change, would your conclusions change?

A. They might.

Q. If the input assumptions assumed more revenues or greater savings than you were provided, might your recommendation as to what the zone of reasonableness or reasonable safety be changed?

A. I don't think what I would consider to be the zone of reasonableness would change. It would just be that the numbers that came out of the analysis would of course change and if I'm not being responsive I apologize.

Q. The zone stays the same whether or not the company is within it or not changes?

A. Right. The whole principle has got to have a little anchor anyway.

Q. Referring to Exhibit 93, would you agree that for Washington Natural Company the actual capital

structure has been more debt heavy than the capital structure allowed by the Commission for ratemaking purpose?
A. Yes, and you're comparing the -- I'm sorry, find the exhibit that I was just given.
Q. Public counsel No. 22.
A. Yes. And this is the total debt to total capital ratio?
Q. Right. Is it correct that that is the actual capital structure, correct?
A. Yes.
Q. And this is more debt heavy than the capital structure that has been used for ratemaking purposes for Washington Natural Company?
A. Yes. That's my understanding.
Q. Like to refer to your testimony at page 21.
A. I have it, thank you.
Q. You set out the debt to capital ratio there. Have you assumed that the merged company will continue to pay a dividend of $1.84 in preparing these calculations?
A. Yes.
Q. Do you know what the combined book value per share of the merged company is initially? Is it between $16 and $17?

A. I believe that's right.
Q. Per share?
A. Per share.
Q. Would you agree that a dividend of $1.84 on a booked value of less than $17 a share is somewhat out of the ordinary for gas, electric or combined utility?
A. You're dividing dividend by the booked value? That's what you asked me, I think.
Q. Yes.
A. Yes. It's certainly on the high side.
Q. What would a typical dividend yield on book value be for an electric, gas or combine?
A. Probably on the area of 8 or 9 percent, somewhere in there.
Q. If Puget Sound Energy, the merged company, paid a dividend yield similar to other utilities, would you agree that there would be more retained earnings and the equity capitalization ratio would improve relative to the results you've shown on page 21?
A. Yes. Or putting it differently, just so I understand, if I grasped your question, for example, if PSE would decide to pay less than $1.84, which is its intention, then what would happen everything else

the same? The answer is of course they would have less outside financing requirements. Their equity ratio would rise. Is that what you asked me?
Q. That is what I asked you.
A. Yes, the equity ratio would rise.
Q. And just to be very clear, in case somebody would misconstrue your statement, their intention as you understand it is currently to pay $1.84 dividend?
A. That is my understanding of their intention.
Q. Correct. Referring to Exhibit 94 which is your response to public counsel No. 23.
A. Yes.
Q. Would you agree that the financial results from staff's rate plan in this proceeding would compare favorably with the actual financial results these companies have experienced over the last three years?
A. Certainly with respect to WECO and with respect to Puget it would be in line with that. It wouldn't be higher than that, but it would be in line with that.
Q. Referring to the next exhibit, Exhibit 95, public counsel No. 24, would you agree that the financial results from staff's plan would compare

favorably to the actual financial results which the combination of the two companies have achieved over the past two years -- five years?

A. Yes. If you put it in terms of combination, absolutely.

Q. In response to public counsel data request No. 25, and I will be happy to provide you a copy if you need it --

A. Believe it or not I brought it with me. I have it.

Q. Question was referring to page 22 of your testimony, what is Dr. Lurito's understanding of the typical payout ratio for gas, electric or combination companies and your answer was?

A. My answer was that the typical payout ratio for Moody's electrics in 1993 was 80 percent. It was about 70 percent for Moody's gas distributors. "Dr. Lurito is not familiar with the payout ratio for the typical combination company."

Q. Is that still the case today?

A. It is.

Q. How does the dividend payout ratio that PSE proposes of $1.84 compare to the typical payout ratios for electric or gas utilities?

A. Just so the record is clear, I think the question was not quite right as stated. I think you asked me about the ratio, and you asked me about the dividend itself.

Q. Yes, ratio --

A. What you're talking about is the payout ratio. Is that fair?

Q. Yes. You did get the microphone with the questions in it.

A. All right. As you know, under the staff rate plan the company would not have earnings sufficient to pay out of current earnings their dividend. Both companies' payout ratio historically has been very, very high, in some cases obviously over 100 percent because they've not been able to pay dividends out of earnings and in some some cases, like in the case of Washington Energy where the earnings have been negative, it's undefined, it's astronomically high.

Q. And does that continue to be the case with Puget Sound Energy?

A. The payout --

Q. Under the proposals?

A. Yes. Under the staff rate plan if they maintained $1.84 dividend then they would have to borrow that dividend because their earnings would not be sufficient to maintain it out of current earnings.

Q. And what is the percent -- do you know what the percentage is under the company's own proposal, the payout ratio?

A. Let me see if I can -- be patient. Let me see if I can dredge that up.

Q. Patience is something we all need in this room.

A. Under the company's plan?

Q. Yes.

A. Under the company's plan they would earn on average over the five-year period, and I don't know if you've cast the question that way, but if I could answer it that way their average is [confidential] of earnings. If they had $1.84 dividend then the payout ratio would be just about 86 percent.

MR. MANIFOLD: Your Honor, I have no further questions of Dr. Lurito. I do have a procedural question that I would like to pose now and it can either be taken up now or later as you wish. There were a number of bench requests made and responded to by joint applicants. We haven't actually dealt with whether, how and when those will be introduced as exhibits or not. Some of them include material that we were otherwise going to introduce later, so I am just assuming that at some point we'll take that up and I bring that to your attention.

JUDGE SCHAER: What the bench is doing with the bench requests is we had gone through and determined which ones of them we would want to see in the record and the accounting advisors faithfully keep keeping track of which portions of those other parties put in, and we are taking them out of the portion that we would then put in. And we had contemplated waiting until we were knew with the cross of the direct cases and then putting in what was left that we thought needed to go into the record before the rebuttal cross. So if you have something that you want to have put in you need to do it.

MR. MANIFOLD: I'm just hesitating because everybody already has copies because of having received copies through the bench request mechanism, and I hate to go out and make another set of copies for that purpose. Let us deal with this off the record.

JUDGE SCHAER: Certainly. Because if you want to identify that something came in through the bench request you may be able to limit the number of copies that you need to hand out.

MR. MANIFOLD: Thank you. I have no other questions of this witness.

JUDGE SCHAER: Mr. Frederickson, did you have questions for Dr. Lurito?

MR. FREDERICKSON: No, I don't, Your Honor.

JUDGE SCHAER: Mr. Wright?

MR. WRIGHT: No questions, Your Honor.

JUDGE SCHAER: Mr. Freedman.

MR. FREEDMAN: I have no questions.

JUDGE SCHAER: Mr. Merkel.

MR. MERKEL: No questions.

JUDGE SCHAER: Commissioners, did you have questions for Dr. Lurito?

CHAIRMAN NELSON: Go ahead.

COMMISSIONER HEMSTAD: Pass.

COMMISSIONER GILLIS: One quick one.

EXAMINATION

BY COMMISSIONER GILLIS:

Q. On page 5 of your testimony on lines 5 through 7 I'm just curious why you pulled out demand side management, as a merger that would dictate the demand side management initiatives would be sacrificed as something that would be significant enough, I guess, to negate a merger?

A. Again, I wasn't really saying that that one thing would do it. Perhaps it's inartfully worded. I was simply trying to give examples of the kinds of things that might, might arguably disqualify in the minds of the Commission a merger. It's certainly not a high priority. The most thing to me that the Commission must deal with is the issue of, as I said, the balancing of investor/consumer interests and getting a handle on what this new company is going to do, how it's going to do it, if it's going to be able to meet the new environment as it changes better than stand-alone companies. All of those kinds of questions are far more important than this one.

Q. That's just an example you're citing?

A. Exactly. No more than that.

EXAMINATION

BY CHAIRMAN NELSON:

Q. Dr. Lurito, at page 10, lines 2 through 4, you were cited, I think, by Mr. Harris to this question about the relationship between this industry and nonregulated industries. And I think he asked you about assuming the continuance of the Commission and the full panoply of regulatory tools, do you, looking ahead a couple of years, see the possibility of either congressional or legislative restructuring?

A. Of course that could well happen. I can only answer the question as where we are today and what is forseeable, but obviously there's many things afoot that could change everything, and very dramatically, as you say, legislatively or otherwise. And yes, and I think in this particular case the Commission has to contemplate the merger to see whether or not in its judgment it is beneficial in a new world that might not look exactly like this world. I think that's exactly part of our problem, isn't it, that we need to do that, that we need to put a company together that may be able to withstand changes that maybe move in the direction of causing the company's rating to go down somewhat and what have you. And we have to provide a survivability.

Q. Do you see parts of this company as being candidates for light-handed regulation or deregulation?

A. Well, it could well be that the generation portion at some stage might become deregulated just by the sheer force of competition looking downstream. I think that's the wave of the movement, of the industry, and at some point in time that may be a reality here. Yes.

EXAMINATION

BY JUDGE SCHAER:

Q. Dr. Lurito, just a moment ago in response to a question from Mr. Manifold I believe that you indicated on average over the five-year period that under the company plan it would earn [confidential] per share. What level of return on equity is that?

A. The average return on equity consisting with that is 12.7 percent.

Q. Like to discuss with you a little bit of what's brought out by Mr. Story in his rebuttal and here's some of your responses. First, why didn't you adjust the ratios you calculated for the effect of purchased power contracts?

A. Well, in the first place I am not sure that that is an appropriate thing to do. I realize some rating agencies, and I know there's been some rebuttal testimony in this case by Mr. Abrams speaking to that issue, applying what he considers to be the Standard and Poor's techniques, even though Standard and Poor's does not do this formally, but applying their techniques to the staff plan to see what kind of coverages and what kinds of capital structures emerge.

In my judgment the appropriate thing to look at is straightforward descriptions of coverage requirements as published by Standard and Poor's, but, but even if Mr. Abrams's test that adjusts for purchased power is applied in this case to staff's rate plan, Mr. Story's response to I believe it's staff data request 236 shows that they would be able to maintain the BBB rating even if purchased power is taken into account. That is, the coverages and the capital structures would withstand that.

Q. What's your response to the other concerns Mr. Story raised regarding your treatment of noncash items as cash items?

A. Yes. As a matter of fact, as you know, that data request I just alluded to, No. 236 --

Q. Let me let you know that the bench does not receive responses to data requests so this is a mystery to me.

A. I'm sorry.

MR. CEDARBAUM: Can I interject? Based on the cross-examination to Dr. Lurito and with respect to your questions I had intended on redirect to offer that staff data request response -- or Mr. Story's response to staff data request 236 and I can go ahead and distribute that now if that would be helpful.

JUDGE SCHAER: I think that might be helpful.

MR. CEDARBAUM: I've also been advised by Mr. Harris that although this wasn't stamped top secret that it ought to be treated that way. So I will just hand it out to the people with decoder rings.

Would you like me to inquire on this one exhibit?

JUDGE SCHAER: I'm going to ask you, I've got two things here that aren't the same thing. One is response to 236 and one is response to No. 20.

MR. CEDARBAUM: It should be just response to 236.

JUDGE SCHAER: I think you got these in the wrong pile. Do you want to go ahead and ask?

MR. CEDARBAUM: What exhibit number has this been given?

JUDGE SCHAER: This has been marked for identification as TS-96.

(Marked Exhibit TS-96.)

MR. CEDARBAUM: Dr. Lurito, referring you to what's been marked for identification as TS-96, do you recognize this as the company's response to staff data request 236 that you've been discussing today?

THE WITNESS: Yes.

MR. CEDARBAUM: Just for the record what

exactly did staff ask in this data request?

THE WITNESS: Yes. The request -- is it okay to read the request?

MR. CEDARBAUM: I think so.

THE WITNESS: The request was, "Please rerun Exhibit TS-(JHS-8) assuming an electric rate reduction of $75.5 million instead of the $103.4 million rate reduction that JHS-8 assumed and correcting for all errors you believe Dr. Lurito committed as referred to on page 6 of rebuttal testimony."

MR. CEDARBAUM: And the attachment is Mr. Story's response which includes some of the information that you've just been discussing with respect to purchased power?

THE WITNESS: Yes.

MR. CEDARBAUM: Thank you. I would offer Exhibit TS-96.

JUDGE SCHAER: Any objection? Document is exhibited.

(Admitted Exhibit TS-96.)

Q. I had just asked you, Dr. Lurito, what your response was to other concerns Mr. Story raised regarding your treatment of noncare items as cash items?

A. Yes. I guess my response is his response. In other words, he was kind enough to do exactly what he was requested to do, namely adjust or correct for all the errors I committed among which he claimed, as you know, the one you mentioned. And what's interesting the results show that if anything I have underestimated the financial viability of the staff rate plan. In other words, when Mr. Story corrected for all the, in quotes, errors he believed I made, his average return on equity --

THE WITNESS: Can I say this?

MR. CEDARBAUM: I suppose you can say it's above or below what you showed for the staff.

THE WITNESS: Thank you, I'm sorry. Because I don't want to mess up the record.

A. Anyway, the return on equity is above what return on equity I have in my testimony and the earnings per share over the five-year period is higher than I had in my testimony regarding staff rate plan. The common equity ratio was higher than in staff rate plan as I computed it, and the coverages were higher. Therefore, what really happened is when I applied our techniques to adjust for these things I was a little less exact than Mr. Story who has this, you know, much more complete model. So if anything I underestimated the viability of the company rather than over-estimated it and he was kind enough to provide me with the numbers that showed that.

Q. Do you agree with the corrections that he shows in this exhibit?

A. I have no reason to disagree with them.

Q. On the items that you just discussed, can you give me a reference to perhaps the page and line where those things show up so that those of us with copies can look at them, please?

A. On the last page of that response Mr. Story provides capital structure, if you will, adjusted for purchase power, and I think that was one of your questions, and in the page right before that he provides coverages and other things adjusted for purchased power. And on page 5 -- if I said coverages I may be wrong on that page, but if you go to page 5 at the bottom he has some more adjusted for purchased power items. The coverages are there adjusted on page 4, which is probably the best page I should have directed to. He provides pre-tax coverage and capital structure and other ratios adjusted for purchased power.

Q. In measuring the rate earned on common equity capital, total capital, against a benchmark for reasonableness, is it appropriate to compare the return calculated in forecasts to a return determined in a general rate case, as you have done?

A. As I have done that and as perforce everyone in the case has done that because this is not a traditional rate case setting, I think, so you're asking me -- I don't think you're saying is it less appropriate to do that? Is that kind of the tenor of the question?

Q. Yes.

A. Well, obviously we could probably speak with a higher degree of certitude if we were sitting here with a test period and all of the trappings, if you will, of a general rate proceeding, but it's the best we have.

Q. Looking at page 10 of your testimony, and lines 13 through 15, how did you determine that 10.6 return on equity was proper? Was that based on the relative book value of the two applicants?

A. No. That was based simply on a weighted average of what the company has been allowed, the 10 and a half for Puget and the 11 to 11 and a quarter that's been allowed to Washington Natural. It's simply an average of those based upon the amount of common equity they have. In other words, on a relative book values.

Q. On page 16 of your testimony you refer to the applicant provided sensitivity analysis utilized in your adjusted model?

A. Yes.

Q. Can you provide a reference, a record requisition number, data request number or some other reference for that sensitivity analysis?

MR. CEDARBAUM: I'm not sure. It might have been part of the response to record requisition 19 that Mr. Harris talked about with Mr. Lurito before. We can check on that and let you know.

A. Yes. Could I check because I don't have the answer right now with me either. I'm sorry.

JUDGE SCHAER: Could you find that out say sometime before the end of the day today or noon tomorrow sometime while we're still on the record?

MR. CEDARBAUM: Yes.

A. I do have it. I just found it in my notes. It's applicants' response to WUTC data request 153.

Q. Good. Then I can ask you the second part of my question, which is, can you explain exactly how you used it in your exhibits?

A. Can I explain exactly, no. I can give you an idea because it's very complex. What I simply did was to look at what staff's proposal was in each category, either of revenue changes or power stretch goals or merger savings and what have you, and ask myself, for each $10 million of change, how would it affect each of the line items, interest, interest before -- income before interest. There's so many variables. Anyway, how that change would affect each of the key variables that I'm concerned with in my rate plan for analyzing. Income for equity. The income before interest in tax. The interest. That kind of thing, using a sensitivity analysis.

Now, that was not precise as it turned out, but it was the best that I had available at the time because, as you can imagine, the company has an extremely complicated model, financial model. As it turned out we did very, very well. We just made a couple of assumptions that were not quite right, namely that when the company needed capital it didn't need as a source of capital amortizations which of course are noncash expenses. I had assumed when we did the sensitivity analysis that that would be a demand for capital. Because of that my interest expense was too high, typically. My return on equity result was a little too low. Mr. Story kindly called my attention to those problems. They weren't large, but -- and in his response to what has now been marked as Exhibit TS-96 he corrected, if you will, those little errors that I did make and as you see the result was that if anything I had understated the viability of the company.

Q. On page 24 of your testimony you state that management has the responsibility to pursue the merger as a potential source of cost savings.

A. Yes.

Q. If for some reason the companies decide not to pursue the merger, would you then recommend penalties or revenue requirement reductions based on lost merger savings?

A. No, but what I would recommend is that the company be held to generating every dollar of saving that it can even without the merger. For example, there are some power stretch goals that can certainly go forward absent the merger. There are, I'm sure, some best practices savings that could be garnered through management initiative in that regard which could go forward, and I think the Commission would have to inquire in traditional rate case setting, assuming that the merger didn't happen, to see to it that the company is doing all that can be done to further this savings mode.

JUDGE SCHAER: Thank you. That's all I have.
Any redirect for this witness?
MR. CEDARBAUM: Just a few questions, Your Honor.

REDIRECT EXAMINATION

BY MR. CEDARBAUM:
Q. Dr. Lurito, looking at Exhibit 91, which is that summary sheet from the '92 Washington Natural rate case?
A. Yes, I have it in front of me now.
Q. At the bottom second line up it indicates that within 48 hours of the Commission's rate order Washington Natural senior debt was downgraded to BBB plus?
A. Yes.
Q. What is your opinion as to the cause of that downgrade?
A. Well, it would seem to me that the rating agencies upon reviewing the order felt that at least in the short run the company would not earn the rate of return that I recommended, and obviously my responses to the questions that were put to me, and that Mr. Harris has quoted here on this exhibit,

obviously had the assumption that the company would earn the return that I am recommending and my response to all of those questions was in that context.

Now, we all know what happened to WNG beyond 1993 in terms of its earnings. It didn't do very well, obviously, and it could well be that the rating agency saw that because there were a lot of changes that took place in that order for the company, and maybe they felt they weren't going to earn the cost of capital under those circumstances, at least not for a while. Now things are getting back on track again, of course, but in that time period that was their belief, but it had nothing to do with my recommendation.

Q. What were some of the changes in the rate order that you believed did cause that impact?

A. Well, the way they changed the merchandising activities and their relationship to some subsidiaries, and that sort of thing. Now, I'm not an expert in the order, but I know there were some pretty significant changes that took place and perhaps the rating agencies looked at that, and said, oh, dear, the company at least in the short run is not going to be on track with respect to the allowed rate of return and downgraded on that basis.

Q. Looking at Exhibit 91, if the Commission granted the company's proposed ROE, the 12 and a quarter, do you think that the downgrade wouldn't have occurred?

A. I really don't know. I honestly don't know the answer to that.

Q. Finally, in the course of your cross-examination, you referred to the S and P guidelines. This was in the context of a discussion on purchased power, and I believe you indicated that S and P does not formally recognize any guidelines with respect to coverages and debt ratios for purchased power. Can you just explain what you meant by that?

A. Yes. What I meant by that, and we went into this in great detail in at least the last Puget case I was involved in, and the issue there was, the issue on purchased power is how is it handled. In other words, is it passed through, is it simply put in base rates and may or may not be recovered or what have you. What Standard and Poor's are giving us are some formulae that they believe are appropriate in making these computations, but you don't see those things published in any Standard and Poor's publication as to exactly what they are for each and every company. That's something that I believe that

Mr. Abrams provided and it was calculations that he has made -- that have been made.
So that what I am simply saying is that I don't think those guidelines are that tight, that Standard and Poor's is going to say to investors, you better go and compute an adjusted coverage and an adjusted debt ratio to take account of purchased power before you even think about applying these guidelines that we're publishing here.
Q. And finally on Exhibit TS-96 you referenced returns on equity. Just for the record, that can be found on page 3 of the response; is that right?
A. Actually it can be found on page 1 right below earnings per share about 80 percent, down from the bottom. You will see it says preferred stock dividend, then earnings available to common, then earnings per share, and then return on average equity. It can be found there. I think it's elsewhere too but for sure there.
Q. And you've been talking about in page references the handwritten number at the bottom?
A. I have, yes, I'm sorry.
MR. CEDARBAUM: Those are all my questions.
JUDGE SCHAER: Anything further for this witness?

MR. HARRIS: One or two questions.

JUDGE SCHAER: Mr. Harris.

RECROSS-EXAMINATION

BY MR. HARRIS:

Q. On Exhibit TS-96 the analysis there assumes 100 percent achievement of stretch goals just as the other analysis that we were talking about earlier; is that correct?

A. That's correct.

MR. HARRIS: That's all I have.

JUDGE SCHAER: Anything further for Dr. Lurito? Thank you for your testimony.

Let's take our afternoon recess at this time. While we're at recess we would ask that Mr. Talbot take the stand and that anyone who has exhibits for Mr. Talbot distribute them and let's be back on the record at 2:57.

(Recess.)

JUDGE SCHAER: Let's be back on the record after our afternoon recess. Dr. Lurito has been recalled briefly to the stand, and I believe, Mr. Harris, you had some questions.

MR. HARRIS: Dr. Lurito, while you were being cross-examined by public counsel and other areas in your testimony, you discussed in several instances return on equity forecast, average earning per share forecast and dividend payout ratios. Is there a place in your exhibit where that information can be found?

THE WITNESS: Yes. On Exhibit TS-88, page 2 of 2. On that page, on line No. 15 I set forth for each year over the five years of the rate plan the return on equity. Those numbers can be averaged and my response was consistent, or that would be the answer.

The earnings per share are on line 17. Again, they can be averaged, and to get the dividend payout ratio on line 18 is shown dividend per share and on line 17 is shown earnings per share, and obviously by dividing one can get the payout ratio.

MR. HARRIS: Thank you, Dr. Lurito. In light of that, Your Honor, in the top secret nature of this information we move at this time that all references to the ROE average earnings per share that are now in the record and the dividend payout ratio that's now in the record, the specific numbers be stricken from the record.

JUDGE SCHAER: Is there any objection to this?

MR. CEDARBAUM: And in place of that would be his description of this exhibit?

MR. HARRIS: Yes.

MR. CEDARBAUM: I have no objection to that.

MR. MANIFOLD: No objection.

MR. CEDARBAUM: No objection.

JUDGE SCHAER: That motion will be granted.

MR. MANIFOLD: Your Honor, just a moment.

JUDGE SCHAER: Yes.

MR. MANIFOLD: I believe that Dr. Lurito gave those numbers in response to a question that I asked, and it was in order to compare one scenario with another scenario, and obviously it's fine to not use those numbers, but I wonder since those numbers are going to be taken out if we shouldn't substitute some qualitative comparison for the quantitative one. I think that the questions had been in light of some other payout ratios and how did what the company was projecting compare to that and perhaps if he can answer quantitatively -- qualitatively, excuse me, without getting into the top secret information, if that would be possible.

MR. HARRIS: We would have no objection to that.

JUDGE SCHAER: Do you want to pose such a question, Mr. Manifold?

MR. MANIFOLD: Dr. Lurito, can you answer my question of two hours ago without using any top secret information?

THE WITNESS: I believe I can.

JUDGE SCHAER: I'm sorry, I'm not going to be able to remember what your question was two hours ago. Now, if you need some time to bring that up after Mr. Talbot I can give you that leeway but we need to find what's in this record.

MR. MANIFOLD: Dr. Lurito, do you remember what the question was?

THE WITNESS: I think it had to do with under a company's plan how did the payout ratios compare to typical payout ratios in the industry.

MR. MANIFOLD: I think that's correct.

THE WITNESS: And what I had indicated to, I believe in response to one of your data requests, what those ratios were for the industry in general and the answer would be that their payout ratio would be higher, then, under the company's plan and those figures.

MR. MANIFOLD: Under the company's plan their projected payout ratio would be higher than industry averages?

THE WITNESS: Yes.

MR. MANIFOLD: Thank you. Is that enough reference, Your Honor?

JUDGE SCHAER: I believe so.

Is there anything further for Dr. Lurito? Thank you, sir.

THE WITNESS: Thank you.

JUDGE SCHAER: Would you like to call your witness, Mr. Manifold?

MR. MANIFOLD: Yes. Mr. Neil Talbot.

Whereupon,

NEIL TALBOT,

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

DIRECT EXAMINATION

BY MR. MANIFOLD:

Q. Please state your name for the record.

A. Neil H. Talbot.

Q. And did you prefile testimony and exhibits in this matter?

A. Yes, I did.

Q. Do you have before you what was --

JUDGE SCHAER: Would you like me to mark those, Mr. Manifold.

MR. MANIFOLD: Yes, Your Honor.

JUDGE SCHAER: I'll mark the testimony of Mr. Talbot as Exhibit T-97 for identification, and Exhibit NHT-1 as Exhibit 98 for identification. And I believe there are five top secret exhibits. Is that correct, Mr. Manifold?

MR. MANIFOLD: Yes, if not six. It goes through TS-NHT-7.

JUDGE SCHAER: We've just marked two so I believe that would be five more. So I believe that Exhibit TS-99 would be NHT-2; is that correct?

MR. MANIFOLD: Yes.

JUDGE SCHAER: Exhibit TS-100 would be NHT-3. Exhibit TS-101 would be NHT-4. Exhibit TS-102 would be NHT-5 and Exhibit TS-103 would be NHT-6.

The only exhibit that I have been provided for Mr. Talbot by any of the parties is a copy of his deposition.

MR. MANIFOLD: Excuse me, Your Honor. Did you mark his NHT-7?

JUDGE SCHAER: Oh, you're right. So TS-104 will be NHT-7, and then Exhibit 105 for identification will be the deposition of Mr. Talbot.

(Marked Exhibits T-97, 98, TS-99 - TS-104

and 105.)
JUDGE SCHAER: Go ahead, Mr. Manifold.
Q. You have before you, Mr. Talbot, what's been marked for identification as Exhibit T-97?
A. Yes, I do.
Q. Is that your prefiled direct testimony?
A. Yes.
Q. Are the answers in there the accurate answers to the questions as stated at the time you filed your testimony?
A. They are.
Q. Do you have before you what's been marked as Exhibits 98 through TS-104? Are those the attachments -- the exhibits accompanying your testimony?
A. Yes.
Q. And is the information in there true and correct to the best of your belief?
A. It is.
MR. MANIFOLD: Your Honor, I would move for admission of Exhibit T-97 and Exhibits 98 through TS-104.
JUDGE SCHAER: Is there any objection?
MR. HARRIS: No objection.
JUDGE SCHAER: Those documents are

admitted.

(Admitted Exhibits T-97, 98, TS-99 - TS-104.)

Q. Do you have any changes or corrections to make to T-97?

A. No, I don't believe so.

MR. MANIFOLD: The witness is available for cross-examination.

JUDGE SCHAER: Mr. Harris, did you have cross?

MR. HARRIS: Yes, Your Honor.

CROSS-EXAMINATION

BY MR. HARRIS:

Q. Good afternoon, Mr. Talbot.

A. Afternoon, Mr. Harris.

Q. You also have before you what's been marked for identification as Exhibit 105, which is a copy of your deposition transcript with one section redacted?

A. I better take the redacted version then. I have a complete version as well.

Q. You have a correction sheet for that transcript?

A. Yes. I provided it to the reporter or recorder and I have that sheet here, yes.

Q. We'd move for the admission of Exhibit 105 at this time with the correction sheet attached to it?

JUDGE SCHAER: Is it attached to the copy you've distributed?

MR. HARRIS: No. We will pass those out at the next break if that's acceptable, Your Honor.

MR. MANIFOLD: That's fine.

JUDGE SCHAER: Any objection?

MR. MANIFOLD: No objection.

JUDGE SCHAER: That document is admitted and we will expect to get that distributed by the end of the day.

(Admitted Exhibit 105.)

Q. Mr. Talbot, during your deposition we asked you a number of questions about stretch goals you may recall?

A. Yes.

Q. And we have no intent of repeating those here. I think in response to the questions you said that you had not done any empirical analysis of the likelihood of achieving stretch goals. Is that a fair characterization of your testimony?

A. Yes. I have not done any independent evaluation apart from my view that results of company studies presented to rating agencies would be presumed to be reasonably reliable.

Q. And to be fair you had no data to do any empirical analysis of the stretch goals, correct?

A. That is correct.

Q. And you included the stretch goals at 100 percent achievement levels in all of your different analyses; is that correct?

A. Well, the way the company used the term goals, it didn't always use the term goals in the presentation to rating analysts, rating agencies. There was more of a sense in the presentation that these were reasonably achievable savings. The company did not express in the written documents any likelihood that they would not be achieved, and I would say their express statements that the goals might turn out to be too modest equally likely as being too aggressive.

Q. I think the question was whether you included them at 100 percent achievement in all of your analysis.

A. 100 percent of the numbers given in the rating agency presentation, yes, not 150 percent, not 50 percent.

Q. You talked about what the company or how the company represented or presented these stretch goals. Of course you don't know what the company said at the rating agency presentation, correct?

A. No. I must admit I was surprised that the company is distancing itself from their statement from the written documents, and in an attempt to understand where Mr. Torgerson in his rebuttal might be coming from I went back and reread the responses to staff 38, and for the life of me I cannot see that that response bears any resemblance to the reworking of it contained in Mr. Torgerson's rebuttal testimony. It seems to me that this was the company's view about its future, as provided in response to a question, "what do you think your forecasts are," because it was the only forecast presented. I think it was a very sound basis on which to develop analyses of the future financial prospects of the company over the next 25 years.

MR. HARRIS: Your Honor, with all due respect I would move to strike the answer. The question was a simple question, did you know what was said at the rating agency presentation. The answer was nonresponsive.

JUDGE SCHAER: I'm going to let the answer stand at this point so we can keep moving forward. What I'm going to ask you to do, Mr. Talbot, is to listen carefully to the questions that are asked of you by counsel. To the extent that you're able to do so, to answer yes or no, and then give whatever explanation you believe is necessary to make your answer -- complete answer to the question asked, but if there are other areas that you need to go into I think you're going to need for your counsel to ask you those areas on redirect.

THE WITNESS: Very well, Your Honor.

Q. Since the time of your deposition, have you done anything to assess the likelihood of the company achieving stretch goals?

A. Well, I did go back and read the presentation, as I said earlier, and I think that does go to the credibility of those goals, and I concluded that they were presented as reasonably achievable objectives.

Q. Have you done anything else besides going back and reviewing the presentation?

A. I ran some additional analyses in response to a company request to do so.

Q. I'm sorry my question wasn't precise enough. Have you done anything else to assess the likelihood of the company achieving stretch goals other than reviewing the presentation?

A. No, not beyond what I just said.

Q. Doesn't it make sense to you, Mr. Talbot, that the company would set forth as separate line items two stretch goals if it intended to discuss the risks of those goals at the rating agency presentation?

JUDGE SCHAER: Could you ask that without the double negative because I'm going to be confused by what a yes or no answer means.

MR. HARRIS: Sure. Let me try that one again, Mr. Talbot.

Q. Does it make sense to you that if the company intended to discuss specifically the risks of achieving stretch goals with the rating agencies that they would set forth those stretch goals as separate identified line items?

A. That could be the explanation for separately identifying them, yes.

Q. Do you know if anybody else has undertook any effort to analyze the likelihood of the company achieving stretch goals?

A. I am not aware of any, for example, outside management consultant coming in apart from, of course, the work done by Mr. Flaherty which reflected merger savings.

Q. Have you rerun your financial analyses

eliminating stretch goals?
A. Not eliminating them, but I have run the analysis reflecting 50 percent of the stretch goals.
Q. Did you review those runs?
A. Yes.
Q. Did you draw any conclusions after reviewing those runs? Let me be more specific. Did you draw any conclusions about the financial viability of PSE at the 50 percent stretch goal level?
A. I think it would be more of a challenge with that level of achievement of savings for the company to achieve or maintain a good level of financial soundness. It would be more of a challenge.
Q. You talk in your testimony about a test of financial viability; is that correct?
A. Yes.
Q. Did you draw any conclusions about whether PSE would be financially viable under your analysis at the 50 percent stretch goal level?
A. I believe the company would be viable but it would be a challenge to, for example, achieve the capital structure necessary to maintain the ability of the company to borrow money as needed, raise money on the capital markets.
Having said that, the company could

maintain its viability in the following manner. And that is, that companies faced with similar challenges have frequently modified their dividend policy, particularly where the dividend payout is a relatively high number to start with. That gives the company, in this case on any of the projections, tremendous leeway to strengthen its capital structure, improve its coverages and enable it to be able to borrow all the money that it might need according to its construction schedule, but to do that it would have to consider measures of that kind, which it obviously would rather not do.

Q. Like Dr. Lurito, you relied on the rating agency presentation as the starting point for all your financial analyses, correct?

A. Yes, I did.

Q. And you're aware, aren't you, that the company did not rely on the rating agency presentation in putting together its opening case?

A. Right. There are two separate sets of evaluations. One is the evaluation done by Ms. Lynch, and I believe alternative versions of that assessment have been done by Mr. Lazar for the public counsel. I took the different track, which is to start with the total picture, the total financial profile of the company, and using that approach, top down approach, if you will, make adjustments reflecting certain differences in financial assumptions, and in that respect my analysis is directly comparable to Dr. Lurito's.

Q. And you're aware that the rating agency presentation was produced in response to a data request?

A. Yes, staff 38.

Q. And I take it from your earlier testimony that you did review Mr. Torgerson's cross-examination as part of your review of the materials in this case?

A. You would have to refer me to particular statements that he made, but yes, broadly I did. Scanned that.

Q. By the time that you did your analysis, were you aware that the company had expressed some concern about using the rating agency presentation as the basis for these financial analyses?

A. Yes, in general terms I was.

Q. Were you also aware that Mr. Torgerson had produced forecasts that the company believed to be more reliable and more accurate in response to record requisition 19?

A. No, I wasn't aware of that particular response.

Q. Give me just a moment. I want to get that for you.

JUDGE SCHAER: While he's doing that, Mr. Van Nostrand, would you pull the blind behind you down another inch or so. Thank you very much.

Q. Mr. Talbot, I've handed you record requisition 19 and response and my question for you is, have you ever seen that before?

A. I've seen this document and/or similar reworkings, but I wouldn't like to say that I've seen this particular one as opposed to the one different from the rebuttal responses which have some of the similar structure in terms of the adjustments made.

Q. So do you know whether you had that information available to you when you were doing your financial analysis?

A. I did not take into account. If I did have it I was not influenced by it.

Q. And you don't recall, as you sit here today, whether you had that information? I'm reading that from your answer.

A. I don't specifically recall if I had this particular response.

Q. If you had had that information would you have relied on it instead of the rating agency presentation?

A. No, I don't believe I would have for the following reason. As I read it -- and I am scanning and in the back of my mind also comparing the rebuttal testimony of Mr. Torgerson -- I would categorize the adjustment made into what one might call technical adjustments to convert the financial forecast, which was made for financial purposes, into a Commission basis forecast. I would not have made those changes because I was not really primarily interested in a Commission basis forecast. I was looking ahead over a five or six year period, in an attempt to develop a financial analysis, how would investors fare under this scenario, various scenarios.

As to the other adjustments, they basically fall into two categories. The one is certain cost escalations, which are increased in these analyses compared to the rating agency presentation for O and M costs, construction costs, et cetera. I don't think I would have made those changes because, again, I felt that the rating agency presentation overall was a very balanced account. I do not have that same feeling about the various adjustments made. They all seem in one direction to me.

The other change, which is part of the second set of changes, is that -- and I am not sure if I see this here, but is clear that there will be some revenue losses due to competitive rates of various kinds, schedule 48, special contracts and possibly a pilot program, which I believe is now under discussion by the company with the Commission. The Commission, I believe, is looking to the company to present a pilot program for customers other than those eligible for schedule 48.

It is somewhat surprising to me that that kind of factor was apparently not taken into account in the rating agency presentation which, as I say, was presented as the company's best estimate of its revenues, but nonetheless everyone in the various proposals discussed here by staff, public counsel and the company, we've all included revenue reductions to respond to those lost revenues due to competitive prices. So, I think we've all agreed on that. We haven't agreed at this point to making the cost adjustments as well. I would resist that because I think that would be presenting a kind of worst case scenario. If we take the rating agency presentation, we reduce the revenue component of it and we increase the cost component, it makes a mockery of the original presentation, in my opinion.

Q. But isn't it true that if that is the most likely future scenario for this company that that's what we should be doing regardless of whether it makes a mockery of the rating agency presentation or not?

A. Well, clearly we should be trying to get to the best long-term financial outlook for the company under the stated assumptions. I maintain that the rating agency presentation was such a document. Nothing that's come in really has changed my view about that.

Q. You've testified in other regulatory proceedings.

A. Yes.

Q. Would you agree that Dr. Lurito's testimony earlier today -- I believe I'm characterizing this correctly -- if we were to apply the known and measurable standard in this proceeding that stretch goals would not qualify as known and measurable?

A. Yes. I don't think that any long-range projection of five or six years would qualify as known and measurable.

Q. Now, the test that you are proposing be applied -- I think you explain it well in your deposition -- it's a test that focuses principally on

financial viability; is that correct?
A. Yes, with one modification. Not just bare viability, in terms of the bare viability to raise money, but the financial soundness on top of that.
Q. Some cushion above teetering on not being able to finance?
A. Yes. I don't think I would be comfortable recommending a rate plan where I felt that the company would always be close to the edge, let's say, in terms of not being able to raise money. So, I would like to see in my plan that I endorsed not only bare viability but something on top of that, some cushion, as you said.
Q. You have testified in other merger proceedings?
A. I have.
Q. Any of those proceedings did you propose the financial viability test that you propose here?
A. Frankly, I don't recall.
Q. In several of those proceedings you testified in favor of some sort of sharing arrangement among shareholders and ratepayers; is that correct?
A. The word "sharing" sort of sounds like apple pie and so forth and I'm sure I've used that word a number of times. You have to be a little more

specific I think in terms of something directly applicable to this case.

Q. On page 19 at lines 12 through 16 of your testimony --

A. Can you repeat that.

Q. Page 19, lines 12 through 16. You assert that it should be a challenge to achieve double digit returns given the transitional nature of the industry. Is that a fair summary of what you say there?

A. I think the primary reason for suggesting a challenge is twofold, really, and the one is the existence of a five year rate plan. The other reason is the changing nature of the industry.

Q. What is it about the changing nature of the industry that should drive returns lower?

A. I think during a transition period you have between a regulated industry and one which is likely to be deregulated in terms of price at some point in the future, or at least portions of it, the generation portion, if you will, not the transmission and distribution portion probably. There really are two standards. The one standard is cost plus a reasonable return ratemaking, and the other standard is the market price. Clearly, as identified by Mr. Marcus, for example, in his testimony in this case, the company, or Puget in particular, has certain potentially stranded costs, which means costs in excess of market price levels.

In a transition it's not clear to me what test one should apply. I don't think, frankly, that either of the extreme tests really fit. I don't think it makes sense to say, well, the company shouldn't recover a penny of its costs, nor does did make sense to me to say it should necessarily recover 100 percent of it. That's one of the reasons I proposed that it should be a challenge to meet the traditional type of return so that it in a sense gives the company a real incentive to bring its costs closer to market levels. It's a transition where one is trying to get the regulated rate down to a market price over a period of time.

Q. I want to ask you a few questions about prior testimony that you've given. I've provided you with copies of your testimony on behalf of the Maine Office of Public Advocate in February '96, a copy of your testimony on behalf of the American Association of Retired Persons September '94, and an article that you authored entitled "Evaluating Price Cap Proposals in the Electric Utility Industry." Do you have those three documents there?

A. Yes, I do.
Q. Price caps are in many respects similar to the sort of rate plan that is proposed here; is that correct?
A. Well, yes and no. A full-fledged price cap proposal would be more along the lines of Mr. Heidel's proposal which was not accepted on to the record. But having said that, yes. The yes part of the answer is that a multi-year rate plan or where the increases in the company's proposal are fixed in advance at the present time, shares many of the features of a price cap plan.
Q. Which is why, for example, in the Southern California Edison testimony at page 9 you describe the New York Telephone three year rate freeze as the first telephone price cap in the U.S.?
A. Yes.
Q. And why also you've described stay-outs which, in one sense, the plans being proposed here are a version of a price cap plan in other testimony, specifically in your Bangor Hydro testimony?
A. Yes. It is a simplified version of the price cap plan.
Q. And part of what you're trying to do with these plans is you're attempting to give the utility

incentive to be innovative and efficient?

A. Yes. Insofar as rates are set for a five-year period you're building in what is called regulatory lag. In other words, if the company's return deviates and its costs deviate from what was expected at the outset it will be a long period before rates are adjusted to that, unlike the ordinary case of traditional regulation where, of course, if the company's costs and returns deviate from what was expected or authorized in the previous proceeding that the company can come in or the staff can come in for rates to be adjusted.

Q. So you're also taking away the burden and expense of annual general rate cases?

A. That's true. In that respect, a stay-out or a fixed rate plan is in the nature of light-handed regulation, in answer to the chairman's question earlier, that that is in fact one of the positive features I think of a price cap plan. It is a version of light-handed regulation.

Q. And it also takes away the management distraction associated with the general rate cases?

A. Yes. Management orientation during that period would be much more toward saying, well, how can we save money and make more money, be more efficient, more responsive to our customers if we anticipate competitive alternatives for them versus traditionally there was compliance, obviously, with the Commission requirements, but sometimes one suspected that the utility might not have its heart in necessarily doing the best job. The game that was played was a rate case game to try to get as much as possible out of the Commission rather than out of the assets of the company.

Q. You would agree that taking away this management distraction is especially important during this industry transition period?

A. Yes, I think it is, for the reason that it gives the company an incentive to move its costs closer to the market price level with which ultimately presumably it will have to compete.

Q. In your evaluating price cap proposals article you state at page -- I'm sorry, it's in the introduction, page 7, vii.

A. Yes.

Q. That at least plans, after all, are only a modified version -- I misquoted -- "are, after all, only a modified version of traditional regulation but with both greater periods between full rate cases and annual rate adjustments in between." Is that a fair way to describe what we have proposed here too?

A. Yes, I think it is in two respects. And likewise, I think that the price cap plan is in two respects. The one is that there is still some regulatory safety net. In a formal price cap plan that would be an earning sharing mechanism. In the case of the company's proposal or the alternative proposals by staff and the public counsel, there still would remain, I believe, the ability for the company to request emergency or interim rate relief if its financial circumstances were in jeopardy. And I happened to look back at, I believe, the last case on that subject and there are fairly broad emergency rate relief criteria. So I think the company has that alternative which it doesn't have in the marketplace. If Digital Equipment Corporation is losing money it can't go to any agency and say, well, gee, can we have some emergency rate relief. It just restructures itself. It cannot do anything in terms of manipulating its market.

And the other factor, of course, is that at the end of the period there is a return to some kind of ratemaking in which presumably cost of service in the traditional manner will be assessed and rate allocations between customer costs and so forth. So there's always that sense. It's not a case that the traditional regulatory mechanism is entirely eliminated. It's suspended to a period of time. It will come in at the end of the period, although by that time, if you will, the clouds of competition or sunlight of competition, or however way you want to look at it, will be breaking, and so there will be that added emergency or immediacy, if you will, to the competitive issue, so that in that sense it won't be a very traditional rate case by concept. Given that sort of underlying yet market reality I assume there will at the end of any rate period or price cap period be a proceeding in which fully allocated cost of service is undertaken.

Q. And if by that time hypothetically the company has achieved extraordinary savings ratepayers will benefit from that?

A. Yes. In traditional regulation extraordinary savings are snatched away from the company and flowed through to ratepayers.

Q. When you set up on one of these plans -- I'm focusing on your first bullet point in the middle of that page -- it's important to consider the alternative, in other words, what rates could be expected under traditional regulation?

A. Yes.

Q. And that's why, for example, in the Southern California Edison case on page 10 you state, "The question is whether cost allocations may result in rates that are higher than they would have been under traditional regulation."

A. Yes.

Q. Your point there again is it's important to compare the plan to what would result under traditional regulation?

A. Yes. The reason being, of course, that if a rate plan does have greater incentives, one would want those incentives, which should be reflected in productivity gains, cost savings, to be reflected at least in part in rates, so that in an ideal situation it would be a win-win situation where the company would improve its situation or potentially do so and the ratepayer would benefit.

Q. And the plans also have to be carefully tailored to the individual utility?

A. Yes. And the reason I say that is because I think that one of the dangers has been that there tends to be an approach of one size fits all, whereas, in fact, I think if you look at any two utilities in the country, any number of them each has its own unique set of cost causative factors based really on growth and on both sides of the growth issue, namely, whether they're adding new capacity, which can be costly, or used to be costly now could be actually cheaper, and the other issue is whether they're able to get more through growth out of their existing assets versus the depreciation of those assets, so rate base may be diminishing, sales may be increasing.

So if you look at any company I think you will find that the general industry trends are an imperfect fit for that company, which is why I thought that the rating agency presentation by the way, to tie back to that, was a good basis because that was specific for this company.

Q. And the point you make also is that it's important to take account of the specific utility's cost trajectory?

A. Yes.

Q. Now, in the second bullet point back in your article here at page 7 in the introduction you make the point that if the utility has to offer discounted rates to large customers it should have the opportunity to make up those losses by enhancing efficiency and cutting costs; is that correct?

A. Yes.

Q. And in the same article, page 3 you make the point that transmission and distribution remains a natural monopoly. Would you agree with that?

A. Yes, I would. It may still be appropriate for performance-based ratemaking or price cap regulation or light-handed regulation, and I have no doubt that in many jurisdictions that will be introduced over time, but I think my understanding of the technology is that for the most part transmission/ distribution cannot be reasonably duplicated in an area so that it remains a so-called natural monopoly and therefore requires regulation.

Q. Jumping ahead to page 5, the third bullet point down, in that section you're discussing some of the growing opposition to traditional regulation, and the third bullet point you discuss attempting to micro-manage utilities?

A. Yes.

Q. Do you agree that that's generally not a good idea?

A. Yes. The kind of regulation that I personally prefer, and I think that's the way the industry is moving, is instead of detailed nitpicking by Commissioners as to each item of expenditure, whether it was prudently incurred or wasteful or whatever, to basically set broad goals for the company and say, go to it, exceed these if you can, we're giving you a challenge. You can do it any way you like. We are not telling you how to meet these rate limits. We're giving you the broad opportunity to equal or exceed a cost standard, if you will. And I believe that's the way not only electric utilities but regulation generally is moving towards a reluctance by regulators to be specific as to how efficiencies should be achieved.

Q. Is five years a typical length for a rate plan?

A. It's typical on the long hand, if you will. And the reason for that is I think that in some cases there's a feeling that history will overtake or events will overtake a rate plan through restructuring and so forth so that possibly by the time you got to three or four years you might be in a situation where the rate plan instead of being progressive becomes a retrograde thing and is holding up further progress. But having said that I think five years is quite typical. I've seen even ten-year plans, which I objected to by the way, I thought that was much too futuristic, but five is reasonable.

Q. On page 7 of your article you talk about something you labeled as stretch factors, which you can imagine caught my attention. I think you suggest including stretch factors in your rate plans. It's in the section that's entitled "productivity offset."

A. Yes, I have it.

Q. And you discuss the difference between stretch factors and forecasts and you describe stretch factors as targeted productivity goals as opposed to expected productivity gains?

A. Yes. The distinction is really one between predicting the future and attempting to control the future or manage it. I think many projections simply extrapolate out the past experience, including the case of a regulated industry, which is moving to a more competitive situation. That is inappropriate. What one wants is to move that industry from a traditional mode to a competitive mode, and that's where in that context is where the concept of stretch factor is an appropriate one. It's an additional productivity factor.

Q. Is what you describe as a stretch factor what we call a stretch goal here?

A. I believe they're very similar, yes.

Q. And you're in favor of making the utility responsible for achieving them, correct?

A. Yes, I believe that is appropriate.

Q. I'm going to jump down to page 41 of your article. You include a summary of proposed and adopted rate plans?

A. Yes.

Q. And I look across where it says stretch factors, and of the four plans two have none built in; is that correct?

A. No, that's not quite correct. In the Central Maine Power case, which I was involved in incidentally on behalf of the consumer advocate, I said nothing explicit. It was part of the overall assessment of a reasonable rate trajectory, but that rate trajectory was a negotiated one between the various parties. It wasn't what the company wanted, it wasn't what the consumer advocate wanted. It was a compromise.

Q. And in the Southern Cal Edison plan, is that .5 percent?

A. Yes.

Q. And in the Pacific Power and Light plan it's effective only the first year. Am I reading that correctly?

A. Frankly, I forget if that applied beyond the first year. I just don't recall if it applied beyond the first year, that plan.

Q. And the way it applied in the first year was simply capping the increase at 2 percent?

A. Yes. And no increase if the company's average price exceeded 5 percent over the national average electric price.

Q. And Niagara Mohawk no stretch factors?

A. Yes, apparently not. I wasn't involved in that case, but I looked through the papers to extract this information and I did not see an explicit factor.

Q. More generally, would you agree that under any well designed rate plan that utilities should have the opportunity to make above normal profits if it succeeds in cutting costs, succeeds in being innovative or make below normal profits if it does not?

A. In broad principle, yes, but I would say also it depends. I think it is appropriate to make a cost reduction goal, if you will, a significant challenge to management so that it might be less probable that management would exceed their target than fall short of it, and I say that really for two reasons. In the present case, the one is that the company is getting a substantial benefit with respect to a merger. This isn't just a rate plan, it is a merger case. Seems to me that that is a major benefit to the company, plus a major benefit in this case, as Mr. Marcus testifies, is that this case is, in effect, an interim stranded cost recovery case. During the next five years, according to Mr. Marcus's scenarios, the company may achieve as much as one half or even much more than one half of stranded or potentially stranded cost recovery. So, even though this isn't explicitly a stranded cost recovery case, implicitly probably half of that probably will be put behind the company if it gets to recover all its costs over the next five years, which everyone agrees that it should.

So if you take those factors into account I think it's appropriate from a ratepayer standpoint to say, the company is getting a lot here. Let's have a real challenge to the company to achieve these goals and to earn above average return during that period because it's already earning so much.

Q. In February of '96 when you testified in the Bangor Hydro case -- I want to direct your attention to page 7, lines 13 through 16.

MR. MANIFOLD: Page again, please?

MR. HARRIS: Page 7, lines 13 through 16.

Q. You testified that a plan is most likely to be effective if the plan extends for several years and does not shield the utility from making or losing considerable amount of money as a result of management actions. "This is what promotes efficiency and innovation." Isn't the same true here?

A. Yes, it is.

MR. HARRIS: No further questions.

JUDGE SCHAER: Off the record for a moment.

(Recess.)

JUDGE SCHAER: We're back on the record. Mr. Cedarbaum, did you have questions of Mr. Talbot?

MR. CEDARBAUM: No, I don't.

JUDGE SCHAER: Mr. Frederickson.

MR. FREDERICKSON: No, I don't.

JUDGE SCHAER: Mr. Wright.

MR. WRIGHT: Yes.

CROSS-EXAMINATION

BY MR. WRIGHT:

Q. Afternoon Mr. Talbot. I'm John Wright and I represent Bonneville Power Administration.

A. Good afternoon.

Q. My questions are limited to residential exchange issues. Your testimony did raise the subject a couple of times, and they're primarily in the interest of clarification as much as anything else.

So perhaps we could just turn to a couple of references. On page 21, lines 12 -- well, I guess 9 through 12 of your testimony, you say, "I've developed a regulatory case in which the company's projections are modified to reflect the absorption by PSE of cost increases resulting from the expected reduction of Bonneville's residential exchange credit. The amount that is finally negotiated is uncertain at this time." And the last sentence was what confused me a little bit. I didn't know exactly what you meant by that.
A. My understanding from discussions with public counsel consultant Jim Lazar -- you might be able to clear up some of my reference better than I can -- was that a certain proposal had been made by Bonneville, and that we included approximately one half of that adjustment in this financial -- in these financial runs.
Q. How did you arrive at the one half?
A. It was an amount that we agreed was as good a guess as any, but admittedly it falls short of a prediction, if you will, but it reflects some reduction, one half of the level that we believe is proposed by Bonneville.
Q. And do those calculations include the $145 million that was allotted by the Congressional

directive for FY 97?
A. I will have to defer to Mr. Lazar on that one, who will be on the witness stand.
Q. That's fine. And then I guess I'm kind of out of order here. I have another reference on page 14. You know, I understand your testimony correctly to conclude that that public counsel's rate plan is superior to the one proposed by the applicants?
A. Clearly, yes.
Q. And in what way with particular reference to the exchange is that so?
A. Applicants' case does not include any reference to the exchange. In other words, any reduction in the exchange would simply flow through to customers. In my testimony, and I believe in the other public counsel witness's testimony, we were very concerned that at the same time that competitively priced power was being withdrawn or threatened to be withdrawn in whole or part from residential and small -- and farming customers, that schedule 48 customers would be getting access to competitively priced power. That didn't seem to be that we were all moving in the same direction and it seemed to raise all sorts of problems with cost shifting and so forth, indirectly.
So it seemed to me and I believe to the

other witnesses that if one class of customers is getting more access to competitively priced power the company should at a minimum protect the residential customers from losing that, what they already had, and moreover should build in a pilot program to bring competitive benefits directly to those customers who are not eligible for schedule 48.

Q. And so under the applicant's rate stability plan any decrease in exchange benefits would be passed on to the residential customers on top of that 1 percent increase. Is that your assessment?

A. That is clearly my assessment. They didn't refer to it. It's a flow-through item as far as the applicant is concerned. I think somebody said that in the last day on the witness stand. I think that's pretty clear.

Q. Would it be correct to say that under the public counsel plan the applicants would be expected, at least to some extent, to indemnify or hold the customers harmless for any reduction in benefits?

A. I think that's a way of expressing it, yes.

Q. Based on your knowledge of how the residential exchange program works, do you see any kind of discontinuity between implementation of the exchange program and performance-based ratemaking mechanisms?

A. Could you repeat that.

Q. Well, based on your understanding of how residential exchange benefits are calculated, do you see any discontinuity or any potential problems in calculating those benefits under a performance-based ratemaking mechanism? That doesn't help, does it?

A. It's a tough question. It's a difficult question. I think you could look at the reduction in the credits as a kind of a cost pressure that has to be absorbed by somebody, either the customer or the company, and to that extent it's in some ways similar to any other cost pressure.

Second thing that comes to mind is that on the other hand the question arises, and I don't know the answer to this question, to what extent are these cost pressures under the control of the company, because normally in performance-based ratemaking you're trying to bring about incentive for the company to control costs that it can control, to some -- at least some degree. So there's a question in my mind, well, how much can the lobbying of the company on behalf of its customers basically affect the reductions in the credit that are finally agreed upon.

And yet another level to that is market

pricing. These credits do, in effect, bring certain class of customers currently closer to market price through their credit. To that extent that's good. And one can see in the future something similar to bringing a market price discipline, if you will, either by the company absorbing the credit or by a pilot program or some combination of those factors so that the company ultimately has to deliver electricity which is competitively priced or beginning to approach competitive price, just as it is proposing to do with respect to schedule 48 customers and is considering doing, seriously considering doing now, with some other customers too through a pilot program and yet not yet developed.

Q. Is it fair to say that much of your testimony is based on the view that at least in generation the market will evolve from its current regulated structure to a more competitive deregulated structure?

A. I absolutely believe that. I believe that generation is going to be deregulated in terms of price within the next five to ten years nationwide.

Q. And in that market would you expect to see all customer classes have more choice of suppliers?

A. Yes, but that in itself is a challenge.

It's clearly easier for large customers to access the market. They have information. They have the clout of being large buyers. It is more difficult to put the institutional structures through which smaller customers can participate, through aggregation, possibly through municipal entities, et cetera. It's a more difficult thing institutionally. The market is set up to provide, already set up to provide, really to provide large customers like Enron and whatever. It will be the stroke of a pen to remove price deregulation to access the market for all customers. It's harder. Clearly as a consumer advocate I would clearly recommend that the institutional structures should be put in place to achieve access for the small customers as well.

Q. But you wouldn't necessarily see a philosophical conflict between a competitive market and a program like the exchange program which essentially offers rate relief to a particular class of customers? And I guess in some ways I'm asking, is there a philosophical problem with the existence of a rate relief program in a truly competitive market?

A. I would probably accept that proposition, namely, that the earmarking of sources of power for some customer classes is certainly a modification of a competitive market. That would not occur in a competitive market, particularly a fully competitive market where residential customers, for example, could through various institutions access the market without any special earmarking. But I think, on the other hand, that in this particular case, I think that the residential exchange is seen more by me as a way of getting rate relief to a class of customers, residential and farm customers, which brings them closer to the market price. I wouldn't suggest in the long run that they should pay less than the market price or more than the market price.

So, yes, I agree that it's peculiar and not a market thing, and may be inconsistent with markets to have special earmarked supplies for some class of customers, but if an earmarking can bring you closer to the market price, well, to that extent it's actually -- it is an appropriate or possibly appropriate means of bringing partial competition to that -- or competitive pricing to that class of customers.

MR. WRIGHT: Thank you. No further questions.

JUDGE SCHAER: Commissioners, do you have any questions for Mr. Talbot?

COMMISSIONER HEMSTAD: I don't.

EXAMINATION

BY COMMISSIONER GILLIS:

Q. On your market scenarios it appears at least several of them envision implementation of the pilot, is that right, of a pilot program, open access pilot?

A. Yes, I believe all of the cases --

Q. All four?

A. -- that I call market cases have to a greater or lesser extent a pilot program feature.

Q. On page 23 you refer to revenue losses from implementation of the pilot program. My question for you is, is it necessarily the case that an open access scenario will lead to revenue losses for the company?

A. If the company is truly giving a customer access to the market in a pilot program without any charge to strandable costs, then those costs would to that extent be stranded during that time period of the program. So that is a revenue loss in excess of a cost reduction, in excess of avoided costs for providing that service.

Now, if there is a provision to recover stranded costs through an access charge or wires charge, some such mechanism, then of course to that extent that covers the full amount of stranded costs, there isn't a revenue lost to the company. There's no revenue lost net of its cost reduction. But unfortunately, of course, if the company goes to that extent to totally recover its revenue losses it's also removed the incentive for its customers to access the market because it's going to be very hard for the market competitors to then come in and offer a rate that it's going to induce some customers to switch from their traditional supplier, so I think most pilot programs are heavy to grapple with this problem, what do you do with stranded costs, and most of them are saying we'll allow some recovery but not all of it so we'll get some significant reduction, the rate perceived by the customers, so that they can compete, they can get alternative providers to provide them with some savings. In that way of course there is some revenue lost to the company, but there's also -- it's opening up the market to competition in the sense alternative providers can come in and compete effectively and get established, get that toehold in the market. They're doing this already in New Hampshire. There are about 30 odd providers that are registered with the state Public Commission and are beginning to capture their initial market shares.

Q. So it hinges on what is the distribution charge and how market resources are handled?

A. That's correct.

Q. So it could be any amount depending on how that's handled as far as revenue loss for the company?

A. Clearly, the distribution component for transmission and distribution would presumably reflect the costs of providing that service on an ongoing basis just as the rates now include that component implicitly. As to the generation component that's the one where the wires charge one would generally intend in a pilot program would be less than the full stranded cost generation component in the current rate.

Q. I noticed that you've participated in the collaborative on Vermont's restructuring or at least you sent in a paper?

A. Not Vermont. Just about every other state in the union but not Vermont, as it happens.

Q. I had one other question for you. I can't find it in here at the moment. You mentioned you had a discussion of the benefits of the rate plan from the investors' perspective, and as I recall your argument it went something like the company is able to leverage their regulated position to mitigate over market costs, and puts them in a stronger position in the end so investors -- is that essentially your argument?

A. Yes. I think one of the major benefits is their ability to get about half or more than half of their stranded costs behind them. It moves them roughly halfway during that five-year period to a market price level, if that answers your question. I think that's a major benefit of a five-year stay-out or fixed rate plan for the company. To that extent it is an interim recovery of possibly half or more than half of the strandable costs.

Q. With that in mind, my question for you is, do you have an opinion about whether that type of a rate plan proposal where there would be a rate predictable period would be -- should the Commission have a concern about that being anti-competitive in the long run versus an alternative such as New Hampshire and Vermont are pursuing of a more earlier open access but the transition charges being collected through the distribution system?

A. I think it is a question of phasing, and I think it does depend a lot from state to state. I think that a good rate plan for a five-year period would be sound, sound policy. I think in other states there is a greater sense of urgency about market access. There are states, typically states in which the electricity costs of some of the utility cases are very, very high. That tended to be the case, like in New England or California where people are so disgruntled with existing regulation that they have gone forward very aggressively to restructure the industry, but actually, of course, that doesn't really result in lower rates, very much lower rates immediately, even though I think the California intention is a 10 percent reduction. But, you know, it's not clear that it really will be a real 10 percent reduction because over time it may just be a deferral of some of those costs through a kind of a rate recovery mechanism.

So I really don't think it's one or the other, black or white. I think it's quite reasonable to have a five-year plan, although I would say that I think it's desirable to allow within that plan pilot programs so that alternative providers get established in the marketplace with sort of a 5 to 10 percent load type of exposure and that to some extent the lost revenues associated with that are absorbed by the company or accepted in some manner because there is that problem of giving a competitive rate to alternative providers and not having such a high exit fee or wires charge that it really interferes with competitive alternatives. So I think if you have a five-year plan plus pilot programs of some significance, not trivial ones, I think you're really doing what I think a lot of states will do. Some others of course are proceeding much more aggressively to immediate access with wires charges and that's also another way to go, but I don't think it's clearly preferable to what might happen as a result of this case.

COMMISSIONER GILLIS: Thank you. That's all my questions.

THE WITNESS: Thank you.

EXAMINATION

BY JUDGE SCHAER:

Q. Mr. Talbot, what is your opinion about adjusting ratios and debt ratings for purchased power contracts?

A. I don't think the answer to that is a simple one, Your Honor. I think that it is a factor in terms of leverage, the effect of leverage on bond holders and preferred stockholders. On the other hand, I don't think that any of the agencies is proposing a quantitative or mechanistic approach to evaluating that. For example, there are benefits to a company financially in certain well structured purchased power agreements. For example, take and pay as opposed to take or pay can be beneficial. I think in the case of Puget's purchased power agreements, there is some hydro resources in there which might fit very well within its overall -- and might reduce it possibly. So although clearly the majority, to be straightforward about it, the majority of the contracts I think are above market, as I understand, subject to check on that, and therefore may warrant taking into account that factor but I wouldn't apply it mechanistically. I think it's a useful factor to see as Mr. Abrams has suggested, but I wouldn't quite give it as much weight as he has. I think he might have gone a little far in emphasizing -- close to emphasizing mechanistic approach to saying, well, we run the numbers with this factor and we'll get a fixed cost recovery of 2.X versus 2.Y and I think that's taking it a little too far.

Q. You had a lengthy discussion with Mr. Harris about an article that you had written apparently about what should go into a rate cap or how you would structure a rate cap?

A. Yes.

Q. Have you reviewed the company's case in chief in this matter?

A. Yes. As opposed to Mr. Heidel's testimony?

Q. As opposed to Mr. Heidel's testimony or to any of the rebuttal testimony. Just their original filing?

A. Yes, I have.

Q. Did that filing include the information that you would need to set up the kind of rate cap we're talking about in your article?

A. I think so. Some of the comparatives are there. In terms of setting what the future rate level could be, and particularly I think the issue of whether the company should give future rate increases, I think that's been pretty well addressed. Other elements like earnings sharing mechanism, an inflation adjustment factor, which would make annual adjustments depend upon inflation less a productive factor less a stretch factor, et cetera, all of those sort of formulaic issues are not being presented in the company's case in chief, and of course -- well, the whole earnings hearing feature has not been developed.

Q. How does the rate cap theory that your article was written about tie into the question that's really before us of whether or not to approve the merger? How do you build in the merger savings or those pieces of what's going on? Is that part of what would be the productivity adjustment or is it a whole separate layer of analysis that needs to be looked at differently? I'm kind of getting those mixed up in my head and I'm wondering if you could clear those apart.

A. I sometimes wake up in the middle of the night and say, well, what is this case about? How many cases in one do we have here? Is it three or four cases in one? And I think that's a real issue. I think primarily from the way I looked at it is two cases in one. I do think there's a merger case with merger savings associated with that and that's one case, and the other is is a multi-year rate proposal. The merger doesn't inherently depend upon that, nor does the rate plan perhaps conceptually depend upon the merger. They are tied in the company's mind and they are being presented as a package which stands or falls, I guess, but I do think of them as separate and that's why I think it's appropriate to say, well, on the one hand you have a merger which achieves certain synergies, cost savings, and on the other hand, I think it's appropriate to say it is a multi-year rate plan which has more incentive for the merged company, PSE, after the merger to save costs than it would have if it were just a merged company under traditional regulation, and that incentive, I believe, should go with some stretch goals for the company. And I think that's a fairly common view.

So I would distinguish them, and that's why I think it's appropriate to take into account both sets of targets. They're both sets of targets. Mr. Flaherty's targets are targets and the best practices and power stretch savings are targets as well, and I think it's appropriate to build those into a reasonable scenario, figure if it's going to result in viability for the company, financial soundness, not just bare viability.

I would maybe add one point which I think is relevant, and that is I think if you are building in rate increases in the future, it's a more difficult thing to do than if you have a rate freeze. Rate freeze is kind of almost a traditional thing. There are a number of cases where people will say we'll have a stay-out for a period of time if you give us whatever we want, whatever it is, merger or some factor, some regulatory objective that they had. Future rate increases I think are more difficult to justify and require a higher standard, I think, of cost savings and cost responsibility on the part of the company.

Now, just to round off the argument, I think those very standards of cost responsibility diminish the need for a rate increase in the future. So I think that takes me back to the sense of rate stability as being a stay-out by the company as part of the condition of the merger seems to me appropriate. So you would be building in both -- I believe under the financial scenarios you would be building both the merger savings as targets to be achieved by the company and also the stretch savings.

I'm sorry to go on, but there's one additional point, and that is in the additional filing with the rating presentation, the presentation to the rating agencies, the company did say that we hope to equal or exceed the merger savings goals. It was clearly stated in that document, and I think that's correct. I think they could do better than that. I think they will do better than that and, again, I think that goes to the argument for rate stability or an increase, and if I've helped you with that.

Q. That was going to be my next question. You mentioned something about meet or exceed and I was going to ask you what that reference was, so I think you responded to all the questions I had.

Any redirect for this witness? Mr.

Manifold.

MR. MANIFOLD: Well, first of all, Your Honor, there have been a number of questions of the witness regarding his -- you called this an article? The AARP piece?

THE WITNESS: It's a position paper.

MR. MANIFOLD: The position paper that he drafted for the AARP entitled "Evaluating Price Cap Proposals in the electric utility industry." I would like to offer to make the entire document an exhibit.

JUDGE SCHAER: Let's mark that Exhibit 106 for identification. Is there any objection to that document coming in?.

MR. HARRIS: No, Your Honor.

JUDGE SCHAER: That document is admitted.

(Marked and Admitted Exhibit 106.)

JUDGE SCHAER: Do you have copies or do you need to make copies?

MR. MANIFOLD: I will make copies and have those in the morning.

JUDGE SCHAER: Could you give me the name one more time?

MR. MANIFOLD: Certainly. It's entitled "Evaluating Price Cap Proposals in the Electric Utility Industry" by Neil Talbot dated August 1996.

JUDGE SCHAER: Thank you.

REDIRECT EXAMINATION

BY MR. MANIFOLD:

Q. Mr. Talbot, I assume it's okay if I make more copies of your copyrighted material for this purpose?

A. I should check with my client. They do actually say it's copyrighted but I can't imagine the AARP would mind.

Q. There's been much testimony, of course, today both on questions to you and to earlier witnesses about the rating agency presentation. Do you recall or would you accept that public counsel data request No. 27 to Mr. Sonstelie of your company asked, A, provide all Puget forecasts of revenues, expenses and rate base applicable to 1996 and beyond with and without the merger; and B, provide the specific cost trends and projections cited on page 14, lines 21 to 22. And the response was from Mr. Story of Puget Power which said, "Please refer to the company's response to staff data request No. 38."

A. Yes, I've read that.

Q. Would you accept or are you familiar with the staff data request No. 38 to which that refers?

A. Yes. I have it in front of me.

MR. MANIFOLD: Your Honor, it's our intent to present this as an exhibit with a subsequent witness, but just let me ask if it's accurate that what that data request sought was staff was asking the company for its best estimates of the stand alone and merged financial forecast for the period 1996 through 2001.

A. Yes. That was the question framed and answered.

Q. And the company provided what's been called the rating agency presentation response to that data request?

A. That's correct. That in itself consists of several documents that were all presented apparently at the same time to the rating agencies.

Q. Have you -- are you aware of the company presenting any supplement at any time during this case to that data request for its best estimate of financial forecasts to present to either public counsel or staff, any other studies it had done other than the rating agency forecast up until the time it filed rebuttal?

A. No, except for the material that I was questioned about earlier with respect to adjustments made by Mr. Torgerson. Apart from those, which are subsequent, I don't know of any other complete forecast, if you will, particularly not a detailed written document of probably totally, if you add them all up, 100 pages or so, which really explains the numbers, develops the numbers, and develops stand alone for the two companies and then combines them into what they call a NewCo forecast which is the predecessor or generic name for what is PSE, so I haven't seen anything to compare with this at all.

Q. In your professional judgment, what would you find more or most reliable? The internal planning documents of a company or the the subsequent testimony that presents to a utility commission when it's seeking rate relief?

A. Well, you always have a problem with respect to the fear that those that know don't tell and those that tell don't know. You know, that's the old problem. I personally put a lot of credence in a forecast made to investors or statements made to investors and I regard a statement made to a rating agency which is an agency whose job it is, as I believe Mr. Abrams will say when he's on the witness stand, his job is to present material on companies, evaluations of companies for purposes of investor evaluations such as summarized in, for example, rating the bonds BBB or single A or whatever. That's an investment service, and I place considerable credence in that.

Now, the question arises here in light of what's happened since, was this a rosy scenario, and well, I don't think it was that rosy. I think it was a reasonably achievable scenario, because you cannot be too speculative when you're talking to investors because we know that if you're too speculative when you talk to investors you can be sued. Your bond counsel and everything will do that; don't do that. Tell the truth. Stick to it. And so I do place considerable credence. If they present numbers, which are based on target or goals I don't think that if they were asked at that time, are these speculative they would have said, yes, they are speculative numbers. They would have said they will be a challenge for us, there's no guarantee we're going to achieve them. On the other hand, as they say in one or two pages in that document -- three places actually -- these forecasts may be exceeded, but we may also fall short of them.

So, that's why I strongly recommended to you, Mr. Manifold, that we put this entire document into the record because if you read that document it speaks for itself.

Q. Well, that's as broad a hint as one can get.

MR. MANIFOLD: It had been my intent, as I said earlier, Your Honor, I would like to move for the admission, and I think all of the relevant parties have copies. It's top secret and I will make an additional copy for the record as needed. I would like to move to have marked and move for the admission the staff data request No. 38 for the company and its response.

JUDGE SCHAER: Mr. Manifold, is part of that already in the record?

MR. MANIFOLD: I believe about four pages are, TS-34.

JUDGE SCHAER: So this would be supplementing TS-34 with the approximately 96 other pages?

MR. MANIFOLD: Right. And it did occur to me to only put in the pages that weren't in the previous exhibit but, quite frankly, since it's only a few pages in the previous exhibit it would make it a more meaningful document to put the whole thing in so it can be referenced as one whole.

JUDGE SCHAER: So, are you offering that at this time?

MR. MANIFOLD: Yes. I would like to have it marked and offer it.

JUDGE SCHAER: Let's mark that for identification as Exhibit 107.

(Marked Exhibit TS-107.)

JUDGE SCHAER: That's the response to staff data request No. 38. Is there any objection to that?

MR. HARRIS: No.

JUDGE SCHAER: Would you like that designated top secret.

MR. HARRIS: It is top secret, yes.

JUDGE SCHAER: That will be Exhibit TS-107.

(Admitted Exhibit TS-107.)

MR. MANIFOLD: Your Honor, to try and alleviate a little bit of how much is in the TS category, may I ask that we mark the data request itself, which is a one-page document, as one exhibit number, and then the response, which is top secret, as the top secret response. That way at least the request itself will be available to those without decoder rings.

JUDGE SCHAER: Why don't we mark the request as Exhibit 108 for identification. Is there any objection to its admittance?

MR. VAN NOSTRAND: No.

JUDGE SCHAER: That document is admitted.

(Marked and Admitted Exhibit 108.)

(Discussion off the record.)

JUDGE SCHAER: Back on the record. While we were off the record there was a brief procedural discussion regarding what copies needed to be provided of Exhibit TS-107 and of Exhibit 108. Please proceed, Mr. Manifold.

Q. Mr. Talbot, Mr. Harris asked you a question about in what's now been marked as Exhibit TS-107. I think he said that the stretch goals were set out individually in that and he asked if you would speculate with him that the company did that because they wanted to call particular attention to them and discuss them with the rating agencies. What conclusion do you draw from that, if any?

A. Well, as I said in response to the other questioner, I really don't know why they single out some. Actually not all, I believe they're stretch goals. I believe there were also some assumptions about escalation of O and M costs and construction costs which were in there somewhere. I'm not sure if they were explicitly dealt with in the same manner. I don't think they received a sort of line item identification.

Q. Would you agree that in the approximately 100 pages a lot of things got line item potential?

A. Clearly there were a number, a large number of items, yes.

Q. You were asked some questions from your testimony in main in the Bangor Hydro case, I believe specifically page 7, line 13. For completeness, would you feel it appropriate to mention the testimony you have on that same page the previous question, the question that's at line 7 and answer through 10?

A. Can you just give me the reference again?

Q. Yes, the Bangor testimony, page 7. I think Mr. Harris asked you about the response starting on line 13. I wondered if you felt it would be appropriate to include the question and answer that preceded that.

A. Yes. The question that preceded was, "What overall criteria should design or guide a price cap plan," to which I give the answer, "Key criteria, its promotion of economic efficiency and innovation, its fairness and its ability to facilitate the industry's structural transition." I take it, it was the previous question and answer that you wanted.

Q. Yes.

MR. MANIFOLD: If I might just have a moment.

Q. Perhaps you should also read the one on the top of the page starting at line 1 and we'll work our way backwards on your testimony.

A. First question on that page, what are the key elements of the price cap plan, and the answer was the key elements of the price cap plan include a ceiling on prices to prevent abuse of market power in those segments of the market that are not competitive and flexibility to reduce prices below the ceiling in order to match price and service offerings with the needs of customers in the competitive segments of the market.

Q. In that same piece of testimony, I notice in the table of contents it says that in the design of a rate plan for Bangor Hydro there are a number of different elements one of which is a customer service quality adjustments at page 24 of your testimony. When I turn to page 24 I don't find that. Do you recall why that would be the case if that is accurate?

A. I think what what must have happened -- I'm speculating here -- is that we intended to put in a customer service quality or decided it was premature at the time.

Q. Was there a customer service proposal in that proceeding? Would that be reflected in the table that's accompanying the AARP article which is Exhibit 106? Excuse me. I'm confusing Central Maine Power with Bangor Hydro Electric Company. I will withdraw that question.

A. Yes. Central Maine did have a service quality provision.

Q. Counsel for BPA asked you some questions about any inconsistencies or whether there were any inconsistencies between continuation of the benefits of the residential exchange and moving towards competitive markets. In a competitive market would you expect a marketer of energy such as BPA, if there were a competitive market, to sell cheap power to certain customers such as aluminum companies and PUDs and to refuse to sell that power to another customer such as Puget?

A. No. In a competitive market, normally the only restriction would be contract. In other words, if there was historical contractual commitment to that extent that portion of the market would be tied up but absent a contract, one wouldn't have an earmarking of particular source to particular customers.

Q. Just a couple of final questions to clarify things. In response to some questions from Commissioner Gillis, you indicated that the rate plan could be viewed as an interim recovery of stranded costs of I think you said over 50 percent over the five years, and I want to be clear. By that you did not mean to the exclusion of recovery of the remainder of stranded costs but rather that during that period of time that portion of what might be stranded costs would be recovered and after that time one would decide, one could decide what would happen with the remaining percentage?

A. Yes. If you look out to the future from today, I would say there's a considerable fear, and I believe in a data response Mr. Abrams agreed there would be a general concern among investors about the recovery of fixed costs. It's not regarded as a done deal at all, and as I think I quoted in my testimony, some companies, some companies don't even believe in it. Pacific Corp being one of them. They say you shouldn't recover 100 percent of fixed costs -- of stranded costs because it would get in the way of the market functioning competitively.

So I think we need to accept that the investment community is concerned about nonrecovery of 100 percent of fixed costs. Fixed costs currently are included in rates. So to the extent that all costs currently are included, pretty well are recovered under any plan being here proposed, be it public counsel's plan, all these plans cover all costs, the only extent, to what in addition to that cover more or less return. That's the area of argument not the recovery of costs. And I would say in appending to that, which is, by the way, from the accounting standpoint in terms of FASB 71, is that if you as a Commission want to make sure that a multi-year rate plan allows your utility companies to continue to keep on their books regulatory assets, there must be a probable recovery of the value of those assets over a ten-year period. So -- and then I think that is covered in this state by the emergency rate relief element as well as by the terms of all the plans being here proposed.

So by continuing to recover these costs over a five-year period under the rate plan, Mr. Marcus has figured out, under different rate scenarios, how much would be left at the end of the five-year period, and that amount is only -- one scenario if I recall is more than 50 percent still outstanding at the end of the five-year period and in other cases it's been full or over full recovery of stranded costs.

At the end of the period the company would be actually in a situation where it could simply float into the market without losses at that time. So that's what I meant by this characterization. Not to come up with a formula to say, this is the amount that should be recovered and this is the amount that shouldn't be recovered, just to say that in a rate plan that covers costs in rates for a period of time that at the end of that period there is less stranded costs outstanding. What happens to that is still to be determined, and I am not suggesting that should be determined here, particularly. I think that's for the future, but to the extent you have less of a stranded cost problem in five years, which is much easier to resolve.

MR. MANIFOLD: I have no other questions.

JUDGE SCHAER: Anything further for this witness.

MR. HARRIS: Two or three questions.

JUDGE SCHAER: Please proceed.

RECROSS-EXAMINATION

BY MR. HARRIS:

Q. I'm not sure it was intended, but in your answers to questions to Mr. Manifold I was left with the impression that you're suggesting that somewhere in the rating agency presentation the company suggested that it would exceed the stretch goal targets. That's not true, is it?

A. No. What is correct -- I think I said this -- was that somewhere in their presentation the company said we can equal or exceed or may even exceed the merger savings goals identified by Mr. Flaherty.

Q. Then in response to some questions by Mr. Manifold about public counsel requests No. 27 and staff data request No. 38 you were asked, wasn't the company asked to provide its best forecasts? I've read 27. I don't see the word best anywhere. Doesn't it just ask for all forecasts?

A. Yes.

Q. Wouldn't the company have to then produce in response to that best, worst, in fact any forecast it had?

A. Perhaps I should go back and read it.

Q. Yes. I refer you specifically in 27 to subsection A which reads, "provide all Puget forecasts."

MR. MANIFOLD: I think Mr. Harris has raised a good point and I would be happy to stand corrected that I should have not said "best." It says "provide all forecasts" and just one forecast was provided.

MR. HARRIS: And also the same is true with respect to 38. It does not ask for the company's best forecasts.

THE WITNESS: What it asks for is not the best forecast. It just says, please provide, quite specifically, A, each merger applicant's stand alone without merger annual financial forecasts for the period beginning 1996 through 2001; and then B, similar stand-alone information for result of operations, et cetera. C, similar information to A and B under the assumption that the merger is consummated.

Also, and I quote, reconciliation and description of how the savings per exhibit TJF-3 were accounted for in the forecasts. And then supporting work papers.

MR. HARRIS: That's all my questions.

JUDGE SCHAER: Is there anything further for Mr. Talbot? Thank you for your testimony. We will be beginning tomorrow morning at 9 a.m. with Mr. Torgerson on the stand. I would like parties to have distributed before 9 a.m. any exhibit which they would like to have admitted through Mr. Torgerson, and with that we are off the record and reconvene tomorrow morning at 9:00.

(Hearing adjourned at 5:00 p.m.)