

1 **Q. Please state your name and business address.**

2 A. My name is Roland C. Martin; my business address is 1300 South Evergreen Park  
3 Drive SW, Olympia, Washington 98504.

4 **Q. By whom are you employed and in what capacity?**

5 A. I am employed by the Washington Utilities and Transportation Commission (WUTC)  
6 as a Regulatory Consultant in the Electric Section.

7 **Q. Would you please describe your educational background and professional  
8 experience?**

9 A. I received a Bachelor of Science in Business Administration, major in marketing  
10 management, from the University of the Philippines in April, 1975. I am also a  
11 graduate of the University of Pangasinan where I received a degree of Bachelor of  
12 Science in Commerce, major in accounting, in March, 1980. On an ongoing basis, I  
13 attend educational seminars on regulation and ratemaking.  
14 I have been employed by the Commission since May, 1982. I have performed various  
15 phases of accounting and financial analysis of regulated utility and transportation  
16 companies both independently and jointly with other specialists, either as a lead or  
17 member of a team. During the course of my employment, I have been a Commission  
18 Staff witness in numerous formal contested proceedings before this Commission. I  
19 presented testimony in Cause Nos. U-84-28, U-88-2380-T and UG-900190 concerning  
20 The Washington Water Power Company's filings for general rate increases. I also  
21 testified in Cause No. U-85-32 concerning the general rate increase filing of  
22 Continental Telephone Company of the Northwest, Inc. and in Cause No. U-86-02

1 regarding Pacific Power and Light Company's filing for a general rate increase. I have  
2 participated in a number of rate proceedings involving Puget Sound Power & Light  
3 Company (Puget) including the past energy cost adjustment clause (ECAC) filings, the  
4 general rate increase filing in Docket No. U-89-2688-T, the proceeding that dealt with  
5 Puget's cost recovery proposals in Docket Nos. UE-901183-T and UE-901184-P, the  
6 Periodic Rate Adjustment Mechanism (PRAM) implementation proceedings in Docket  
7 Nos. UE-910626, UE-920630, UE-940728, and UE-950618. I was the lead revenue  
8 requirement specialist in Puget's consolidated filings including a petition for  
9 accounting of residential exchange benefits, rate design case, and general rate change  
10 (Docket Nos. UE-920433; UE-920499; UE-921262), and Puget's filing to transfer  
11 revenues from PRAM rates to general rates (Docket No. UE-951270). I was a member  
12 of the Staff team in the proceeding regarding the merger of Puget and Washington  
13 Natural Gas Company into Puget Sound Energy (PSE) in Docket No. UE-960195 .

14  
15 **PURPOSE AND SUMMARY OF TESTIMONY**

16  
17 **Q. What is the purpose of your testimony in this proceeding?**

18 A. I present the methodology for treating the gain and benefits of the sale of the Colstrip  
19 facilities should the Commission adopt the traditional accounting and rate making  
20 option, as discussed by Mr. Elgin in his testimony. Staff's methodology ensures that  
21 the gain from the disposition of the facilities accrues to ratepayers.

1 In addition, based on the analyses presented by the Company, there should be a  
2 deferral of power supply revenue requirement decreases expected from the short-run  
3 excess of cost of facilities' ownership over market prices. This deferral is necessary to  
4 counter the effects of market prices going above Colstrip costs in the later years, as  
5 shown by PSE's analyses.

6 I will present regulatory options that will accomplish the objective of passing benefits  
7 to ratepayers. I will also describe the impact of certain contingencies on the  
8 magnitude of the gain, and certain tax and accounting matters related to the  
9 transaction.

10  
11 **GAIN ON SALE OF THE COLSTRIP FACILITIES**

12  
13 **Q. Please describe your understanding of the gain as calculated and presented by**  
14 **the Company.**

15 A. Mr. Story presents in Exhibit No. 2 the calculation of an estimated book gain of  
16 \$37,586,440 from the sale of the Colstrip transmission and generation facilities. This  
17 is an estimate because a number of elements in the calculation may change, including  
18 the timing of the transaction closing date, as explained in his testimony. The \$37.6  
19 million is an estimate as of June 30, 1999 . According to PSE, it could increase by  
20 approximately \$10 million if PSE succeeds in obtaining an IRS ruling that would  
21 permit pass through of excess deferred taxes as part of the net gain on the sale. On the  
22 other hand, the amount of gain will decrease to approximately \$20.6 million if the

1 transmission facilities are not sold. Also, if Portland General Electric(PGE) does not  
2 obtain regulatory approval for the sale of its Colstrip investment, the purchase price  
3 for PSE's Colstrip generation assets would decrease by \$20 million. With a change in  
4 anticipated closing date to September 1, 1999, and an update of costs, the gain is  
5 calculated by the Company to be \$37,827,366.

6 Staff's analysis assumed that both Colstrip generation and transmission investments  
7 were sold and PGE obtained regulatory approval, consistent with Mr. Story's exhibits  
8 showing the calculation of the gain. These contingencies have a significant impact on  
9 the analysis, however. Should any one of these contingencies not occur, PSE should  
10 be directed to refile the details of the transaction based on known facts for further  
11 Commission review and consideration.

12 **Q. Please describe briefly PSE's proposal with respect to the net gain of \$37,586,440.**

13 A. PSE proposes to amortize this gain over a five-year period commencing July 1, 1999.  
14 The Company is not proposing any change from its original request of one-half year  
15 amortization in 1999, should the transaction close at a date later than July 1, 1999.

16 **Q. What is Staff's methodology with respect to the net gain under the traditional  
17 accounting option discussed by Mr. Elgin?**

18 A. Staff proposes to pass through the entire net gain to ratepayers. This would be  
19 accomplished by deferring the total gain until the next general rate case, at which time  
20 the precise benefit application in rates would be decided. In order not to deny  
21 ratepayers the time value of money on the deferred gain, Staff proposes that the

1 balance accrue a return equal to PSE's authorized electric net of tax rate of return of  
2 7.69% with annual compounding.

3 **Q. Is this treatment consistent with the Merger rate plan that was approved by the**  
4 **Commission in Docket UE-960195?**

5 A. Yes. The Merger Stipulation and Order specifically provided that associated gains or  
6 losses from property transactions during the rate plan period that are a direct result of  
7 the Merger, shall be included in PSE's current earnings (rather than deferred).

8 The properties presented in the Merger proceeding which were contemplated to be  
9 disposed of to achieve Merger synergies did not include production and transmission  
10 facilities in general or the Colstrip facilities in particular. It included distribution  
11 facilities and general plant such as headquarter assets, service centers and warehouses.

12 The sale of the Colstrip facilities, therefore, is not a direct result of the merger.

13 **Q. What guidelines support the Staff methodology?**

14 A. The parties to the Stipulation and Order of Dismissal dated May 26, 1992 in  
15 Washington Court of Appeals No. 29404-1 embraced the Commission's adoption of  
16 an adjustment in Docket U-89-2688-T that gave the property sales gain/loss to the  
17 customer, based on an allocation reflecting the time the property was included in  
18 ratebase. Specifically, paragraph 6 of that Stipulation provided in part: "The amount  
19 to be allocated to the customer in future rate cases will be based on the amount of time  
20 the property was included in ratebase in relationship to the total time the property was  
21 held by the Company." Because ratepayers have supported the Colstrip facilities since  
22 rate base inclusion to date of sale, ratepayers deserve the full benefit of the gain.

1 **Q. Are there prior Commission decisions that support the Staff proposal?**

2 A. Yes. In Docket No. 87-1533-AT involving the sale of The Washington Water Power  
3 Company's (WWP) combustion turbine generator, the Commission authorized the sale  
4 based upon the premise that 100 percent of the after tax gain was returned to the  
5 ratepayers. WWP was ordered to defer the gain on the sale into a deferred credit  
6 account until final disposition of the gain was determined in applicant's next general  
7 rate case.

8

9 **POWER SUPPLY EFFECTS**

10

11 **Q. In addition to the gain, what other "benefits" did the company quantify?**

12 A. As discussed in Mr. Gaines' testimony at pages 21-23, there are benefits in addition to  
13 the \$37.6 million gain. The additional "benefits" are expected to come from the  
14 replacement of Colstrip power with lower cost power purchased at market prices.

1 Q. **Please comment on these "benefits".**

2 A. It would be inaccurate to characterize these short run power supply cost reductions as  
3 benefits of the sale without accounting for the overall effects in the broader time frame  
4 of analyses. Mr. Gaines states that the base case results show an approximate \$128  
5 million accumulated present value benefit over the next ten years (Exhibit T-6, page  
6 21, line 13). However, he fails to point out that the accumulated amount declines to  
7 \$23.8 million at the end of the nineteen and ½ years study period which indicates that  
8 increased costs diminish the "benefits". To identify the effect of the sale on power  
9 cost, we need to segregate the gain from these figures. Excluding the gain, the \$23.8  
10 million translates to a negative benefit, or increased power cost burden, of \$22.8  
11 million. This means that, on a broader perspective, power costs will not actually  
12 decline and that the benefits of the sale come not from lower power costs, but from  
13 the gain on the sale of the facility.

14 Q. **Please discuss Staff's proposal with respect to the power supply benefits.**

15 A. Mr. Elgin provides an extensive discussion of the basis for Staff's proposal, consistent  
16 with the preceding observation. It is necessary to adopt a mechanism that will provide  
17 customers the ability to offset the expected increased costs of power identified in the  
18 studies presented by the Company.

19 Staff's methodology is to accumulate in a deferral account the periodic power cost  
20 revenue requirement reductions that are expected to occur during the earlier part of the  
21 nineteen and ½ years of the study period. The reductions are measured in the same

1 fashion as the Company did in Exhibit 7, i.e., the excess of Colstrip costs over market  
2 costs.

3 Under the Staff treatment, revenues to be deferred will be the periodic decreases in  
4 power costs as measured by the study and converted to the revenue requirement level  
5 by applying the latest conversion factor for revenue sensitive items. The amounts  
6 deferred will be accumulated in a deferred revenue credit account with the average  
7 balances earning an annually compounded return, similar to the treatment of the gain.  
8 Again, similar to the treatment of the deferred gain, the exact manner of benefits pass-  
9 through to ratepayers would be decided in the next general rate case.

10 **Q. Why is Staff relying on the studies presented by PSE considering that they are**  
11 **estimates with varying results under different scenarios?**

12 A. All of the scenarios but one presented by the Company indicate a point in time when  
13 market prices exceed Colstrip costs. The power cost reductions occur during the early  
14 periods of the analyses which ends in the year 2018. If these power cost decreases are  
15 not deferred, but are allowed to flow through to PSE's bottom line, then ratepayers  
16 will be disadvantaged greatly in the future because the short run cost decreases would  
17 not offset the great potential of increased replacement costs over Colstrip costs,  
18 should the studies prove to be true.

19 **Q. Please describe what has been marked as Exhibit \_\_\_(RCM-1).**

20 A. This exhibit shows the derivation of the amounts of the annual revenues to be deferred  
21 for inclusion in customer rates in the next general rate case, based on the assumption  
22 that both Colstrip generation and transmission facilities are sold, and PGE receives



1 regulatory approval to all its Colstrip investment. As I stated earlier, if the events do  
2 not occur, the Company should be ordered to file updated analyses consistent with my  
3 methodology.

4 The amounts shown in the exhibit are the annual deferral amounts and will not be  
5 subject to periodic true-ups of projections. The reason why Staff recommends no true-  
6 up is that the deferral of predetermined amounts provides some certainty of offset  
7 provision for customers who will ultimately shoulder increased costs due to expected  
8 increases in market costs. This ensures that the Company retains the responsibility to  
9 achieve the presented cost reductions and will ensure that PSE adheres to its  
10 proposition that the sale of Colstrip provides economic benefits to ratepayers. Lastly,  
11 it avoids accounting complexity and the difficulty of relying on data that may not be  
12 available when PSE no longer owns the facilities.

13 **Q. Please explain each detail in Exhibit \_\_\_\_ (RCM-1).**

14 A. Line 1 represents the years when power cost reductions are attained because Colstrip  
15 costs exceed market costs. Line 4 shows the total cost of Colstrip with prorated costs  
16 for 4 months in 1999 and annual costs from 2000 to 2003. These costs come from  
17 PSE's Scenario 4 instead of the base Scenario 1.

18 **Q. Please explain the difference between the base Scenario 1 and Scenario 4, and**  
19 **explain why you used Scenario 4?**

20 A. I used Scenario 4 as the starting scenario for deferred revenue measurement because it  
21 is based on plant availability derived from seven year average availability of the  
22 Colstrip units, rather than the NERC average for similar plants included in Scenario 1.

1 The seven year average of actual data is the method of plant availability determination  
2 accepted by the Commission in the Company's last general rate case. In rejecting  
3 Puget's national average approach, the Commission said it disfavors the use of  
4 national averages to project production plant availability when actual figures are  
5 available. (Docket Nos. UE-920433; UE-920499; UE-921262, Eleventh Supplemental  
6 Order, pages 40-41). Scenario 4, therefore, is more consistent with the manner in  
7 which Colstrip costs are embedded in current rates.

8 **Q. Please explain line 6 labeled "Plant Reclamation Reserve and Ending Balance**  
9 **Adjustment".**

10 A. This line shows the effects of removing certain cost items from the Scenario 4 costs.  
11 These items include plant reclamation costs and ending plant balances, both reflected  
12 annually in the Colstrip total cost determination. PSE also presented scenarios treating  
13 these two items as lump sum costs. The reclamation and plant ending balance costs  
14 are either avoided or mitigated by the sale of the facilities. While they may be  
15 construed as benefits because they will not need to be added in rates if the facilities are  
16 sold, it is appropriate to remove them in the calculation of revenue requirement  
17 decrease, may it be annual or lump sum, since ratepayers are not currently paying  
18 these costs in rates.

19 I calculated these adjustments by running Scenario 4 with plant reclamation reserve  
20 and ending balance amounts removed from the input data. The result is what is shown  
21 on line 7 which, when compared with the original Scenario 4 (line 4), yields the  
22 adjustments on line 6.

1 **Q. Please continue with your explanation of Exhibit \_\_\_(RCM-1).**

2 A. Line 9 represents the market costs from Scenario 4 as presented by the Company. The  
3 difference between Colstrip costs as adjusted and market costs is shown on line 10,  
4 representing the power cost decreases of selling Colstrip and market power  
5 replacement. I converted these cost reductions to the revenue requirement level by  
6 applying the conversion factor for revenue sensitive items including bad debts, utility  
7 tax and regulatory fee from PSE's December, 1998 Commission basis report. The  
8 revenues to be deferred, totaling \$71.9 million from 1999 through 2003, are shown  
9 on line 12. For booking purposes, Staff suggests apportioning monthly amounts  
10 based on the shaping factors used in PSE's terminated periodic rate adjustment  
11 mechanism to recognize unevenness of revenue flow within a year.

12 **Q. Considering that the Merger rate plan period ends in December, 2001, how will a**  
13 **general rate case filing by PSE affect the deferred revenue balance to be**  
14 **considered in setting rates?**

15 A. If, for example, PSE files a general rate case with new rates to become effective  
16 January 1, 2002, the amount of deferred revenues to be considered in rates will be the  
17 balance as of the end of the period immediately preceding the effective date of the  
18 rates determined in that rate proceeding. In this example, it would be the balance as of  
19 December 31, 2001, plus the accumulated accrued return.

20 **Q. Are you presenting an alternative to the revenue deferral until the next general**  
21 **rate case?**

1 A. Yes. As an alternative to waiting until the next general rate case to pass through the  
2 power cost reductions to customers, the Commission could condition approval of the  
3 sale on PSE foregoing the programmed rate increases in January 2000 and January  
4 2001. The scheduled merger rate plan increases were premised on cost increases  
5 associated with purchased power costs. The Colstrip sale results in short-term power  
6 cost decreases. It is, therefore, reasonable to consider these factors together. Because  
7 there is more than enough in the deferral account to offset the effect of these scheduled  
8 increases, this alternative makes sense because it simply offsets amounts owed by  
9 ratepayers against amounts owed to ratepayers.

10 **Q. Please explain further how this method would be implemented.**

11 A. For the year 2000, the Company estimated an overall effect of \$16,570,000 additional  
12 revenues from the scheduled increase. The Company would simply get this amount  
13 from the deferral balance and forego filing the January 1, 2000 scheduled rate  
14 increase. For year 2001, the Company can similarly offset the increase against the  
15 deferred revenue account in an amount equal to the additional revenues had that  
16 scheduled increase taken effect. Staff proposes the Company calculate what would  
17 have been the impact of the increase on actual monthly revenues for offset against the  
18 deferral account, subject to Staff verification. This method has the effect of PSE  
19 getting its programmed increases without additional burden of rate increases for  
20 ratepayers.

21 For the year 2002, the Company would then have the option of filing for general rates  
22 effective January 2002 .

1

2 **TAX AND ACCOUNTING CONSIDERATIONS**

3

4 **Q. The Company requests that it be allowed to include the excess deferred taxes**  
5 **associated with the Colstrip facilities in the calculation of the book gain to be**  
6 **amortized over five years (Exhibit T-1 (JHS-T), page 5, lines 12-14). What is**  
7 **Staff's response to this request?**

8 A. According to PSE, it intends to request a ruling from the Internal Revenue Service on  
9 the excess taxes associated with the Colstrip facilities. A favorable ruling would allow  
10 passing these taxes back to the customers. Staff agrees with the Company that pursuit  
11 of a ruling is appropriate to ensure that proper tax treatment is followed. Should PSE  
12 succeed in obtaining a favorable ruling, the taxes should be included in the book gain  
13 calculation.

14 **Q. Do you agree with the Company's inclusion of \$2,805,000 environmental cost**  
15 **estimate in the calculation of book gain?**

16 A. No. I do not believe that it is appropriate to offset this contingent liability against the  
17 gain. While some environmental costs of clean-up is incurred, such costs will remain  
18 unknown at the closing date. When an actual claim may be received, PSE will have  
19 the opportunity to investigate both the merits of the claim and the prospects of  
20 insurance recovery. PSE will also have the opportunity to evaluate if the accounting  
21 and regulatory treatment accorded environmental remediation costs in Docket UE-  
22 911476 can be applied. For example, under the provisions of that order, costs eligible

1 for deferral for recovery in rates in future rate proceeding are limited to those amounts  
2 paid to outside vendors and contractors, and do not include legal costs. Also, deferred  
3 costs are reduced by any insurance proceeds or payments from other responsible  
4 parties.

5 Staff believes the estimated environmental cost should be excluded from the gain  
6 calculation and instead be treated consistent with other environmental clean-up costs.

7 **Q. What is the effect of this exclusion on the gain?**

8 A. The effect is to increase the estimated gain from \$37,586,440 to \$39,403,538.

9 **Q. Does that conclude your direct testimony?**

10 A. Yes.