

Exhibit No. T- (HL-3)
Docket No. UE-92-1262
Witness: Hugh Larkin, Jr.

BEFORE THE
WASHINGTON UTILITIES & TRANSPORTATION
COMMISSION

COMPLAINANT

VS.

PUGET SOUND POWER & LIGHT COMPANY

RESPONDENT

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION	
UE-920433; -920499;	
No. -921262	Ex. T-794 ✓

*entered except
pp 2-4*

1 Q. ARE YOU THE SAME HUGH LARKIN, JR. WHO HAS PREVIOUSLY
2 SUBMITTED DIRECT TESTIMONY AND EXHIBITS IN THIS CASE?

3 A. Yes, I am.

4 Q. WHAT SUBJECTS WILL YOU BE ADDRESSING IN THIS
5 SUPPLEMENTAL TESTIMONY?

6 A. I address the following in this supplemental testimony:

- 7 o The calculation of a consolidated tax savings adjustment using the
8 information Puget provided in its supplemental response to DOD-1871.
- 9 o A correction that has to be made to reflect DOD witness Legler's
10 recommended capital structure and rate of return.
- 11 o Some of the updates presented by the Company and my intention to
12 address as many of these, and discuss their impact on my recommended
13 adjustments, either in additional supplemental testimony or in oral direct
14 testimony at the hearings.

15 Q. ARE YOU PRESENTING ANY REVISED SCHEDULES IN CONJUNCTION
16 WITH THIS SUPPLEMENTAL TESTIMONY?

17 A. Yes. Exhibit No. ____ (HL-4) contains the revised schedules. Schedule 36,
18 which computes the consolidated tax savings adjustment, is a new schedule
19 which has not previously been presented.

Consolidated Tax Savings

excluded all

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Q. IN YOUR DIRECT TESTIMONY, AT PAGE 72, YOU MENTIONED THAT YOU HAVE RECEIVED PUGET'S SUPPLEMENTAL RESPONSE TO DOD-1871. HAVE YOU REVIEWED THAT INFORMATION?

A. Yes. That information, which Puget has classified as "Confidential," shows that, by participating in a consolidated tax return with its subsidiaries, Puget realizes consolidated tax savings.

Q. DOES THE COMPANY'S FILING ADEQUATELY REFLECT THE TAX SAVINGS ASSOCIATED WITH PARTICIPATING IN THE CONSOLIDATED RETURN?

A. No. The Company has made no adjustment to recognize the savings resulting from its participation in a consolidated tax return.

Q. HOW ARE CONSOLIDATED TAX SAVINGS PRODUCED?

A. Tax savings result from the filing of a consolidated income tax return with the IRS by virtue of the fact that companies with negative taxable incomes offset the positive taxable incomes of other companies, thus creating a lower taxable income on a consolidated basis. Consequently, a consolidated return produces a lower actual income tax liability for a group of companies than the sum of the tax liabilities produced by the same individual companies filing returns on a stand-alone basis.

excluded

1 Q. HAVE MEMBERS OF PUGET'S CONSOLIDATED GROUP
2 CONSISTENTLY PRODUCED TAX LOSSES, WHICH PRODUCE
3 CONSOLIDATED INCOME TAX SAVINGS?

4 A. Yes. In each of the most recent five years, a number of Puget's non-
5 regulated affiliates have produced tax losses. These tax losses have been
6 summarized for each year on Schedule 36 in an aggregate format to protect
7 the confidentiality of the information. Puget's tax-loss subsidiaries have
8 contributed to the creation of consolidated tax savings that benefits Puget as
9 a member of the consolidated group.

10 Q. HAVE YOU MADE AN ADJUSTMENT TO REFLECT THE TAX SAVINGS
11 ASSOCIATED WITH PUGET'S PARTICIPATION IN THE FILING OF A
12 CONSOLIDATED TAX RETURN?

13 A. Yes. This adjustment is shown on Schedule 36. I used the "modified
14 effective tax rate" method to reflect Puget's share of the consolidated income
15 tax savings. Specifically, using the information the Company provided in its
16 supplemental response to DOD-1871 (which Puget labeled "confidential"), I
17 computed the five-year average of non-regulated subsidiary tax losses in
18 order to obtain a representative amount. Moreover, the five-year period
19 ending with 1991 represents the most current actual information available.
20 I applied the current federal income tax rate of 34% to this average tax loss
21 to compute the amount of consolidated income tax savings.

excluded.

1 Q. WHAT IS THE AVERAGE AMOUNT OF CONSOLIDATED TAX SAVINGS?

2 A. As shown on Schedule 36, line 3, the consolidated income tax savings
3 amounted to \$871,128.

4 Q. HOW DID YOU ALLOCATE THE AMOUNT OF CONSOLIDATED TAX
5 SAVINGS TO PUGET?

6 A. I utilized the proportion of Puget's positive taxable income to the total
7 positive taxable incomes of Puget and its non-regulated subsidiaries with
8 positive taxable incomes. I used the same five-year period, 1987 through
9 1991, to compute the consolidated tax savings amount and Puget's share of
10 these savings. On average, Puget has contributed 98.43% of the positive
11 taxable income to the corporate consolidated return. Accordingly, I allocated
12 98.43% of the consolidated tax savings to Puget.

13 Q. WHAT IS PUGET'S AMOUNT OF THE CONSOLIDATED TAX SAVINGS?

14 A. The amount of my recommended consolidated income tax savings
15 adjustment is \$857,486, as shown on line 5 of Schedule 36.

16 Q. HAS YOUR ADJUSTMENT BEEN COMPUTED USING A METHOD THAT
17 COMPLIES WITH THE REQUIREMENTS OF TAX LAW?

18 A. Yes, it has.

1 Q. WHAT IS YOUR RECOMMENDATION?

2 A. The Commission should reduce test year income tax expense by \$857,486 to
3 flow thorough to ratepayers the full amount of savings that a utility, such as
4 Puget, realizes from participating in a consolidated income tax return.

5 Correction for DOD Witness Legler's Recommended Rate of Return

6 Q. PLEASE EXPLAIN YOUR CORRECTION FOR DOD WITNESS LEGLER'S
7 RECOMMENDED RATE OF RETURN.

8 A. Exhibit ____ (HL-2), Schedule 2, page 2 of 3, Part II, had reflected a capital
9 structure and cost rates which were not those recommended by DOD
10 witness Legler. As shown in Exhibit ____ (HL-4), I have revised Schedule 2,
11 page 2 of 3, Part II, to reflect correctly Dr. Legler's recommendations
12 concerning Puget's capital structure, cost rates, and weighted cost of capital.

13 Q. DID THIS CORRECTION IMPACT OTHER SCHEDULES?

14 A. Yes, it did. Accordingly, Exhibit ____ (HL-4) also includes the following
15 revised schedules which were impacted by this correction:

16 Schedule 1 - Revenue Requirement;
17 Schedule 2, page 1 - Summary of Adjustments; and
18 Schedule 35 - Interest Synchronization.

1 Company's Updates and Corrections

2 Q. AT PAGE 74 OF YOUR DIRECT TESTIMONY, YOU MENTIONED THAT
3 PUGET HAD PROVIDED A SUPPLEMENTAL RESPONSE TO STAFF
4 DATA REQUEST NO. 1085, WHICH CONTAINED VARIOUS
5 CORRECTIONS AND UPDATES TO ITS FILING. PLEASE COMMENT
6 CONCERNING THOSE REVISIONS.

7 A. Puget's supplemental response to Staff data request no. 1085 did contain a
8 number of corrections and updates to the Company's filing. I will briefly
9 comment upon each of those revisions.

10 Puget's revision to its depreciation expense adjustment (no. 2.06) increases
11 net operating income by \$201,440 and decreases rate base by \$1,547,800, in
12 comparison to Puget's original filing. My summary schedule will be updated
13 to reflect Puget's revision.

14 Puget has revised its property sales adjustment (no. 2.07), which increases
15 net operating income by \$40,594, in comparison to Puget's original filing. I
16 have no objection to this Company update, although it is unclear whether
17 this represents the most current information, such as that provided in
18 Puget's response to WUTC supplemental deposition request no. 68.

1 Puget revised its employee insurance adjustment (no. 2.11), which decreases
2 net operating income by \$705,924, in comparison to Puget's original filing.
3 Most of this relates to Puget's changing its recorded test year expense
4 amount from the filed amount of \$6,376,847 to a revised amount of
5 \$5,273,933. To the extent this is merely an error correction, I do not object
6 to Puget's revision. As part of this revision, Puget also decreased its pro
7 forma insurance expense for union employees by \$61,728. I have no
8 objection to reflecting that correction either. I will be updating my Schedule
9 20 to reflect Puget's corrections.

10 Puget revised its SFAS 106 adjustment (no. 2.12), which decreased net
11 operating income by \$53,103, in comparison to Puget's original filing. Puget
12 also decreased its computed rate base amount by \$269,677. Puget's filing
13 had calculated a rate base amount, but had not carried that forward to the
14 Company's rate base calculation. As described in my direct testimony, no
15 rate base amount for SFAS 106 is necessary; I continue to recommend a zero
16 rate base amount for SFAS 106. I will be updating my Schedule 21 to reflect
17 the impact on my recommended expense adjustment resulting from Puget's
18 revised SFAS 106 amount.

19 Puget also revised its wage increase adjustment (no. 2.14) for an increase in
20 administrative and general wages of \$24,077 for "pay at risk" and a decrease

1 in payroll taxes of \$99,344, for a net increase to operating income of \$49,676,
2 in comparison to Puget's original filing. At this point, I am reserving
3 judgment concerning the propriety of including the \$24,077 "pay at risk"
4 amount in Puget's wage increase. This amount had not been included on
5 Puget's payroll workpaper, page 119. Puget's supplemental response to Staff
6 data request no. 1085 included an explanation that, for 1993, the
7 Washington State unemployment tax wage base increases from \$17,600 to
8 \$18,500 and the tax rate decreases from 1% to 0.6%. Puget's revision also
9 reflects the 1993 Medicare tax base of \$135,000. (Previously, Puget had
10 assumed \$135,300.) I have no objection to reflecting these corrections to
11 payroll taxes.

12 Puget revised its retirement plan adjustment (no. 2.16), which increases net
13 operating income by \$105,965, in comparison to Puget's original filing. I
14 have no objection to reflecting this Company update.

15 Puget also revised its customer deposits interest adjustment (no. 2.18),
16 which increased net operating income by \$81,777, in comparison to Puget's
17 original filing. Puget's filing assumed an annual interest rate of 6.16%; the
18 update uses the 4.01% rate applicable to 1993. When I update my summary
19 schedule for the effects of Puget's revisions, this correction will be reflected.

1 Puget revised its working capital adjustment (no. 2.24), which decreased rate
2 base by \$761,266, in comparison to Puget's original filing. Puget increased
3 the "Other Investments" amount on line 30 of Puget's page 2.24 calculation
4 by \$794,302, although from the documentation supplied by the Company in
5 supplemental response to Staff data request no. 1085 it is unclear why Puget
6 made this revision. I intend to update working capital to reflect the
7 Company's proposed change to the "Other Investments" amount in the
8 working capital calculation. This change will affect the nonoperating
9 working capital portions of some of my recommended adjustments.

10 The Company revised its operating expense adjustment (no. 2.27), which
11 decreased net operating income by \$201,107 and decreases rate base by
12 \$155,000, in comparison to Puget's original filing. Puget's revision
13 encompasses the following changes:

- 14 o a corporate dues expense increase of \$36,153;
- 15 o a "pay at risk" expense increase of \$293,555;
- 16 o the exclusion from operating expense of a \$25,000 payment for outside
17 services; and
- 18 o the exclusion from rate base of Accounts 190-17 and 190-18 (ADIT debit
19 balances for supplemental pensions).

20 I have recommended adjustments for Puget's EEI and other dues, and will
21 be revising those adjustments to reflect Puget's restated amounts. As
22 mentioned above, I am reserving judgment concerning the propriety of
23 including "pay at risk" amounts, and Puget's proposed revisions to increase
24 this expense. I will accept Puget's \$25,000 exclusion of the outside services

1 expense item. Puget's adjustment to remove Accounts 190-17 and 190-18
2 from rate base is the same adjustment reflected on lines 2 and 3 of my
3 Schedule 12; since Puget is revising its filing to exclude these balances from
4 rate base, my adjustment to exclude them would no longer be necessary. A
5 difference would remain for the item shown on line 1 of my Schedule 12,
6 concerning the exclusion of the balance in Account 190-11, ADIT associated
7 with Colstrip interest income.

8 Puget revised its property tax adjustment (no. 3.02), which increased net
9 operating income by \$606,540, in comparison to Puget's original filing. I
10 have no objection to this revision by the Company.

11 Puget revised its Montana corporate license tax adjustment (no. 3.03), which
12 decreased net operating income by \$373, in comparison to Puget's original
13 filing. I have no objection to this de minimus change.

14 Puget revised its interest synchronization adjustment (no. 3.04) and its
15 federal income tax computation (3.06). These revisions appear to be the
16 result of the Company's other changes. I will attempt to reflect in an
17 update of my summary schedules the Company's current position, as
18 reflected in the Puget adjustments discussed herein.

1 Q. HAVE YOU RECEIVED OTHER POSSIBLE "UPDATES" AND/OR
2 "REVISIONS" FROM THE COMPANY?

3 A. Yes.

4 Q. HOW WOULD YOU PROPOSE TO HANDLE SUCH ADDITIONAL
5 UPDATES AND REVISIONS?

6 A. It would be appropriate to reflect the impact of Company revisions and
7 corrections that are known at one time rather than on a piecemeal basis.
8 Accordingly, I will have one further update to my schedules, which will be
9 provided to the parties in advance of my oral direct testimony.

10 Q. DOES THAT CONCLUDE YOUR SUPPLEMENTAL TESTIMONY AT THIS
11 TIME?

12 A. Yes, it does.