EXHIBIT NO. ___(MJS-1T)
DOCKET NO. UE-11___/UG-11___
2011 PSE GENERAL RATE CASE
WITNESS: MICHAEL J. STRANIK

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-11____** **Docket No. UG-11____**

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

JUNE 13, 2011

PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF MICHAEL J. STRANIK

PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF MICHAEL J. STRANIK

I. INTRODUCTION

Q. Please state your name, business address, and present position with Puget Sound Energy.

A. My name is Michael J. Stranik. I am the Assistant Controller for Puget Sound Energy, Inc. ("PSE" or "the Company"). My business address is 10885 N.E. Fourth Street, Bellevue, Washington, 98009.

Q. Would you please provide a brief description of your educational and business experience?

A. Please see Exhibit No. ___(MJS-2).

Q. What topics are you covering in your testimony?

A. I describe the natural gas results of operations and natural gas revenue deficiency. I will describe the different allocation methods used to allocate common expenditures between electric and natural gas operations. I explain the various adjustments to the results of natural gas operations for the test year used for this proceeding, plus changes to rate base, working capital, conversion factor and the overall revenue requirement and the resulting natural gas revenue deficiency. I will also discuss the current natural gas results of operations compared to the results of operations in the last general rate case and the resulting causes of the current revenue deficiency. I will present an analysis performed on the net benefit provided by owning the Company aircraft versus commercial travel options.

Based upon the adjusted test year operating revenues of $1,055,321,059 the total requested gas general rate case revenue deficiency is $31,864,884, which represents a 3.0% average increase for natural gas customers.

II. TEST YEAR FINANCIAL STATEMENTS AND RATE BASE

Q. Would you please explain Exhibit No. ___(MJS-3)?

A. Exhibit No. ___(MJS-3) presents the actual financial statements for the test year. Page 3.01 of Exhibit No. ___(MJS-3) presents a comparison between the unadjusted gas income statement for the test year ending December 31, 2008, in Docket No. UG-090705 (the "2009 general rate case") and the unadjusted gas income statement for the 12 Months ending December 31, 2010, the test year for this general rate case filing. The same periods are used to present the following pages in Exhibit No. ___(MJS-3). Page 3.02 of Exhibit No. ___(MJS-3) presents the combined balance sheet, page 3.03 of Exhibit No. ___(MJS-3) presents the rate base calculation, and Page 3.04 shows the working capital calculation that is included as part of the rate base calculation. Page 3.05 of Exhibit No. ___(MJS-3) presented for the current filing, shows the Allocation Methods, or factors, used in allocating common expenditures between electric and natural gas operations. Please refer to the Prefiled Direct Testimony of Mr. John H. Story, Exhibit No. ___(JHS-3), for a more detailed discussion of how these pages were adjusted for the reallocation between tax accounts. Pages 3.06 through 3.09 show how this tax reallocation was tracked for the balance sheet, rate-base and working capital presentations.

Q. Are rate base and working capital calculated in the same manner as allowed in the last general rate case?

A. Yes. As discussed by Mr. Story, they reflect the removal of the tax accounting change for repairs as directed by the Washington Utilities and Transportation Commission (the "Commission") in the 2009 general rate case, as well as the removal of a related tax method change for retirements.

Q. Has there been a change in natural gas rate base since PSE's most recent proceeding that changed natural gas rates?

A. Yes. In the 2010 natural gas tariff filing in Docket No. UG-101644, natural gas rate base was $1.615 billion. In this proceeding the natural gas rate base is $1.658 billion, which is an increase of $43 million in rate base.

Q. What are the major causes of the increase in natural gas rate base since the tariff filing?

A. The majority of the growth in rate base can be attributed to distribution plant which increased $62 million excluding the effects of deprecation and deferred taxes. Based on historical spending patterns approximately 58 percent is related to replacement of existing infrastructure which does not generate new revenue.

III. CAUSES OF THE NATURAL GAS REVENUE DEFICIENCY

Q. Would you please describe the causes of the natural gas revenue deficiency?

A. Yes. To determine the major causes of the changes between two regulatory filings the Company uses a unit cost analysis. This analysis is simply the major categories of the income statement and rate base that have been pro formed and restated for each of the regulatory periods, divided by the delivered load for that period. This calculation determines the major categories' unit cost for that particular period. The differences between the current period and prior period unit costs are then multiplied by delivered loads for the current regulatory period. This product determines how much that major category has increased or decreased in cost since the last regulatory period taking into consideration load growth.

Exhibit No. ___(MJS-8) shows this calculation for the difference between the adjusted test period for this general rate filing, as determined in Exhibit

No. ___(MJS-4) and the adjusted test period for the 2010 natural gas tariff filing. In the 2010 natural gas tariff filing, a full settlement was reached with parties resulting in a revenue deficiency that was $5.4 million less than originally requested by the Company. In the settlement, the parties did not allocate the agreed upon revenue requirement to specific ratemaking adjustments. Accordingly, for purposes of presenting the prior period on Exhibit No. ___ (MJS-8), the amounts reflected for each major category are based on the Company's original filing in that proceeding, with the $5.4 million reduction in the deficiency resulting from the settlement being reflected separately on line 25. Major cost drivers of the proposed revenue increase include: 1) $14.2 million for pre-tax return on rate base of which $8.5 million is due to rate of return; 2) $4.0 million for taxes other than income tax; 3) $3.9 million for depreciation; and 4) $5.4 million associated with the settlement from the natural gas tariff filing.

Q. Please explain why the $5.4 million shows as one of the causes of the revenue deficiency in this proceeding.

A. In the natural gas tariff proceeding, the settlement did not specify an adjustment to the filed revenue deficiency. Given this, the overall revenue requirement reduction was presented as one line item for the unit cost exhibit presentation. This line item shows as one of the causes of the rate increase since this line item does not carry forward into the current proceeding. If the settlement adjustments were identified, the increase would have been allocated to the appropriate income statement lines in this proceeding.

IV. NATURAL GAS PRO FORMA AND RESTATING ADJUSTMENTS

Q. Please explain your Exhibit No. ___(MJS-4).

A. Exhibit No. ___(MJS-4) presents the impact of each of the gas pro forma and restating adjustments being made to the December 31, 2010 operating income statement and balance sheet. The first page of Exhibit No. ___(MJS-4), page 4.01, presents the unadjusted operating income statement and average of the monthly averages rate base for the Company as of December 31, 2010, as presented in Exhibit No. ___(MJS-3), in the column labeled "Actual Results of Operation". The various line items are then adjusted for the summarized pro forma and restating adjustments, as shown in the column labeled "Adjusted Results of Operations". This column is the source used to calculate the revenue deficiency. In the second to last column the revenue deficiency is added to the adjusted income statement, and the impact on the operating income statement and rate base is presented in the final column.

Pages 4.02 through 4.05 of Exhibit No. ___(MJS-4) present a summary schedule of all the pro forma and restating adjustments. The first column of numbers on page 4.02 is the net operating income for the year ended December 31, 2010 and the rate base for the same period as presented in Exhibit No. ___(MJS-3). Each column to the right of the first column represents a pro forma and/or a restating adjustment to net operating income or rate base. Each of these adjustments has a supporting schedule, which is referenced by the page number shown in each column title.

The second to the last column, shown on page 4.05 of the summary schedule, summarizes all of the adjustments, and the final column shows the adjusted test period results used to calculate the revenue deficiency.

Q. Please explain your Exhibit No. ___(MJS-5).

A. Exhibit No. ___(MJS-5) presents the adjustments specifically related to natural gas operations only.

Q. Please describe each adjustment, explain why it is necessary, and identify the effect on operating income or rate base.

A. I will explain the adjustments in the order as they are shown on page 4.02 through 4.05, by reference to the column number and title of each adjustment.

5.01 <u>Water Heater Depreciation</u>

This pro forma adjustment restates the test year to reflect depreciation expense associated with gas water heaters using lower depreciation rates that were developed based on a limited scope depreciation study performed specifically for gas water heaters.

Q. Why are you proposing a depreciation adjustment for the gas water heater and conversion burner rental program in this case?

A. The purpose of this adjustment is to correct for the depreciation rates for gas water heaters that were approved and which are in current rates as part of the settlement in Docket No. UG-101644. This adjustment increases net operating income by $4,071,209 for natural gas operations and decreases gas rate base by $2,218,846.

Q. Why is this adjustment tax effected when it was not tax effected in the gas tariff filing?

A. In reviewing depreciation adjustments and their impact on normalization rules, the Company has determined this adjustment is necessary in order to match the deferred tax liability on the balance with changes in the accumulated book depreciation reserve.

Q. Please continue describing the restating and pro forma adjustments.

A. The next adjustment is:

5.02 <u>Reclassification of Bare Steel Pipe To Wrapped Steel Pipe</u>

This restating adjustment is to correct for the depreciation associated with the reclassification and retirement of bare steel that was necessary in order to conform the Company's financial records to the results of field studies performed for the bare steel replacement program.

Back in the late 1950s, based on material specifications and construction practices, the Company made a transition from bare steel to wrapped steel. Prior to 1956 all pipe installed was bare steel with the exception of wrapped steel on high pressure supply system. Pipe installed during the years 1956-1958 was a combination of bare steel and wrapped steel. Pipe installed after 1958 was wrapped steel. The Company's accounting records at that time did not distinguish between bare steel and wrapped steel. Beginning in the early 1990s several studies were conducted to identify bare steel as part of the Bare Steel Replacement Program. When comparing the results of these studies to the financial records, it was apparent that wrapped steel assets were recorded to bare steel sub FERC accounts resulting in an artificially high balance when compared to the bare steel studies. When the sub-FERC account was established for wrapped steel, a reclassification of wrapped steel assets that were booked to bare steel accounts was not performed.

To correct for the misclassification, the Company used the year of installation. All pipe classified as bare steel from 1959 and onward totaling $23.6 million was reclassified from G3763 (DST Bare Steel) to G3764 (DST Wrapped Steel). In addition all bare steel classified as transmission (high pressure supply system) totaling $18.1 million was reclassified from G3767 (TRANS Bare Steel) to G3766 (TRANS Wrapped Steel). To bring the accounting records in alignment with the Field Operations studies of remaining footage in the Bare Steel Program, $5.0 million was retired from G3763 (DST Bare Steel). These entries all occurred in December 2010.

This adjustment recalculates the total impact on depreciation in 2010 due to the reclassification to different plant accounts with different depreciation rates. The Company's accounting system applies a half year convention for transfer transactions that occur during the year therefore the test year only reflects half of the total impact.

The effect of this adjustment is to decrease net operating income for natural gas operations by $195,347 and decreases natural gas rate base by $97,673.

5.03 <u>Contract Changes</u>

In January 2011, PSE entered into a new contract for construction and maintenance services for natural gas operations. This restating adjustment adjusts the test year as if the actual work performed during 2010 was performed under the new service provider contract. Please refer to the Prefiled Direct Testimony of Susan McLain, Exhibit No. __ (SML-1CT) for more detail regarding the new service provider contract. This adjustment increases net operating income for natural gas operations by $640,000.

Q. Please explain your Exhibit No. ___(MJS-6).

A. Exhibit No. ___(MJS-6) presents the common adjustments that apply to both natural gas and electric operations. Each of the individual adjustments will be addressed in testimony as indicated below.

Adjustment	John H. Story Exhibit No. (JHS-1T)	Michael J. Stranik Exhibit No. (MJS-1T)	Matthew R. Marcelia Exhibit No. (MRM- 1T)	Chun K. Chang Exhibit No. (CKC-1T)
6.01 Temperature Normalization				x
6.02 Revenue and Expenses	x	x		
6.03 Pass Through Revenue and Expense	x	x		
6.04 Federal Tax			x	
6.05 Tax Benefit of Pro forma Interest			x	
6.06 Operating Expenses	x	x		
6.07 General Plant Depreciation		x		
6.08 Normalize Injuries and Damages		x		
6.09 Bad Debt	x			
6.10 Incentive Pay	x			
6.11 Property Taxes			x	
6.12 Excise Tax & Filing Fee		x		
6.13 D&O Insurance		x		
6.14 Interest on Customer Deposits		x		
6.15 Rate Case Expenses	x			

6.16 Deferred Property Gains/Losses		x		
6.17 Property & Liability Insurance		x		
6.18 Pension Plan		x		
6.19 Wage Increase	x			
6.20 Investment Plan	x			
6.21 Employee Insurance	x			

6.01 Temperature Normalization

This restating adjustment removes the effect of non-normal temperatures from test year loads, so that test year loads are more reflective of normal operating conditions. The adjusted therms are then priced based upon current rates after the therms are allocated to the appropriate customer class.

The Prefiled Direct Testimony of Dr. Chun K. Chang, Exhibit No. ___(CKC-1T), discusses the Company's weather normalization methodology and the allocation to the rate classes based on the proposed rate class level weather normalization methodology.

After allocation to the different customer classes and adjusting for purchased gas costs, this adjustment increases net operating income for natural gas operations by $6,651,267.

6.02 **Revenue and Purchased Gas Expenses**

This restating and pro forma adjustment restates sales revenues and purchased gas costs to reflect only those rate schedules included in the general rate case and to pro form in the full year effect of the general rate increase approved during the test year in Docket No. UG-090704, the natural gas tariff increase approved during the test year in Docket No. UG-101644, and the November 2010 PGA increase approved in Docket No. UG-101642. This adjustment also removes the credits passed back to customers on Schedule 132 for merger savings, as required in Docket No. U-072375. The revenues associated with leasing of temporary excess capacity at Jackson Prairie on line 25 of $1.1 million were removed due to the expiration of the contract in March 2011. This excess capacity at Jackson Prairie began in November 2008, after the capacity at the Jackson Prairie facility was expanded. The expansion temporarily created excess capacity related to the need for serving natural gas customers. At the same time, PSE’s gas for power portfolio, which is used to serve electric customers, was seeking storage capacity. To mitigate the cost of the temporary surplus capacity for PSE's Core Gas Book, internal capacity assignment agreements were executed wherein PSE’s natural gas operations charged electric operations for the reservation of excess Jackson Prairie capacity. The revenue resulting from an extension of the assignment to gas customers will flow through the PGA and the cost resulting from such assignment to electric customers will flow through the Power Cost Adjustment Mechanism. Please see Exhibit No. ___(JHS-1T) for the explanation of how the corresponding electric test year expenses are treated in Exhibit No. ____(JHS-05), Adjustment 5.01 and 5.01(A).

Finally, this adjustment includes other necessary test year true up adjustments and migration adjustments consistent with what was filed in the 2010 gas tariff increase filing, Docket No. UG-101644. Please refer to the Prefiled Direct Testimony of Janet K. Phelps, Exhibit No. __ (JKP-1T), for further discussion of these adjustments.

This adjustment increases net operating income for natural gas operations by $17,299,412.

6.03 <u>Pass Through Revenues and Expenses</u>

This is a restating adjustment which removes from operating revenues all rate schedules that are a direct pass through of specifically identified costs or credits to customers, such as the conservation rider, municipal taxes, PGA revenues under Schedule 106 and the low income program. The associated expense that is recorded in the test year for these direct pass through tariffs are also removed in this adjustment.

The net impact of this adjustment is to increase net operating income for natural gas operations by $154,724.

6.04 Federal Income Taxes

This schedule restates actual federal income tax ("FIT") expense to the test year for this case. Mr. Marcelia discusses this adjustment in his prefiled direct testimony, Exhibit No. ___(MRM-1T). This adjustment decrease net operating income for natural gas operations by $28,834,101.

Q. Are there any changes to the Federal Income Tax Adjustment since the 2009 general rate case?

A. Yes, previously the Company had included all interest associated with the test year as a deduction to taxable income and then corrected the interest deduction to reflect only interest associated with rate base in Adjustment 6.05 Tax Benefit of Pro Forma Interest. To eliminate the need to include the test year interest in two separate adjustments, the Company is now handling the entire adjustment for tax benefit of interest in Adjustment 6.05. This change does not affect the overall revenue requirement from what would have been calculated in the old presentation as it just moves the interest deduction from the Federal Income Tax Adjustment to the Tax Benefit of Pro Forma Interest Adjustment.

Q. Please continue describing the restating and pro forma adjustments.

A. The next adjustment is:

6.05 Tax Benefit of Pro Forma Interest

This pro forma adjustment uses a rate base method for calculating the tax benefit of pro forma interest. Mr. Marcelia discusses this adjustment in his prefiled direct testimony, Exhibit No. ___(MRM-1T). This adjustment increases net operating income for natural gas operations by $18,805,185.

6.06 Operating Expenses

This restating and pro forma adjustment adjusts the test year for several different items.

1. O&M Impact of Laid Off Employees and Executive Transitions: There were 52 employees laid off during the test year. In addition, the Company removes Steven P. Reynolds' salary, who retired March 1, 2011, and adjusts Kimberly Harris' test year salary as the new CEO. The salary of Mr. Valdman who left the Company in March 2011, was not included as part of the adjustment since the expectation is that his position as CFO will be filled during the course of the proceedings. The total impact on natural gas operating expense of removing the above salaries, shown on lines 3 through 7 of this adjustment, is a decrease of $392,059.
2. Remove Non-Business or Non-Utility Related Expenses: These expenses, detailed below and shown on line 8, which decreases operating expenses by $8,499.

- Board Meeting Expenses – During the test year, 100% of incidental expenses related to quarterly board meetings were booked to utility operating accounts. This adjustment allocates a portion of these expenses below the line. The allocation is based on the portion of the agenda for each meeting that is related to non-utility topics. This is the same allocation used in the test year to record the board members' fees. This adjustment decreases operating expenses by $2,621.
- Non-Business Related Expense –This adjustment removes reimbursement for non-business related matters that were charged above the line during the test year. This adjustment decreases operating expenses by $120.
- Airport Parking - PSE has removed the dedicated parking spaces at the SeaTac airport and area hotels that were charged above the line, which reduces natural gas operating expenses by $5,758.

This adjustment increases net operating income for natural gas operations by $260,363.

6.07 General Plant Depreciation

This restating adjustment corrects a calculation error in the fixed asset system for general plant assets in FERC Accounts 391-398 that applies to both natural gas and electric operations.

When implementing the Final Order approving current depreciation rates in PSE's 2007 general rate case, Docket Nos. UE-072300 and UG-072301, the Net Book

Value balances in these accounts at October 31, 2008 were to be amortized over the new amortization periods applicable to each FERC account, with an implementation effective date of November 1, 2008.

The new rates were implemented November 1, 2008 in the Company's fixed asset detail accounting system. The intent was to amortize the remaining net plant value as of November 1, 2008 evenly over the new life of the account (e.g., 391.2 computers over five years) resulting in a zero balance at the end of that life.

Instead, the method chosen in the fixed asset system did not result in the intended calculation, but rather recalculated the net book value each month instead of using the November 1, 2008 net book value, resulting in a smaller and smaller depreciation expense being calculated each month, which would not result in a zero balance at the end of the asset's life. This resulted in incorrect depreciation expense being calculated from November 1, 2008 to March 31, 2010. An entry was posted in April 2010 to correct depreciation expense for this error.

This adjustment restates the test year to remove from depreciation expense the portion of the April 2010 correction that relates to periods prior to the test year. Additionally, accumulated depreciation at the beginning of the test year is increased for the impact of the additional depreciation that should have been booked prior to the test period along with the average of the monthly averages impact of the additional depreciation expense applicable to the test year.

This adjustment increases net operating income for natural gas operations by $384,999 and decreases natural gas rate base by $113,067.

6.08 Normalize Injuries and Damages

This restating adjustment is prepared in accordance with the 2009 general rate case order in Docket Nos. UE-090704 and UG-090705, which restates injuries and damages by adjusting actual test year accruals and payments of injuries and damages to the three-year average of accruals and payments. The adjustment is designed to normalize injuries and damages for the test year for natural gas and electric operations. This adjustment decreases net operating income for natural gas operations by $54,310.

6.09 Bad Debts

This restating adjustment calculates the appropriate bad debt rate by using the average bad debt percentage for three of the last five years after removing the high and low years. Please refer to the Prefiled Direct Testimony of John H. Story, Exhibit No. ___(JHS-1T), for the detailed discussion on this adjustment. This adjustment increases net operating income for natural gas operations by $1,574,431.

6.10 Incentive Pay

This restating adjustment uses a four-year average of employee incentive compensation instead of the test year expense and is consistent with how this adjustment has been made in past rate case filings. Please refer to the Prefiled Direct Testimony of John H. Story, Exhibit No. ___(JHS-1T), for the detailed discussion of this adjustment. This adjustment increases net operating income for natural gas operations by $246,621.

6.11 Property Taxes

This pro forma adjustment reflects the estimated property tax rates to be paid based upon the test year property values. Please refer to the Prefiled Direct Testimony of Matthew R. Marcelia, Exhibit No. ___(MRM-1T), for an explanation of this adjustment.

Q. Are there any changes to the calculation since the 2009 general rate case?

A. Yes, the calculation approved from the 2009 general rate case used property taxes associated with the 2007 property values and not the test year 2008 property values. Commission Staff proposed this change to the long-standing method of calculating property taxes that had been accepted by the Commission. Please refer to the Prefiled Direct Testimony of Matthew R. Marcelia, Exhibit No.___(MRM-1T), for an explanation of this adjustment and why the methodology as filed by the Company in this proceeding is the appropriate method to determine property taxes for the test year. In this adjustment, the property on which the tax is calculated is the property owned by PSE as of December 31, 2010. This adjustment decreases net operating income for natural gas operations by $1,668,296.

Q. Please continue describing the restating and pro forma adjustments.

A. The next adjustment is:

6.12 <u>Excise Tax and Filing Fee</u>

This restating adjustment adjusts the test year to actual expense for the Washington State excise tax and WUTC filing fee that should be recorded for these costs. This adjustment decreases net operating income for natural gas operations by $49,256.

6.13 <u>Director and Officer Insurance</u>

This restating adjustment removes the portion of Directors and Officers ("D&O") insurance that should be allocated to non-utility activity. This adjustment also annualizes the most current premiums, which became effective during the test year for the D&O insurance as it relates to the Company directors.

In the 2009 general rate case the allocation of D&O insurance was based on the ratio of utility versus non-utility assets. Continuing to use an asset based methodology has become more difficult due to the impacts of business combination accounting (Accounting Standards Codification 805) resulting from the merger. In other words, the assets and liabilities have different carrying values at PSE than they do in the upstream entities.

To allocate insurance expenses between utility and non-utility activity, the Company is using an allocation methodology evenly weighted between the 1) allocation of directors' fees and 2) direct labor charges for Company personnel who are covered by D&O insurance between utility and non-utility charges. Utility D&O insurance is allocated between electric and gas based on the number of customers allocation factor.

This adjustment increases net operating income for natural gas operations by $23,376.

6.14 <u>Interest on Customer Deposits</u>

This pro forma adjustment reflects the impact of interest associated with using customer deposits as a reduction to rate base. This pro forma adjustment adds to operating expense the cost of interest for this item based on the most currently implemented annual interest rate which is 0.42%. Pursuant to WAC 480-100-113(9), the interest rate paid on customer deposits is determined annually based on the interest rate for a one year Treasury Constant Maturity as of the fifteenth day of January of that year. This approach is consistent with prior general rate cases. This adjustment decreases net operating income for natural gas operations by $21,705.

6.15 Rate Case Expenses

This restating adjustment restates rate case expense to a normalized level. Please refer to the Prefiled Direct Testimony of John H. Story, Exhibit No. ___(JHS-1T), for the detailed discussion of this adjustment. This adjustment decreases net operating income for natural gas operations by $142,724.

6.16 Deferred Gains/Losses on Property Sales

The purpose of this restating and pro forma adjustment is to provide the customer with the gains and losses from sales of utility real property since the last general rate case. The gains and losses are allocated to gas and electric based on the use of the property. The amount of the gains and losses are amortized over a three-year period with the deferred amount being included in working capital. This adjustment is done in compliance with the settlement agreement for property sales in Docket No. UE-89-2688-T. For natural gas operations, there were no new deferred gains or losses not already approved in the PSE's 2009 general rate case. This adjustment decreases net operating income for natural gas operations by $92,595.

6.17 Property and Liability Insurance

This pro forma adjustment reflects the actual premium increases for property and liability insurance expense. These costs are allocated between electric and natural gas depending on the purpose of the insurance. Common property and liability insurance is allocated to electric and natural gas operations based on non production plant allocation factor. This adjustment increases net operating income for natural gas operations by $35,752.

6.18 **Pension Plan**

This restating adjustment calculates pension expense based on a four year average of cash contributions to the Company's qualified retirement fund and removes the Supplemental Executive Retirement Plan expense from test year expense.

In the 2009 general rate case, the Commission affirmed that the actual four year average of cash contributions ending with the historical test year should be used for setting rates. Using cash contributions instead of expenses recognized under Accounting Standards Codifications allows for consistency when applying this adjustment.

As determined by the plan actuary, the Company made a $24.5 million tax deductible cash contribution in 2008, $18.4 million in 2009, and $12 million in 2010, totaling $54.9 million for the four year period ending December 2010. The calculation is consistent with previous general rate cases in which the Commission has allowed the normalized four year average of cash contributions ending with the test year to determine the amount that is to be included in operating expense. The qualified retirement plan is allocated to O&M based on the distribution of wages and then allocated between electric and natural gas based on the employee benefit assessment allocator from Exhibit No. ___(MJS-3), page 3.09.

The expenses associated with Supplemental Executive Retirement Plan were disallowed in the 2009 general rate case; therefore, the test year expenses for that plan are eliminated from the current filing. This adjustment decreases net operating income for natural gas operations by $582,788.

6.19 Wage Increase

This pro forma adjustment reflects the impact of known wage increases after December 2010. Please refer to the Prefiled Direct Testimony of John H. Story, Exhibit No. ___(JHS-1T), for the detailed discussion of this adjustment. This adjustment decreases net operating income for natural gas operations by $1,250,164.

6.20 Investment Plan

This pro forma adjustment reflects the additional expense associated with the wage increases and is based on the current employee contribution rates. Please refer to the Prefiled Direct Testimony of John H. Story, Exhibit No. ___(JHS-1T), for the detailed discussion of this adjustment. This adjustment decreases net operating income for natural gas operations by $52,354.

6.21 Employee Insurance

The effect of this pro forma adjustment updates the test year insurance payments to the current average cost per participant. Please refer to the Prefiled Direct Testimony of John H. Story, Exhibit No. ___(JHS-1T), for the detailed discussion of this adjustment. This adjustment decreases net operating income for natural gas operations by $39,703.

V. CALCULATION OF THE NATURAL GAS REVENUE DEFICIENCY

Q. Would you please explain what is presented in the Sixth Exhibit to your Prefiled Direct Testimony, Exhibit No. ___(MJS-7)?

A. The Sixth Exhibit to my Prefiled Direct Testimony, Exhibit No. ___(MJS-7), presents the calculation of the natural gas revenue deficiency based on the pro forma and restated test period. The different pages in Exhibit No. ___(MJS-7) are:

7.01 General Rate Increase

This schedule, shown on Exhibit No. ___(MJS-7), page 7.01, reflects the test period pro forma and restated rate base, line 1, and net operating income, line 6. Based on $1,658,305,524 invested in rate base, an 8.42 percent rate of return and $119,825,618 of net operating income the Company has a revenue deficiency of $31,864,884.

7.02 <u>Cost of Capital</u>

This schedule, shown on Exhibit No. ___(MJS-7), page 7.02, reflects the proposed capital structure for the Company during the rate year and the associated costs for each capital category. The capital structure and costs are presented in the Prefiled Direct Testimony of Mr. Donald E. Gaines, Exhibit No. ___(DEG-1T). The rate of return is 8.42 percent and 7.29 percent net of tax.

7.03 <u>Conversion Factor</u>

The conversion factor, shown on Exhibit No. ___(MJS-7), page 7.03, is used to adjust the net operating income deficiency by revenue sensitive items and federal income tax to determine the total revenue deficiency. The revenue sensitive items are the Washington State utility tax, Washington Utilities and Transportation Commission annual filing fee, and bad debts. The conversion factor used in the revenue requirement calculation, taking into consideration the adjustments discussed earlier, is 0.621490 for natural gas operations.

VI. MERGER SAVINGS

Q. Are you aware of savings that are reflected in the test year as a result of the merger?

A Yes, The test year includes savings of fees and expenses related to: outside independent directors, shareholder services fees associated with transfer agent and registrar function, annual report design and printing, New York Stock Exchange listing fees, and other accounting related fees required for a public company. These savings, achieved as a result of the merger with Puget Holdings LLC, exceed $1.2 million.

VII. COMPANY AIRPLANE

Q. Are there any other issues you are addressing in your testimony?

A. Yes. In Docket Nos. UE-090704 and UG-090705 the Commission ordered the Company to provide evidence showing that ownership of a corporate aircraft is more economical that other forms of travel available to the Company. My testimony presents the evidence requested by the Commission regarding the economic benefit of PSE's aircraft.

Q. Please describe PSE's aircraft and how it is used for business purposes.

A. PSE owns an eight passenger Beechcraft KingAir turboprop aircraft that was purchased in 1986 and has been in continuous service since its purchase. It is used only for corporate business. Exhibit No. ____(MJS-09) provides pictures of the airplane, operational statistics for use during the test year and general benefits provided by the airplane.

The airplane provides value to the customers and the Company by allowing quick and safe access to the Company's generating resources. These resources have diverse locations in eastern Washington, southern Washington and Colstrip, Montana, all of which have limited commercial flight service available. Without the airplane, travel to Colstrip or to the Lower Snake River Wind project would take an extra day of travel plus additional expense for rental cars and overnight lodging. Fifty-one percent of all flights during the test year were to destinations with limited airline service.

The PSE airplane is a useful business tool that offers scheduling flexibility, minimizes travel time, and provides a secure work environment en route that allows PSE employees to maximize their productivity while traveling.

Q. Is the Company airplane only used to transport employees to meetings?

A. No. The Company airplane is also used on a monthly basis from approximately November through June to perform snow level survey flights in the Cascade Mountains. The snow level surveys consist of taking pictures of snow markers in the Cascade Mountains. This data is used to efficiently manage PSE's Upper and Lower Baker hydro operations.

Q. Can you provide an example of where there would be lost productivity for employees without the plane?

A. Yes. For instance, if an employee were to drive from Seattle to Portland, the trip time is approximately three to four hours depending on traffic conditions. A trip on the Company airplane would be approximately one hour, a savings of approximately two to three hours per employee. Additional productivity losses would occur when start time of the meetings are early in the day. For instance, if the meetings were to start at 8:00 a.m., it would be a safety concern to have an employee leave on a long driving trip in the early morning hours. Therefore, overnight lodging would likely be required, which increases the costs of driving trips. Another alternative would be commercial flights when available; however, airport parking, security and lack of employees being able to discuss business actions during travel would also impact the employees' productivity.

Q. Are there any savings when using the Company aircraft instead of using a commercial flight?

A. Yes, there are savings to using the Company aircraft instead of flying on a commercial carrier. To determine the savings, PSE used a software program for corporate aircraft operations which calculates the true trip costs for each flight. Overall, the software determined that PSE saved approximately $149,880 related to travel costs and increased employee productivity during the core hours of a business day (8:00 a.m. to 5:00 p.m.) when using PSE's aircraft versus other methods.

Q. Are there other savings related to using a corporate aircraft?

A. Yes. By using PSE's aircraft, employees are able to return to their homes at night versus having to stay overnight. During 2010, PSE's employees were able to be home 4,000 hours more during non-business hours than if they used a commercial carrier. This is a benefit for the Company, its employees and their families. The Company benefits from more productivity, as employees arrive rested. The decreased in overnight travel may also benefit PSE through less employee turnover. Customer also benefit from increased employee productivity and decreased employee turnover. As part of the cost/benefit analysis, I have included these non-business hours and valued them based on the average salary by level of employee for each trip. The savings are approximately $393,000.

Q. Are there overall benefits with a corporate aircraft?

A. Yes. The following table provides a summary of the overall benefits of having a Company aircraft which is approximately $36,500.

Aircraft Cost/Benefit Summary
January 1, 2010 to December 31, 2010

Aircraft usage allocated to Company departments	$126,945	
True trip costs savings using Company aircraft during business hours	149,880	
Benefit of avoiding non-business hours away from home for employees	393,509	$670,334
PSE's Aircraft's fixed and variable costs		633,789
Benefit associated with aircraft		$ 36,545

VIII. CONCLUSION

Q. Does this conclude your testimony?

A. Yes, it does.