BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

PETITION OF PUGET SOUND POWER & LIGHT COMPANY FOR AN ORDER REGARDING THE ACCOUNTING TREATMENT OF RESIDENTIAL EXCHANGE BENEFITS	GENERAL RATE FILING DOCKET NO. UE-920433
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. PUGET SOUND POWER & LIGHT COMPANY, Respondent.	DOCKET NO. UE-920499
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. PUGET SOUND POWER & LIGHT COMPANY, Respondent.	DOCKET NO. UE-921262 VOLUME XIV PAGES 2129 - 2352

A hearing in the above matter was held on June 2, 1993 at 10:30 a.m., at 1300 South Evergreen Park Drive Southwest, Olympia, Washington, before Chairman SHARON L. NELSON, Commissioners RICHARD CASAD and RICHARD HEMSTAD, and Administrative Law Judge ALICE HAENLE.

Cheryl Macdonald, RPR, CSR, Court Reporter

The parties were present as follows:

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION STAFF, by DONALD T. TROTTER and SALLY G. BROWN, Assistant Attorneys General, 1400 South Evergreen Park Drive Southwest, Olympia, Washington 98504.

FEDERAL EXECUTIVE AGENCIES, by NORMAN FURUTA, Associate Counselor, Department of Navy, Western Division, 900 Commodore Drive, Bldg. 107, (Code 09C), San Bruno, California 94066-2402.

PUGET SOUND POWER & LIGHT, by JAMES VAN NOSTRAND and STEVEN C. MARSHALL, Attorneys at Law, 411 - 108th Avenue NE, Bellevue, Washington 98004.

WASHINGTON INDUSTRIAL COMMITTEE FOR FAIR UTILITY RATES, by MARK P. TRINCHERO, Attorney at Law, 2300 First Interstate Tower, 1300 Southwest Fifth Avenue, Portland, Oregon 97201 and PETER RICHARDSON, Attorney at Law, 702 W. Idaho, Boise, Idaho 83702.

PUBLIC INTEREST, by CHARLES F. ADAMS, Attorney at Law, Suite 2000, 900 Fourth Avenue, Seattle, Washington 98164.

I N D E X

P R O C E E D I N G S

JUDGE HAENLE: The hearing will come to order. This is an additional day of hearing, the 14th day, I believe, in the consolidated Puget matters. We are on the general rate case phase at this time. The date is June 2, 1993 and this is taking place before the Commissioners. Before we continue with Mr. Elgin's cross-examination, there were the procedural matters that I mentioned yesterday, and we do need to get those out of the way. One of them is the marking and discussion and entry if appropriate of the responses to bench requests. Did you, Mr. Marshall, or Mr. Van Nostrand -- I did not find in the record the response to bench request 501, which is the chairman's request to Mr. Sonstelie to provide a statement of management policy. Has that been provided?

MR. MARSHALL: No, your Honor. We had been discussing this issue with Mr. Trotter and Mr. Adams about having Mr. Sonstelie available at the beginning of cross-examination of the company's rebuttal to make a short statement along that line so that the

Commissioners would have the opportunity at that time to ask questions as they suggested that they would

have had a chance to in a Wednesday morning meeting. We thought that was the appropriate type of response given the indication from the Commission as to the sort of thing that could have been done if it weren't for the ex parte rule during these sessions that we've had here.

We had proposed to have it done at the beginning of this cross-examination of witnesses for staff/intervenors, but it was felt that that would be appropriate to bring the company witness at that time. So what we've done is we've suggested that that be done alternatively at a Wednesday morning meeting but that alternative was decided to be inappropriate given the notice issues for the various parties.

JUDGE HAENLE: So when are you proposing to provide this?

MR. MARSHALL: I believe the cross-examination on the rebuttal case would begin the week of July 19 so that would begin at that time.

MR. TROTTER: Counsel has generally stated it correctly but it all stemmed from their desire to have it done orally as opposed to something in writing. We have no objection to something in writing but they felt an oral presentation was preferable from their point of view so that's what gave rise to this

issue.

MR. MARSHALL: Madam chairman, is that all right with you?

CHAIRMAN NELSON: Maybe you could make it part of the prefiled testimony in rebuttal, would that be all right and then make him available here? Are you too far down the line to do that?

MR. MARSHALL: We may be too far down the line. I will check with him, since it was in the nature of a vision to let people know here in the Commission generally the trends that the company was going to be taking over the next several years rather than try to be specific and in writing, since this isn't really a planning document. It's more of an attempt to allow the Commissioners an opportunity to know the general direction which Mr. Sonstelie at least sees the company going and to prevent the kind of questioning that would be permitted in the Wednesday morning meeting, which again, because of the ex parte rule isn't available during this rate case.

CHAIRMAN NELSON: Well, however you want to do it. My learning style is better with writing than it is with an oral presentation which I have to react to immediately, but what I am after is a sense of

where he is taking the company.

MR. MARSHALL: We thought it was more along the nature of what Mr. Redmond had done last summer and how they may have continued to do it with other companies as well. But I will discuss that further with Mr. Sonstelie. We're trying to be very responsive of course because we realize that this isn't really part of the rate case and yet it's an important part of the information that the Commissioners need to know about the company.

MR. ADAMS: Madam Commissioner, could I ask, I think your suggestion was a good one in the sense that I'm concerned that we will suddenly hear for the first time a bunch of information we're not prepared for, it seems to me an outline of the points he would raise would be helpful to all parties concerned so we have some idea of what he was going to say before we walk into the hearing.

CHAIRMAN NELSON: My notion was to give him a chance to brag, as Mr. Redmond did, about efficiency and cost cutting at the company. And that's why I thought it would be most efficient for my purposes to see something in writing and then be able to ask questions of him when he's back on rebuttal, which I am sure he will be. So whatever is --

JUDGE HAENLE: Would you like an outline filed at the time of prefiling?

CHAIRMAN NELSON: That would be fine with me, too.

MR. MARSHALL: We will try to do our best on that. Again we thought that the best thing to do was to try to separate this from the rate case because we didn't want to make this part of a rate case or an issue in the rate case itself.

CHAIRMAN NELSON: I think you're being too scrupulous there. I think rate cases are the time for the Commissioners to find out what's going on with the company. So, I think it's part of the rate case and that's why I asked for it.

JUDGE HAENLE: So the response to bench request will now include an outline due on the day of prefiling and then having him available at the time of cross-examination of rebuttal.

MR. MARSHALL: That would be fine.

JUDGE HAENLE: In response to bench request 506 was a request for the Towers Parrin study. Now, something was sent to the Commission on April 16 directly from Towers Parrin without a cover letter and

I tried to contact the company when I saw that part of it was marked as confidential. I believe it was you I

spoke to, Mr. Marshall. You, as I understood, were going to provide that as the response to bench request the next week and I don't think we've seen anything yet. What's the situation there?

MR. MARSHALL: That is the response to the bench request and it isn't -- although it was marked on the Towers Parrin, which is the Towers Parrin report is confidential, by our having made that available to the parties it is not confidential.

JUDGE HAENLE: My understanding was you were going to provide it the next week as response to bench request.

MR. TROTTER: When they came in the door and were marked confidential that caused a shock wave through the Commission building and so they were carried into my office and I was told to be the custodian of those until this was all resolved and I didn't hear about -- maybe I did and forgot but they're sitting in my office and I will bring them up at the next break.

JUDGE HAENLE: That was at my instruction. I'm the one that corraled them.

MR. MARSHALL: They should be uncorraled.

JUDGE HAENLE: That's fine. I had understood that those would be treated as a response

to a counsel data request and that you would provide the bench request separately. That's acceptable to us. We do need that. Let's then mark these responses to bench requests as follows: We'll leave a spot for 501. That will be 683 will be the response to bench request 501, that is the outline that we described earlier.

The response to 502 will be 684.

503 will be 685. And I note that there were supplemental to both bench request 503 and bench request 507. Just put those with the responses to bench request with the same number.

The response to bench request 504 will be 686.

The response to bench request 505 will be 687.

Response to bench request 506 will be 688.

Response to bench request 507 will be 689.

Response to bench request 508 will be 690.

Response to bench request 509 will be 691.

510 will be 692.

And the response to bench request 511 will be 693.

Those should have been distributed to all of you and other than the response to 501, which we

have not yet received, and the response to 506, which I hope we will have today once we round those copies up, does counsel have any objection to the entry of bench requests as exhibits, Mr. Marshall?

MR. MARSHALL: No, your Honor.

JUDGE HAENLE: Mr. Trotter?

MR. TROTTER: No.

JUDGE HAENLE: Mr. Adams?

MR. ADAMS: No, your Honor, but am I correct the Towers Parrin report can now be treated as an open document because there's no confidentiality associated with it.

JUDGE HAENLE: That is my understanding.

MR. MARSHALL: That's correct.

JUDGE HAENLE: There is no protective order in this case, as I reminded the company, and that was one of my concerns is that it would not be -- so my understanding is that you can just cross confidential off on that. Any objection, Mr. Furuta?

MR. FURUTA: No, your Honor.

MR. TRINCHERO: No objection.

JUDGE HAENLE: Anyone else available to make an objection?

Then I will enter 684 through 687, 689 through 693 and we will take up the issue of 506 later

in the day when that's provided.

(Marked and Admitted Exhibits 684 through 687, 689 and 693.)

JUDGE HAENLE: We also had the March 22nd depositions of Mr. Storey and Mr. Hoff. The understanding when we did this was that because other parties were not here to comment on that procedure that we would give them a chance to object at the time these were entered into the record. Have you any objection to the entry of the documents, then, Mr. Trinchero?

MR. TRINCHERO: No, your Honor.

JUDGE HAENLE: Mr. Adams, were you involved?

MR. ADAMS: Yes, I was involved but I have no objection.

MR. FURUTA: No objection.

JUDGE HAENLE: Those two documents then will be entered into the record. I believe that the company and the Commission staff had already agreed on that.

MR. TROTTER: Were those given exhibit numbers?

JUDGE HAENLE: Yes, they were. The deposition of Mr. Hoff is 666 and will be entered into

the record. The deposition of Mr. Storey is 634 and will be entered into the record.

(Admitted Exhibits 666 and 634.)

JUDGE HAENLE: Also have the 1992 annual report which I had previously marked as Exhibit 573(A). It was provided by the company on April 1. Is it all right with you if we enter that into the record, Mr. Marshall?

MR. MARSHALL: Yes, that's fine.

MR. TROTTER: Yes, that's fine.

MR. ADAMS: Fine.

JUDGE HAENLE: Objection from any intervenor?

MR. TRINCHERO: No.

JUDGE HAENLE: Exhibit 573(A) will be entered into the record.

(Admitted Exhibit 573(A).)

JUDGE HAENLE: There are transcript corrections. We can do this later after lunch, deal with the transcript corrections.

All right. Let's continue with Mr. Elgin's cross-examination unless the Commissioners had something else we need to discuss.

Go ahead, Mr. Marshall.

Whereupon,

KENNETH ELGIN,

having been previously duly sworn, was recalled as a witness herein and was examined and testified as follows:

CROSS-EXAMINATION

BY MR. MARSHALL:

Q. Mr. Elgin, do you have in your files before you the response that you made to company data request 4022?

A. Yes, I do.

Q. As I understand it, it was first a request and then there was a corrected response and then there was a supplemental response to request 4022?

A. That is correct. I have the corrected response in my file and the supplemental response.

Q. Well, let's turn to your corrected response to 4022. This is in the area dealing with what the company should have been discussing with analysts and shareholders about PRAM decoupling. And you stated, I believe, in response to that data request on page 1 that you took issue with the Value Line May 31, 1991 report and you state among other things about the

middle of that paragraph, "The statement" -- statement by Value Line -- should read, `This PRAM will eliminate the risk associated with purchased power.'"

Was that the suggested language that you felt that should be in the Value Line report of May 31, 1991?

A. Yes.

Q. And then you state also that the report talks about Puget's need to acquire new power through competitive bidding and you state, "however, the statement does not assure investors that PRAM will provide for timely recovery of these newly acquired competitive bid resources and thereby reduce Puget's risk."

A. That is correct.

Q. So you believe that the Value Line report should have assured investors that PRAM would provide for timely rate recovery of competitive bid resources that have been acquired?

A. Yes.

Q. Then over on page 2 of your corrected response you refer to a Moody's report of October 26, 1992. Do you see that in the fourth paragraph?

A. Yes, I do.
Q. And there you state, "There is no

discussion of the PRAM and its ability to provide full recovery of these new purchased power resources."
A. That is correct.
Q. So you were suggesting that the Moody report should have had a discussion assuring full recovery of these new purchased power resources; is that correct?
A. That is correct.
Q. Now, after the Value Line May 31, 1991 report there was a proceeding on PRAM 2. Did that provide for full and timely recovery of newly acquired resources?
A. Yes, it does.
Q. Wasn't there a Winterfeld adjustment to those acquired resources? You know, the Winterfeld adjustments that I'm referring to?
A. I don't know specifically what you're talking about.
Q. Do you know whether there are any downward adjustments in the amount allowed for resources in the PRAM 2 by Mr. Winterfeld, just in general?
A. I believe Mr. Winterfeld did provide some adjustments to power supply and how it was being

handled through the PRAM, but as they relate to the policy statement that I am discussing here, in general,

Puget's cost of new resources will be acquired through the PRAM.

Q. Was there any deferral beyond one year in PRAM 2, an extension of a deferral? There was, wasn't there, there was a deferral first at three years and then to two years?

A. Yes. If you're talking about the revenues that Puget had booked through the shaping issue, yes. The company had booked those and we've already discussed this, Mr. Marshall, that the issue was over what period of time should those booked earnings be recovered through rates and if it's not recovered over a two-year period then the company cannot book them and they would have had to recast their prior period earnings.

Q. And how much was deferred by increasing from one year to two years? How many millions of dollars were deferred?

A. I believe -- are you talking at the time of the filing or at the time when we were getting a better handle? Over what period of time.

Q. I need a rough estimate. Wasn't it about $80 million that was deferred, additional deferral?

A. The number $40 million strikes me as what I saw in your annual reports.

Q. Was there any interest allowed on that deferred amount?

A. No.

Q. Is interest considered to be a legitimate cost by Dr. Lurito and other cost of money experts in this case?

A. Interest on senior securities are definitely a cost element of service.

Q. And on debt, too?

A. On debt as well, on any senior security.

Q. Now, was there any recommendation you made on what Value Line or Moody's said about the prudency review for these newly acquired resources?

A. No. I think, as I testified to yesterday, I think investors fully expect Puget to be able to demonstrate its actions with respect to resource acquisition are in fact prudent.

Q. Would it have been accurate in the May 31, 1991 Value Line to state as you recommended that "this PRAM will eliminate the risk associated with purchased power?

A. Yes, it will. And it's presuming that Puget is in fact prudent in its decisions. What my testimony with respect to prudency was yesterday was that the staff can't tell. We don't have sufficient

information to know whether or not in fact Puget was prudent.

Q. So the statement should have been amended to read "if proven prudent PRAM will allow these resources to be injected into the rates"?

A. I think, yeah. I don't think that would have added anything but it could very well be characterized that way, but I do think investors have the general perception that any utility resource acquisition has to be as a matter of fact demonstrated by the company that it was prudent. I don't see that that adds anything but it could be so described.

Q. Was there any discussion that you recommended in your data request on how you would define prudency, what standard you would have the company meet?

A. Again, we discussed that yesterday, and I don't have any language. I can't possibly begin to know what information the company had at the time it chose to sign those contracts. I don't know what was available. I don't know how the company would go about demonstrating "prudentness," I can't answer that.

Q. Because in data request 4022 you recommended that Value Line and Moody's should have

had different language than the language they in fact had. Did you write to Moody's or Value Line and suggest that what they had stated wasn't corresponding to your view?

A. No.

Q. You did, however, attend in the fall of 1992 in New York a meeting with Smith Barney, financial analysts; is that correct?

A. That is correct.

Q. And when exactly was that?

A. That was Martin Luther King holiday weekend.

Q. Was that in 1992?

A. It was January I believe of this year.

Q. January 1993?

A. I have to go check my calendar.

Q. Did you take any materials back with you to present to Smith Barney?

A. Yes, I did.

Q. Do you have a copy of notes that you have from your materials or your presentation?

A. I believe I can find that.

Q. We would like to make a request for that.

JUDGE HAENLE: Are you making a record requisition or a formal request?

MR. MARSHALL: We would like to make a record requisition.

JUDGE HAENLE: The next in line is 578, records requisition 578?

(Record Requisition 578.)

A. Tell me exactly.

Q. Your presentation that you made, any notes that you made relating to the presentation, any discussions that you had back there regarding the issues of course associated with Puget Power and what we're dealing with. It's not relevant if you had other discussions about other issues.

A. Well, I think it is. I think other issues are relevant because in general we did talk about purchased power.

Q. That would be fine then, too. I was trying to make it easier for you but if you don't mind, your complete file on that would be fine.

A. Okay.

Q. At that meeting, whenever it was, whether it was in 1993 in January or February, did you state to the people that you felt that their report should state that PRAM will eliminate the risk associated

with purchased power?
A. I believe I did.

Q. Did you state that investors should be assured that PRAM will provide for timely rate recovery of the full costs of newly acquired competitive bid resources?
A. I may not have said it in exactly those terms, but I believe the general gist of my conversation was to describe PRAM and to describe primarily the Commission's order in the second PRAM proceeding and to describe in general, the focus was on the Commission's desire to pursue regulatory reform. Also, as I might add that the community also seemed to want to know something about Bonneville. They wanted to know something about the other -- all three investor-owned electric utilities, and the regulatory reform experiments that we were -- that we are currently engaged in. So the emphasis wasn't just on Puget. It was on all three investor-owned utilities and Bonneville.
Q. Who specifically did you meet with at Smith Barney?
A. I didn't meet with anybody specifically. What I was is a, if you will, a panel speaker. There was a group of investment analysts. I don't remember

any of those people's names. I showed up, flew into Boston one day, did my presentation that afternoon and

flew back to Seattle. So I really didn't have time to meet with anybody informally. It was an hour long presentation and that's what I was discussing. So it was, like I said, it was broader than just discussing Puget and PRAM, but I did make some efforts to try to describe PRAM but they were also interested in Water Power and also interested in Bonneville and Pacific.

Q. In an effort to keep this moving along because I know our time is limited I just really wanted to know the name of the contact that you had at Smith Barney, some specific person there who invited you?

A. Edward J. Turillio, T U R I L L I O.

Q. It was Mr. Turillio who invited you to this?

A. Actually he invited one of the Commissioners and the Commissioners' schedules could not accommodate so I was asked to attend.

Q. And you spoke with him, made the arrangements and came back at his request?

A. I didn't even speak with him. I spoke with his secretary.

Q. You mentioned yesterday with respect to the Standard & Poor's questionnaire, Exhibit 582, that you

had some specific issues that you took up with the company, Mr. Lauckhart or Mr. Knutsen. I had forgotten who you said you dealt with on the Standard & Poor questionnaire.

A. I don't remember exactly who I dealt with and in the context, I do recall a meeting that Mr. Folsom and I had with the company regarding this issue, and I do remember speaking with somebody, I believe it was Mr. Knutsen, about the company's response. But I don't know in what context that was.

Q. What specific responses in that exhibit did you recall speaking to them about? Which ones? And rather than explain it, just identify for me which ones those are because I don't need to go into the details.

A. Well, in general --

Q. Rather than being in general, I just want to know what specific issues in the questionnaire that you took up, if you could refer me to those?

A. Well, it was the theme of the response, that the theme of the response seems to me what Puget is doing is promotion of Puget's debt methodology.

Q. Was there any specific question and answer that you took issue with and then we can go into some generalities if you don't have any specific issues?

This was a questionnaire in a question and answer format?

A. Right.

Q. Was there any specific question and answer that you took issue with?

A. There's 26 pages of questions and answers. There's a tab describing the general background. I don't remember at the time what specific issues. What I'm talking about here in my testimony is that the specific theme of the response. That's all I can answer.

Q. Could I make a request so that we don't take up time so that you just identify the specific questions and answers that you believe that you did discuss with the company? That way we could respond to it appropriately on rebuttal. I don't mean to take up any more time with it but I do need to have what you believe the specific questions and answers were that you believe that you took up with the company.

MR. TROTTER: Excuse me, is that a record requisition?

MR. MARSHALL: Yes, trying to speed things along.

JUDGE HAENLE: You need to be very specific if you're making a record requisition so I can keep

track. This is 579.

MR. MARSHALL: It would be for Mr. Elgin to identify in Exhibit 582 the specific questions and answers in the Standard & Poor questionnaire with which he took issue.

MR. TROTTER: There are other things in that response other than questions and answers. You just want questions and answers or any specific issue?

MR. MARSHALL: If he can identify a specific issue that isn't a question and answer that would be fine, too.

(Record Requisition 579.)

Q. Let me turn for a moment to purchased power evaluation. I take it that you are of course aware of the requirement under the Energy Policy Act of 1992 where state commissions everywhere in the United States examine the impact of purchased power on the cost of capital to utilities and their liability and so forth. Is that your general understanding?

A. The Commission -- my general understanding is that there's a requirement the Commission may decide to address that issue, is my understanding of what the requirement is.

Q. Going to hand you an exhibit that we will mark here which is section 712 of the Energy Policy

Act of 1992 just so that we make sure that we've correctly identified the subject matter that I've asked you about.

JUDGE HAENLE: Are you asking that this be made an exhibit or is this for reference?

MR. MARSHALL: For reference. I don't believe we need to make this an exhibit. It's part of public law.

Q. Is this generally the requirement of state consideration the effects of power purchases on utility cost of capital, leverage capital structures and reliability of wholesale power sellers, consideration of adequate fuel supplies, if I can summarize the title?

A. Yes. These are the amendments to section 111 of PURPA, P U R P A.

Q. And are you aware that there's a requirement that that be -- that consideration be conducted by state regulatory authorities within a year after the enactment of the law which was at the end of October of 1992?

A. Yes.

Q. And have you made a review of the impact of purchased power and a cost of capital to Puget Power?

A. Have I personally?

Q. As a Commission staff?

A. No, we have not.

Q. And is that underway as a part of this case?

A. No. I believe the Commission is looking at what procedures it has available to comply with this, but we have not done anything yet. I had a meeting, I believe, last week with Commissioners' legal advisers to discuss some possibilities, but we have not done anything yet.

Q. The impact of purchased power on the utility cost of capital is something that depends on the specific circumstances with each utility or at least it can. Is that a fair statement?

A. It may or it may not, yes.

Q. In terms of Puget Power, have you heard testimony in this case that Puget Power is the number one utility in the country in terms of the percentage of its purchased power?

A. I've heard the company testify to that effect.

Q. Do you have any reason to dispute that testimony?

A. No.

Q. So accepting that Puget Power is the number

one purchaser in terms of percentage of its power in the United States, this issue about considering the impact of power purchases on utility costs of capital would, is it fair to say, impact Puget at least as much as any other utility in the country if not more?

A. Again, it may or may not have some impact.

Q. Have you mapped out how staff intends to do the review of the impact of purchased power and a cost of capital to utilities regulated by the Commission, specifically Puget Power?

MR. TROTTER: Excuse me, are you referring in the context of this legislative mandate?

MR. MARSHALL: Yes. I think that however this is necessarily tied into this rate case.

MR. TROTTER: It's clear that Dr. Lurito does address the impact of purchased power and cost of capital as do many other witnesses. Mr. Elgin is talking about a specific review under this section of the act. He's talking about a different procedure. So there's clearly not a meeting of the minds here. I just don't want Mr. Elgin to suggest that we're not doing any evaluation in this case when it is clear that there is some but it's not in response to this legislation which the Commission is evaluating the procedures on now.

Q. Is that true? Will there be two separate evaluations of the impact of purchased power on the utility's cost of capital, one in this rate case and then one in another proceeding as it affects Puget Power?

A. I would anticipate that this would be some generic kind of notice of inquiry to respond to this legislation. It would be some generic notice of inquiry having both utilities, affected parties and PURPA developers, independent power producers, the whole range of interested parties to respond to this specific document and this specific requirement. In this proceeding I think we're dealing with the specific issue of Puget's capital structure, rate of return and existing purchased power portfolio and cost of capital nexus. So in this proceeding I think we're dealing with specifics; I think here we're looking at a general generic type of determination as to the impact of purchased power on not only cost of capital but rates and also to me the more important -- one of the more important issues as well is to what extent does the capital structures which are highly leveraged by IPPs and QFs affect the utility's reliability and whether or not they have an unfair advantage. So to me that's much more important issue that this document

is addressing as opposed to what we're doing right specifically in this proceeding which is Puget's purchased power and cost of capital nexus.

Q.   But if the impact of power purchases on utility's cost of capital is an issue in this case, my only question is will there be two separate proceedings and I think your answer is yes?

A.   Yes, I think there have to be.

Q.   When will you conclude with the other proceeding? Will there be time to be taken into consideration in this case to the extent it has an effect on this case?

A.   I can't speak for the Commission schedule, but it is my understanding that something has to be done in October and what that is, whether it means just to go ahead and begin the investigation or whether or not have a full-fledged decision I can't answer that.

Q.   Were you here during the testimony, the cross-examination of Mr. Bill Abrams regarding the impact of purchased power on imputed debt of Puget? First, before you answer that, what is imputed debt?

A.   What imputed debt is the calculation that essentially looks at a utility's purchased power obligations and then looks at a portion of that or all

of it, depending on the structure of the contract and assumes that that has a fixed liability as if it were a debt obligation.

Q. Now, next question --

A. It's like its interest expenses.

Q. So they take a look at the obligation to pay somebody over a long period of time and they impute that as debt same as though you sign a promissory note to somebody?

A. That is correct.

Q. Were you here during the testimony of Mr. Bill Abrams regarding the impact of purchased power on Puget's imputed debt?

A. I don't believe I was here for all of it.

Q. Were you here for any of it?

A. Yes, I was and then I also read the transcript.

Q. Were you here when Mr. Weaver, Mr. Olson discussed that issue? Were you here for their testimony?

A. Again, I don't remember whether I was in and out. I have read their testimony.

Q. Mr. Abrams is of course with a rating agency, correct?

A. That is correct.

Q. And the rating agencies are the ones that calculate the impact of purchased power on imputed debt of regulated utilities, correct?

A. They do that calculation.

Q. It's nothing that Puget does, right? We don't go out and calculate our imputed debt and tell the rating agency what it is, they're the ones that do it, according to their own formulas?

A. That is correct.

Q. You indicated in your testimony at page 27 that staff is concerned with Puget's inability to adequately distinguish to investors the unique operating characteristics of its low cost hydro system with those of other utility systems.

Now, do you agree that Mr. Abrams demonstrated by his testimony that he understood the operation characteristics of Puget's low cost hydro purchases, well aware of their location, their costs, their operating characteristics?

A. He says he does but then his financial analysis with respect to how he treats it doesn't seem to indicate that he has a good understanding. It seems to me that what he's doing, seems to me -- he says on the one hand he understands it but then his analysis and how he applies the risk factors, seems to

me that that connection is lost.

Q. What I am trying to get at by the question is whether you believe that somehow Mr. Abrams hasn't been informed by the company about the operating characteristics of the low hydro, low cost hydro purchases, their location, their cost, their characteristics, and I take it from your answers that you believe that he knows those facts; you're quarreling with how he applies the facts. Is that fair to say?

A. I am quarreling with the fact that it seems to me that what Puget is doing is not taking issue with the analysis and how he's making that calculation. And what I would suggest to take this up further is Dr. Lurito has done a very thorough analysis of this very issue and can talk about the specific quantification and specific risk analysis that he has gone through. I might add, it's one of the things that I take issue with was if you look at his exhibit --

Q. I really haven't asked that question.

A. Well, you have.

Q. I would like to ask the -- the issue is whether we had communicated to Mr. Abrams. If we don't try to confine this to the question I don't

believe we'll be able to finish.

MR. TROTTER: Very open-ended questions.

JUDGE HAENLE: They are definitely open-ended questions but I would appreciate it, if you can make your questions as precise as possible, Mr. Marshall, and if, Mr. Elgin, you can respond only to the question at hand I'm sure your counsel will pick up anything in addition he feels is necessary on redirect.

MR. TROTTER: Is he permitted to answer the last question?

JUDGE HAENLE: He said let me add something else. It seemed to me that he was going off in a different direction so, no.

MR. TROTTER: I just want the record to reflect that all we want is equal treatment.

Q. Do you agree generally that the hydro system in the Northwest is subject to risks including the risks associated with the operation of the Endangered Species Act, for example?

A. Yes.

Q. And are you aware that this summer several groups will petition to list the bull trout and the summer chinook salmon as species that are threatened and endangered by dams on the Columbia River?

A. I am not aware of that specific filing.

Q. Is there anyone on staff who has specifically followed the developments on the application of the Endangered Species Act to the Mid Columbia projects which Puget purchased most of its purchased hydro power from?

A. You may ask Mr. Moast what his knowledge of that is. He's generally responsible for power supply issues on the staff.

Q. Are the contracts that Puget has on the Mid Columbia very long term contracts known as hell or high water contracts?

A. I've never heard that characterization. They're long term contracts.

Q. Are they contracts that obligate the company to pay for all costs associated with them, whether they produce any power at all?

A. That is correct.

Q. If the Endangered Species Act crippled or destroyed the project's ability to generate power, would staff still consider those projects to be prudent investments, prudent decisions by the company?

A. I can't speculate as to what we would do under that circumstance.

Q. What I would like to do now is to turn to

the cost that you have calculated that you recommend be disallowed in this case. In your testimony at page 4 you state the staff has recommended that Puget be required to decrease its revenues in an amount that's approximately 1.7 million dollars as opposed to the 117 million dollars increase that the company filed for?

A. That is correct.

Q. And you say that, "this is a decrease over current billing rates which includes approximately 100 million dollars in increases from two previous PRAM filings." Do you see that?

A. Yes, I do.

Q. And so you're going to be decreasing the request of Puget by approximately 118, 119 million that would more than offset the 100 million dollars increase from the two previous PRAM filings?

A. What the staff is basically saying is that the PRAM increments from one and two now that were temporary increments as part of schedule 100 have now become permanent rates. So those go into permanent rates.

Q. So the fact that you're decreasing Puget's rate request by $118 million is coincidental to the $100 million PRAM filings that you referred to at page

4, lines 3 to 5 of your testimony?

A. That is correct. Essentially what's happening is that the increases that the company has received during the PRAM cycles essentially now that we are back into a scenario where we can look at Puget's costs and establish new revenue costs and rate relationships, we're saying that those increases that the company has received as a result of PRAM basically now provide, if you roll those into permanent rates, provide sufficient compensation for the electric service that Puget is offering.

Q. So you're not saying that we'll give you $100 million on PRAM, on the other hand, this hand we're going to take it away?

A. No, we're not.

Q. That's not what you're trying to say here?

A. No.

Q. The effect of what you're doing, however, is to make a substantial, you say in your testimony, reduction, significant reduction. In fact the entire request that the company has sought you disallow and then some. You go below zero, correct?

A. Yes.

Q. That's more than just something that's significant. It's fairly dramatic, wouldn't you say?

A. It's essentially what you're saying if we go back and look at what Puget's cost of service anduse this test period to establish those rate and revenue relationships or revenue and cost relationships, rates need to be reduced by about $1.6 million.

Q. Now, you've divided the rate reduction that you have in mind into three different categories; is that correct, on page 5 of your testimony?

A. Yes.

Q. Your $118 million or so of disallowance includes $35.7 million on the cost of money, the return on equity and the return on debt. Is that one part of your reduction?

A. Yes. And I do take exception to your characterization that it's a disallowance. It's not a disallowance.

Q. I won't use that phrase then.

A. Okay.

Q. So the $35.7 million, is there any way for you to break that out and determine what the components of that are in your testimony? Can you tell me how much is for what part -- for equity as

opposed to long-term debt or short-term debt?
A. I don't have that calculation. I provide

it in response to company data request. How the staff calculated the $35.7 million, the effects ripple through the results of operations depending on rate of -- return on equity, there's a capital structure component, there's a proforma cost of debt component. There's a component associated with short term interest and so how those are all piecemealed out is very difficult for staff to separate those.
Q. This is in response to staff data request 4001?
A. That is correct.
Q. And it doesn't break out the cost of the equity or cost of long-term debt, just has four lines of text, right?
A. That is correct.
Q. Now, we should be asking these questions of some other witness. Is that fair to say? You don't know how these are broken out specifically?
A. I would suggest you would ask Mr. Martin, but I'm not sure he can do that.
Q. Who would be the right person to ask, Mr. Lurito?
A. Well, I mean, Mr. Martin could probably

provide the calculation but you would have to ask him what he can do for you.

Q. In any event, I shouldn't be asking you the details of that?

A. No, you shouldn't.

Q. Now, the other part of what you have in terms of your reduction is $48 million by what you call the difference in the timing of the company's cost recovery for new resources." Do you see that at page 5, lines 15 of your testimony?

A. Yes.

Q. So 48 million dollars of what you're proposing has to do with timing?

A. Of resources, yes.

Q. Does that imply that the company will be made whole at some point in the future?

A. Yes.

Q. Interest included?

A. Again, is my understanding that the timing issue with respect to resource recovery under the SDM and these issues, interest is not an issue.

Q. What do you mean interest is not an issue, you're not going to allow it or you are?

A. The company has not asked for any interest so we're not --

Q. Why wouldn't interest be a part of a cost recovery if you're going to completely allow for

the appropriate recovery of costs? Isn't interest a cost that every business has to pay?

A. Yes. To the extent that this may impact working capital, to the extent that this may have some other impacts, but the company hasn't asked for any treatment of this.

Q. We haven't asked for a $48 million reduction, though, have we?

A. No.

Q. You have?

A. Yes.

Q. And do you allow interest in the quote, "timing of the cost recovery for the new resources" in your reduction?

A. It's a question of timing, Mr. Marshall. It's when do these resources come on line.

Q. What's the interest on $48 million a year?

MR. TROTTER: Object to this line of questioning. That question is irrelevant because the 48 million is tied to several different projects, none of which are on line. So the answer is zero. This question has no meaning.

Q. Let me ask a hypothetical.

JUDGE HAENLE: Perhaps we could ask the witness as a clarification for me and for the

Commissioners to describe what he means by timing.

Q. Can you tell me what specific project you are going to --

JUDGE HAENLE: Let me find out first what he means by timing and then you may ask your question.

THE WITNESS: It's analogous to the treatment that the Commission gave in the PRAM 2 case in UE-920630 with respect to those two large contracts, is that when those contracts come on line and are actually producing power then through the PRAM mechanism the simplified dispatch model, when those contracts do deliver power and are providing benefit to ratepayers that's the appropriate time to begin the cost recovery.

JUDGE HAENLE: And it's your position that there should not be interest provided because those projects are not yet on line?

THE WITNESS: That's correct.

JUDGE HAENLE: Go ahead.

BY MR. MARSHALL:

Q. Are there any costs that the company will have to front on which they won't get interest for those projects?

A. It depends on when the project comes on line. It depends on when the costs recovery is. It

depends on what the hydro conditions are. It depends on the amount of energy that Puget sells. There's too many factors that go into the calculation of PRAM deferrals and PRAM recovery to say as a matter of fact $48 million will be carried by the company. We don't know and we won't know until we actually have the results, know what's actually happened and know how these resources came on line. There's no way we could calculate carrying costs.

Q. Would you agree that under your method by taking $48 million and according it different timing there will be interest that the company will not receive?

A. There may be, there may not be. It depends.

Q. Are you the right person to ask about the details of how the $48 million was specifically calculated for each of the various projects?

A. Again, the issue with specific projects and their timing, that has to go to Mr. Moast. The specific $48 million calculation that ran through the power costs adjustment, you have to ask Mr. Martin that question.

Q. The one calculation you did with respect to data request 4002 doesn't specify which project would

be delayed, what the timing would be; is that correct?

A. No. Mr. Moast has some specific recommendations for timing with respect to what he feels when these projects will come on line.

Q. So again, you're not the right person to ask about the $48 million?

A. No.

Q. So when you add the $35.7 million and the $48 million of downward movement in costs, what do you come up with for the difference in the remainder of the costs that you believe should not be allowed?

A. I didn't do that arithmetic. I will accept whatever you calculate.

Q. Could you just calculate that for me very briefly? I know it's not in your testimony.

A. Okay. Sum of those two figures is $83.7 million and if you take the company's $117 million request and add the staff $1.7 million reduction you get 118.7 million and then you subtract 83.7 million. That difference is $35 million.

Q. $35 million exactly; is that right?

A. That's what I calculated just then.

Q. Now, of the $35 million do you have a breakdown of what that includes?

A. That includes a whole host of adjustments

that the staff is proposing to the results of operations.

Q. Is there any sheet on which you take each of the things that make up the $35 million and list them?

A. No, I don't.

Q. Do you have in mind components of that list, that is of costs, that would be above 400,000? Could you list those here today?

A. I have an idea of what some of the major ones are. Some of them are --

Q. Let me ask you this first. I guess there's --

A. Do you want me to provide that for you?

Q. Yes. I would like you to provide that for me specifically and then I will ask you a couple of questions about ones that you are able to identify that you have in mind.

JUDGE HAENLE: Were you requesting that be made a record requisition?

MR. MARSHALL: Yes, please.

JUDGE HAENLE: That would be 580.

MR. TROTTER: Is that staff adjustments

more than $400,000?

MR. MARSHALL: Yes, or if you have a list

of all of the adjustments that totaled up to the $35 million that Mr. Elgin had.

JUDGE HAENLE: Is this any different than just comparing the company's proposed results of operations with the staff's proposed results of operations?

MR. MARSHALL: No, I don't believe it is.

JUDGE HAENLE: Why don't you do that.

(Record Requisition 580.)

MR. MARSHALL: No, I don't believe it is.

Q. Of the $35 million, which I take it you would agree is a significant amount, are you the one to ask details about those?

A. I can talk to you about some specific major adjustments that I have spoken to staff about, but Mr. Martin is responsible for the staff results of operations and he's the one who would do this, provide the data for record requisition No. 3. So he's probably the one to talk about the specifics of the adjustments. Mr. Sonstelie, Mr. Nguyen, Mr. Martin, Ms. Sorrells, Mr. Moast, all have in their testimony proposed adjustments which add up to the $35 million they were talking about.

Q. Did you have an overall responsibility to review their calculations and their policy decisions

with respect to any of those amounts that total to the $35 million?

A. I did not review their calculations. I trust their abilities to do those calculations correctly. I have responsibility for the overall policy direction of their adjustments.

Q. And you discussed with each one of them the policy directions on each of the various adjustments?

A. On the major adjustments, yes, and to some extent I think the staff is perfectly capable of making their own judgments with respect to policy issues on accounting or conservation or other things that are within their area of responsibility.

Q. Let me take a couple of the items that I think we've been able to identify as some of the major items on your $35 million list. One is vegetation management and we calculate that to be a disallowance of about $5 million, a little shy of $5 million. Would you accept that subject to check.

MR. TROTTER: Your Honor, we will object to the characterization of a disallowance in that context. It may be a difference at the proforma level. It's not a disallowance.

JUDGE HAENLE: Mr. Marshall, I agree.

MR. MARSHALL: I will rephrase.

Q. The $5 million that the company has asked for and the staff takes issue with on vegetation management, does that sound about right?

A. That is right and that is one that I discussed with Mr. Sonstelie specifically.

Q. As I understand it, the idea behind that is that the test year has one figure and the budget going forward has a different, higher or lower figure; is that correct?

A. Yes.

Q. Now, isn't that true for a whole number of costs that you will have costs in a test year that are either higher or lower than you will find in the rate year?

A. That is correct.

Q. Now, when you adjusted downward for vegetation management because the budget was lower for that one line item, did you adjust upward for other line items in the same O and M category that you were going up?

MR. TROTTER: I object to the question. The question suggested that the budget amount was used because it was lower. The staff case clearly states that the budget level was selected because it was more representative of the company's actual vegetation

management expense in the rate year.

JUDGE HAENLE: Mr. Marshall.

MR. MARSHALL: I stand by my question. It corresponds to the witness's previous answer.

MR. TROTTER: Your Honor, also, notwithstanding Mr. Elgin's eagerness to testify on these issues. We have presented the staff witnesses who have done the specific analysis and I think it would be more appropriate for detailed questions of these items to be addressed to the witness who is sponsoring the adjustment.

JUDGE HAENLE: It does seem to me that if you want him to list what the major differences are as he offered to do earlier that would be fine but I see it as duplicative to go into each one of those when his testimony does state which of the witnesses is responsible for each of these items and it's not going to add much to the record to go through it twice.

MR. MARSHALL: The issue here is one of policy direction. If we're having one-way adjustments we need to know and I think that is a policy issue that is correct for this witness to try to respond to.

JUDGE HAENLE: Since this witness has

indicated he's not the one that has the major responsibility for this adjustment, again, I don't see

that asking this witness about details of the adjustments is going to add anything to this record, Mr. Marshall. Sustain the objection.

MR. MARSHALL: I want to make it clear for the record I wasn't asking him details but rather whether he took other adjustments that were going up as opposed to this adjustment going down, took those into account in the O and M category.

Q. Thank you. Let's go on. As a general proposition, will you agree that adjustments should be symmetrical?

A. No. I don't know what you mean by symmetrical. Adjustments -- we do historical proforma rate making adjustments so that we do adjust at the proforma level so that if we know that something is going to change at the proforma level and it's not offset by other factors we do proforma adjustments. In that sense it's symmetrical. I don't know if that's how you're using symmetrical, yes, but that's a rather broad question.

Q. Let me give you an example. On June 8 the voters of Montana will vote on a new tax that would have the effect of taxing generation from the company's ownership of the Colstrip coal generating plant. Are you generally aware of that tax?

A. No, I am not.

Q. Do you know anything at all about it?

A. No, I don't.

Q. Assuming the tax is a substantial tax of several million dollars and that the voters after having approved it have made that a very specific tax so it can be calculated with exactness, wouldn't that be the kind of adjustment that you would want to make?

A. That would be a proforma adjustment and to the extent that it was not offset by other factors the staff would make an adjustment.

Q. And it would make an adjustment upward?

A. I believe so, but in terms of the specifics of the adjustment and how we deal with the fuel taxes and that you're going to have ask one of the accounting witnesses.

Q. And if an energy bill is passed and there's energy tax at the federal level that has the effect of increasing the company's costs then that should be allowed in if that were to take place before the close of this case?

A. We would have to look at what was specifically the tax, how it was structured, but in general it seems to me that that would be a legitimate cost of service and rate making would have to

accommodate that somehow.

Q. In general terms, costs in, say, the O and M category are not necessarily uniform from one year to the next. Some costs in one area will go up, some costs will go down?

A. That is correct.

Q. In fact, sometimes there's a relationship, if the costs go down in an area on O and M it's because they have to be spent in another area on O and M?

A. Yes, I will accept that.

Q. So in looking at adjustments, just generally speaking, you would want to look to make sure that there aren't offsetting amounts that have to be spent elsewhere. Isn't that fair to say?

A. That's precisely what the definition of a proforma adjustment is and how the staff applies the proforma concept is that to the extent we know something is going to change that's not offset by other factors, we account for that.

Q. Now, again if I were to ask you details of any of those kinds of adjustments, you would refer me to some other witness?

A. Yes, I would.
Q. Now, if I were to ask you questions about

conservation advertising, would that be best handled by some other witness?
A. Yes, Ms. Sorrells.
Q. Same is true for storm damage, working capital?
MR. TROTTER: Your Honor, this is a total waste of time. I will object to this line of questioning. Mr. Elgin -- it's very clear from the staff presentation who the witnesses are. And I will stipulate that if some accounting witness says, no, Mr. Elgin is responsible for this accounting adjustment and Mr. Elgin did not testify to that adjustment we will bring Mr. Elgin back.
JUDGE HAENLE: Sounds like all of the adjustment questions do need to be directed to other witnesses.
Q. What about rate case adjustment, is that your area or some other person's area?
A. I testified to the issue of rate case adjustments in this particular context.
Q. So at least on that one area you're the right person to talk to on that?
A. Yes.

Q. Are there any other areas that you're the right person to talk to?

A. Well, it's pretty clear in my testimony, Mr. Marshall, what I discuss.

MR. TROTTER: Your Honor --

Q. Let's turn to the rate cost issue. On the rate cost issue do you have before you your response to company data request 4027?

A. Not yet but give me a chance and I will get it in front of me. Yes.

Q. In your testimony you provided kind of half the rate case costs in this matter?

A. Yes.

Q. And the quote was to provide a copy of any study that showed how you determined that only one half of the legal fees be allowed as an example. And you stated, "There are no studies. The essence of staff proposal is to share equally the legal costs associated with Puget's presentation between shareholders and ratepayers; is that correct?

A. That is correct.

Q. So are you aware of other commissions in what they have allowed around the country for rate case costs? Have you made any attempt to get that information?

A. You've just answered that question, Mr. Marshall, in response to company data request

4027. I have not done any studies.

Q. Would it be possible to make a study?

A. Yes, it would be.

Q. Has that particular methodology been suggested before by staff for any other company?

A. Not to my knowledge. I don't know of any other company that has this level of rate case expense.

Q. Now, have you been involved in testifying with respect to conservation bond financing?

A. Yes.

Q. Did you get a request under data request 4120 for the materials and notes on your work in that regard?

A. Yes.

Q. Were you able to -- your answer indicated that you couldn't find your file on that, that you had some documents but you don't know where they are?

A. I can't find my file.

Q. And I take it to date you don't have that file?

A. I don't know where it is. I can't find it. I asked it to be filed, I think, and I just don't know where it is.

Q. I am going to hand you a copy of the bill

that was pending before the state legislature last session with respect to conservation bond financing.

A. Yes, I have that.

Q. Is that the legislation that you testified about?

A. This is one of the documents that was in my file, yes, but there was also other -- I had other documents that looked similar to this that were basically, as I recall, code revisor format.

JUDGE HAENLE: Are you requesting this document be made a part of the record or are you just giving it to us for our reference?

MR. MARSHALL: Like it to be part of the record.

JUDGE HAENLE: Mark this as 694 for identification.

(Marked Exhibit 694.)

Q. Now, you include the testimony in your prefiled testimony by reviewing the proposed legislation on this conservation bond financing. Is this this document, this exhibit that we just marked 694, that legislation?

A. Yes, but as my understanding this is what

the company had originally proposed and then there
was, based on the preliminary discussions the company

had with the staff and on the presentation that company made to the Commission as part of the Wednesday open meeting, there was a subsequent proposal that also had amendments to the Commission's valuation statute, I believe 80.04.250, and also some amendments to the Commission's rate making statute for utilities under 80.28. So this was, I think, the first proposal.

Q. Well, as amended, did you support the legislation represented by Exhibit 694?

A. This Commission staff did not, no.

Q. And in your testimony you indicated that the only specific policy issue the staff saw in that legislation was the question of who pays for the resource, is that fair to say?

MR. TROTTER: Could we have a page reference, I'm sorry.

MR. MARSHALL: Should be right at the end of the testimony.

JUDGE HAENLE: Page 36.

A. What I am saying in my testimony on page 36, I think you're maybe misinterpreting my testimony, is that what I am saying is that before we even begin down this road to look at conservation financing, this is one of the things that we have to consider first is

who pays for the resource. And then once we decide that then we can start thinking about what amendments we need to make to the Commission statutes to deal with conservation financing. There are many policy issues, many more policy issues in Exhibit 694 than just who pays for the resource.

Q. Who pays for the resource, was that before the Commission in schedule 83?

A. No, it's not. It's before the Commission as part of this regulatory experiment with decoupling and it's part of Puget's philosophy about acquiring conservation resource.

Q. Does schedule 83 indicate who pays for the conservation investments the company is making currently?

A. Yes. Schedule 83 basically is the implementation of the company's philosophy for acquiring conservation resources.

Q. So schedule 83 was an appropriate time to take up the issue of who pays for the resource?

A. No, it was not. What we were saying is that under schedule 83 there is one methodology for acquiring resources and that is specifically implemented by schedule 83.

Q. I take it the idea behind conservation bond

financing is to be able to take the conservation investment that the company has made and to use that investment to help finance other conservation, other things that the company had in rates that would be less expensive than using equity?

A. That's the company's proposal, yes.

Q. And you agree that there's a fundamental difference now between a conservation investment where the company goes out and installs thermal pane windows, for example, in a customer's business and going out and being a coal-fired plant in terms of the ability of that asset to enable the company to finance further acquisitions?

A. One is a mortgageable asset, the other is not.

Q. The coal-fired plant you can mortgage and get a low rate of interest, low cost money; with putting in a thermal pane window in a customer's home, you can't mortgage that, correct, as the company?

A. No, the company can't but it doesn't mean that the company can't obtain cost effective debt financing to support that investment.

Q. The idea behind conservation bond financing was to make that investment so secure, secure enough so that banks, other institutions, investors, would be

willing to loan money on that security and thereby produce a lower cost source of funds? Is that generally fair to say?

A. Yes.

Q. Right now Puget has approximately $200 million in conservation investments, just today, correct?

A. That is correct.

Q. And do you agree if that $200 million had been spent on coal plant Puget could use the $200 million to borrow money against that at relatively lower rates compared to equity?

A. And if you're comparing -- if you're saying that conservation can only be financed with equity and you're saying that you can't mortgage, I agree with that, but that doesn't then make the connection that conservation can't be financed with a utility capital structure and that the company can't obtain reasonable financing on its conservation investment.

Q. Would you agree that conservation bond financing, if that $200 million were able to be secured appropriately, would be a win-win situation for everybody? It would be able to take an investment and continue to borrow money on it the same as an investment in the coal plant?

A. It may or it may not be. I haven't fully analyzed all the impacts of this. I have some other concerns about this legislation. But in theory, yes. It should be a win-win situation.

Q. What other concerns do you have about the legislation that you haven't mentioned in your testimony?

A. Well, again, my testimony is specifically related to the issue of who pays for the resource, and I think that the Commission -- well, let me get back to your specific question. I think you're mischaracterizing my testimony but I will go ahead and answer your question. I have the concerns about the Commission guaranteeing a revenue stream that's for one specific asset. I don't know how this thing was going to work. I don't know how you can tariff it. I don't know how the revenue stream is guaranteed. I don't know how it specifically will affect other securities in the company's capital portfolio. I just have some concerns about it and I voiced those concerns when the company first presented this concept to the Commission as part of its Wednesday open meeting several months ago. I raised those concerns, I shared those with the company.

Q. Since that time have you had any further

conversations about those concerns?

A. No. In fact the company has said -- company put this on hold and we're going back to revisit this when we have more time at the next session.

JUDGE HAENLE: Were you intending to move the document, Mr. Marshall?

MR. MARSHALL: Yes, I would move the admission of the document.

JUDGE HAENLE: Any objection, Mr. Trotter?

MR. TROTTER: Well, with the understanding that this was the initial version and not the amended version that was also presented to the legislature, we have no objection.

JUDGE HAENLE: Mr. Adams?

MR. ADAMS: No objection.

JUDGE HAENLE: Objection from any intervenor?

MR. TRINCHERO: No, your Honor.

JUDGE HAENLE: This 694 will be entered into the record with the understanding that it is the company's original proposal.

(Admitted Exhibit 694.)

Q. One further area. In your testimony you proposed a treatment of resources with regard to

Tanner/Nintendo situation. Do you recall that testimony?

A. Yes.

Q. In that you propose to make a permanent adjustment to the SDM to remove the highest cost resource required in any future point in time by the actual kilowatt hour load placed upon Puget by Nintendo?

A. Yes.

Q. By that are you suggesting that Puget be forced to charge Nintendo a special higher rate set at the high cost resource?

A. No.

Q. If not under your proposal is Puget supposed to absorb the cost of the gap that your proposal would create?

A. Yes.

Q. If adopted your proposal would have the effect of denying Puget a portion of the actual cost to buy resources needed to serve, correct?

A. Yes.

Q. So are you in effect asking the Commission to tell Puget that it cannot serve Nintendo because it

cannot recover all of its resource costs?
A. No. No. What I'm saying is that the

Commission's order, declaratory order, which is part of my exhibit, Exhibits 673 and 674, is basically to hold other ratepayers harmless for Puget's decision to serve Nintendo when the Commission indicated that it had no obligation to serve it but nothing in our public service laws precluded Puget from serving Nintendo.
Q. Nothing precluded Puget from serving Nintendo?
A. Right. So essentially the essence of staff adjustment is to make other ratepayers indifferent from Puget's decision and it's also to make Puget, if you will -- it's also to enforce the decoupling regime, if you will, for this company.
Q. So in effect you're trying to make it financially impractical for Puget to serve Nintendo, is that fair to say?
A. It should have been all along financially impractical because Puget did not have an obligations to serve this customer.
Q. But that's your intent to make it financially impractical?
A. My intent is to make Puget responsible for

its decision to serve Nintendo. Ratepayers should not be responsible for that decision.

Q. You mentioned that there was nothing to prohibit or to preclude Puget from serving Nintendo. Were you aware of -- I noticed that you attached several things to your testimony in that regard. Were you aware of the order entered by the court denying Tanner's motion for a preliminary injunction in this case?

A. Yes, I am.

Q. Let me hand you this exhibit.

MR. MARSHALL: Again, this is just to make the record complete. I don't intend to go into the details and we will work through this very quickly.

JUDGE HAENLE: You've handed me a multi-page document. The caption on the first page of the document is Order Denying Plaintiff's Application for a Preliminary Injunction. I will mark this as Exhibit 695 for identification.

(Marked Exhibit 695.)

Q. Had you reviewed that before your testimony?

A. Yes, I was aware of it.

Q. I am going to hand you another exhibit which is an order granting Puget's motion for partial summary judgment.

JUDGE HAENLE: I will mark this multi-page

document as Exhibit 696 for identification.

(Marked Exhibit 696.)

Q. Were you aware of Exhibit 696 before your testimony?

A. Yes, I was.

Q. And that order ruled that after September 27, 1991, after the expiration of the service area agreement there was nothing that existed between Puget and Tanner prohibiting Puget from serving Nintendo. Is that your understanding of that order?

A. Yes. It had to do with whether or not there was some ongoing covenant related to that service area agreement and the court ruled that there was not.

Q. And your adjustment would continue beyond September 27, 1991?

A. Yes.

Q. Now, in a general policy area, is it staff's position that any time that there is an alternative supplier of electricity to any given customer so that Puget -- and yet Puget may serve them that Puget should not serve them?

A. No. That's not what we're saying. What we're saying in this specific circumstance, there was a service area agreement, and that from the staff

perspective what we heard from the company was that Puget had an obligation to serve; that as long as the customer requested service within Puget's boundary -- so, in other words, the point of use versus point of delivery was the issue -- that as long as somebody made a request we were obligated to serve. The staff repeatedly told Puget that it did not have in its interpretation, it did not have an obligation. The company refused to accept the staff interpretation of that and forced Tanner to come to the Commission to seek a declaratory order. The Commission agreed with what the staff's -- what was the staff's interpretation of the statute and issued the declaratory order that's in Exhibits 673 and 674, and from the staff perspective what we are doing is making ratepayers indifferent to Puget's decision to serve this customer that it had no obligation to serve and as a matter of fact the customer did have a viable alternative and it should have been served by Tanner.

Q. So you were in effect trying to enforce a service area agreement for that period of time?

A. No, we're not. We weren't.

JUDGE HAENLE: Mr. Marshall, we need to

look for a stopping place. We're almost at lunch.

MR. MARSHALL: I think we can wrap this up

here in about just two minutes.

JUDGE HAENLE: Okay, if you can finish your questions.

Q. Is it your understanding that there is a service area agreement existing now between Puget and Tanner?

A. There is none.

Q. And that's what this order that's 696 addresses, the fact that after September 27, 1991 there's no agreement and therefore no service area agreement, correct?

A. That is correct, and I might add that it's my understanding that Tanner has made several offers to, if you will, establish a new service area agreement for the next 25 years between Puget and Tanner.

Q. Now, this adjustment that you propose, would that hold true for any customer in that area that Tanner believes that it can serve?

A. I don't know of any other disputes. We'll have to look at each dispute on its own merits.

Q. Let me give you an example. If a business were built in Renton next month and another utility proposed to serve it, should Puget Power under your proposal refuse to serve that customer and be required

to quote that customer new customer rates at the highest price resource available?

A. No.

Q. Again, the difference between that and the case that you're talking about is that there used to be a service area agreement between Tanner and Puget, is that the distinction?

A. That's one of the distinctions, and it would depend on the specific facts and circumstances of each unique situation that came before the Commission. It would seem to me that the remedy of the customer in that situation would be if it went to Puget and asked for service and Puget denied service its remedy would be to come before the Commission with a complaint saying Puget had an obligation to serve and under those specific facts and circumstances the Commission would determine whether or not in fact Puget had an obligation to serve. And in the Tanner's specific facts and circumstances, the Commission determined that Puget did not have an obligation to serve.

Q. But that Puget was not precluded from serving?

A. Right.
Q. They specifically said that?

A. That is correct.
Q. I take it your definition of obligation to serve is defined, as I have understood you to say, is that if there is an alternative supplier of power, Puget doesn't have an obligation to serve.
MR. TROTTER: This question has been asked. Mr. Elgin clearly stated it depends on all the facts and circumstances.
JUDGE HAENLE: Does sound repetitious.
MR. MARSHALL: This is to try to get at the definition of his obligation to serve.
JUDGE HAENLE: Thought he already stated it.
MR. MARSHALL: I don't believe he has. Like to ask this one clarifying question to make sure we understand because I believe the policy direction that Mr. Elgin is taking us is to say that if there's an alternative supplier there's no duty or obligation to serve.
JUDGE HAENLE: I believe he indicated that wasn't what the definition was. Go ahead, Mr. Elgin. We're just trying to avoid repetitions.
THE WITNESS: That is right. That's what

I've already indicated. That is not the staff position.

Q. What is the position on obligation to serve?

Is it whether there's a service area agreement or some other factor?

A. The staff position is that the obligation to serve is not absolute. It depends on all facts and circumstances surrounding the request for service and whether or not Puget decides to serve or whether or not Puget refuses to serve. The obligation to serve is not absolute.

Q. Is the only factor you can think of on obligation to serve is whether there is another alternative in electric supplier?

A. One factor.

Q. Any other factor?

A. It depends.

Q. I just want to know is there any other factor other than the one you mentioned?

JUDGE HAENLE: Are you asking for examples of other factors?

MR. MARSHALL: I want to know can he identify any other single factor?

A. Right now I can't identify any.

JUDGE HAENLE: I think it's time we had lunch. This seems to be going on a lot longer than we had in mind. Let's break for lunch at this time and be back at 1:30.

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

AFTERNOON SESSION

(1:30 p.m.)

JUDGE HAENLE: Let's be back on the record after our lunch recess. Did you have additional questions, Mr. Marshall?

MR. MARSHALL: We have no further questions at this time, but we would like to move for the introduction of Exhibits 695 and 696.

JUDGE HAENLE: Any objection, Mr. Trotter? Those are the two orders in the Tanner case.

MR. TROTTER: No objection to 696. I think 695 has very little value but we won't object.

MR. ADAMS: No objection.

JUDGE HAENLE: Objection from any intervenor?

MR. TRINCHERO: No.

JUDGE HAENLE: 695 and 696 then will be entered into the record and there was another matter as well.

(Admitted Exhibits 695 and 696.)

MR. MARSHALL: Yes. We would also like to mark the section laws from Chapter 2 substitute house bill 2198 that he had previously handed out to the parties. It's been determined that that was not in

fact codified even though it's been referred to in testimony.

JUDGE HAENLE: That was your understanding, Mr. Trotter, after looking for it?

MR. TROTTER: Yes.

JUDGE HAENLE: Let's mark that as 697, then, for identification. And this was the matter about which you questioned the witness yesterday afternoon, Mr. Marshall?

MR. MARSHALL: Correct. That I believe the witness himself had referred to provisions in that law being behind the policy of conservation in this state.

JUDGE HAENLE: Any objection to its entry?

MR. TROTTER: No.

JUDGE HAENLE: Any objection, Mr. Adams?

MR. ADAMS: No. I'm a little confused as to which one it was.

JUDGE HAENLE: It was distributed yesterday and the question was -- it was not marked for identification yesterday.

MR. ADAMS: Thank you, no objection.

JUDGE HAENLE: Objection from any

intervenor?

MR. TRINCHERO: No, your Honor.

JUDGE HAENLE: 697 will be entered into the record.

(Marked and Admitted Exhibit 697.)

JUDGE HAENLE: Did you have questions, Mr. Trinchero?

MR. TRINCHERO: Yes.

CROSS-EXAMINATION

BY MR. TRINCHERO:

Q. Good afternoon, Mr. Elgin?

A. Good afternoon, Mr. Trinchero.

Q. If I understand your testimony, you are recommending that the PRAM be continued with some minor modifications primarily to the base/resource cost split and some modifications to the simplified dispatch model. Is that a fair characterization of your testimony?

A. Yes, it is.

Q. You also state that this should be conditioned upon consideration of risk allocation?

A. Yes.

Q. And that the company's return on equity should reflect the fact that certain risks are being shifted from shareholders to ratepayers. Have you attempted to quantify in this case what the effect of

those considerations would be?

A.   I believe that the staff's testimony to that effect is sponsored by Dr. Lurito and he would be the proper person to ask that question.

Q.   Thank you, Mr. Elgin. You also have some testimony regarding the least cost planning process, and I understand from your testimony on cross-examination yesterday that you are not recommending in this case to change the least cost planning process but rather you're suggesting that the company's burden of proving prudence in new resource acquisitions is not sufficiently based solely on consistency with its least cost plan. Is that a correct characterization of your testimony?

A.   That is correct.

Q.   However, you do have some testimony that relates to a more quantitative analysis to be performed in least cost planning and even the suggestion of preapproval of contracts?

JUDGE HAENLE: What are you referring to, please, or where is your reference?

MR. TRINCHERO: I believe it is page 23, beginning at line 14.

Q. Is it your recommendation that the Commission consider a preapproval type of least cost

planning?

A. No, it's not. As the recommendation is to continue with the existing rule and recognize what the current rule does and what its limitations are, specifically with respect to the issue of prudence.

Q. I would like to harken back to some testimony that you gave on cross-examination yesterday regarding your recommendation on the PRAM and the staff's original recommendations in the proceeding in which PRAM was initially adopted. Is it correct to state that the Commission staff in that proceeding recommended two alternatives, the first being a decoupling mechanism and a least cost planning tracker and the second, in the alternative if that were not adopted, the PRAM with a modification to the base and resource cost split. Is that accurate?

A. Not totally. The primary recommendation of the staff was for what we had -- to coin a phrase -- we called it the least cost plan tracker. There was no decoupling in that. What the staff was proposing to do is to look at the company's conservation investments and then to the extent that those conservation investments impacted load we would explicitly calculate what the lost margin was and then provide some kind of recovery for dealing with the

issue of lost margin from conservation investments. And then the second portion was correct was that we essentially imposed some fixes to, if you will, to PRAM, if the Commission wanted to decouple.

Q. Have you reviewed Mr. Schoenbeck's testimony, prefiled testimony in this case?

A. Yes, I have.

Q. And could you briefly summarize for me your understanding of what he's proposing regarding the PRAM?

A. As I understand what his recommendation to be is to, if you will, segregate the resource recovery, or as he's called it the ECAC portion and then impose some risk on the company for power cost recovery and his position is that or what he's taking is that a 90/10 sharing would be appropriate and that then for decoupling purposes to deal with the issue of lost margin to keep that separate, distinct from the ECAC portion or the power cost recovery mechanism. And then he also has some issues related to rate design with respect to PRAM increases.

Q. Is it also your understanding that he supports the staff recommendation on the base/resource cost split?

A. Yes. It's my understanding that he feels

that -- he's basically testifying to what I testified to in that earlier proceeding that created the PRAM that as it is now it's, if you will, gamed and there is no principal allocation or principles governing the allocation. They're driven by the end results to Puget and he does have some concerns and is basically testifying to that.

Q. Is it also your understanding that those recommendations which you have outlined are an alternative that he is recommending if the PRAM is left in place?

A. Yes. In other words, basically what I understand WICFUR's proposal is to be exactly what the Commission staff did in the original is to give the Commission a couple of options. The preferred recommendation would be to separate the two and provide the 90/10 sharing, but if the Commission were to accept the continuation of the PRAM he would support the staff's recommendations with respect to the split between base and resource costs, or the classification between the two.

Q. Do you find merit in Mr. Schoenbeck's initial proposal, that is, the -- not the alternative regarding modifications to the PRAM but actually the preferred approach?

A. I find merit in it to the extent that it's more consistent with what the staff would like to see as the preferred alternative as what we testified to in the 1990 proceeding that created the PRAM mechanism. Our preference is still to, if you will, find a way to deal with the issues that we've identified in the context of traditional rate making.

However, my reading of the Commission's policy directions and to that effect is the Commission is committed to finding a way to make decoupling work and so what we're saying is that the PRAM has some benefits, it has some associated costs and the best fix that we can do right now is to deal with this base/resource classification split and also make some minor modifications to the SDM.

The other overriding issue from the staff perspective is if the PRAM were to be abolished that the signal to the financial community regarding the continuity of regulation and so from that perspective we're saying that there is some value to that. There is some value with respect to the specific behaviors of Puget with respect to acquiring conservation and so therefore we would say that the PRAM -- our recommendation is the PRAM should be continued with these modifications.

Q. You indicated that uncertainty on behalf of the financial community is one of the primary drivers for that recommendation. Are you familiar with a decision that was issued back in January of this year by the Public Utility Commission of Maine that dealt with a very similar revenue per customer decoupling mechanism and resource recovery mechanism?

A. I believe that that was something that was introduced in this proceeding as an exhibit, and I did look at that and as I understand the Maine Commission did pull back from its regulatory experiment with Central Maine Power in that respect.

Q. Would you accept subject to check that the day after the Maine Public Utility Commission accepted that stipulation and issued that order that Central Maine Power's market price rose by 50 percent or -- I'm sorry -- by 50 cents or nearly 2 percent in one day?

A. I will accept that subject to check.

Q. Thank you. The company recently filed its PRAM 3 request. You have made recommendations to modify the PRAM in this proceeding. And I asked a similar question actually of Mr. Bell yesterday.

Would it be your recommendation that any policy determinations by this Commission in this case

regarding how the PRAM and/or decoupling least cost planning tracker mechanisms should operate should be applied to the PRAM 3 request?

A. Yes. However, if the Commission were to adopt the WICFUR proposal we would have to do some sort of reconciliation with respect to deferrals and how we have to deal -- I think there would be a tariff issue with respect to how you're going to deal with just the deferrals and then transition into a proposal like WICFUR's. And I think that could be worked out but that would be some logistics issues with respect to backing out, if you will, those elements of the PRAM 3 filing, which is all deferrals. But there would be some logistics issues but in essence it should all happen October 1. I agree with that.

Q. Thank you very much, Mr. Elgin.

MR. TRINCHERO: No further questions.

JUDGE HAENLE: Mr. Furuta?

MR. FURUTA: No, your Honor.

JUDGE HAENLE: Mr. Adams?

CROSS-EXAMINATION

BY MR. ADAMS:

Q. Mr. Elgin, I apologize. I'll probably be bouncing around a little bit because I've got bits and

pieces after other people have asked questions. Let me start off referring you to page 2 of your testimony, approximately line 16, where you indicate your recommendation is conditioned on the Commission addressing the risk allocation issue. Do you see that?

A. That is correct.

Q. Is it correct that you believe that the existence of the PRAM results in lower required return on equity for Puget?

A. Yes, it does.

Q. Do you also believe that it allows the company, gives the company the ability to finance with a higher debt capitalization ratio than if there were no PRAM?

A. Yes. In other words, the earnings stability that the PRAM provides should enable Puget to be more leveraged and part of that benefit of the leverage should be increased shareholder value.

Q. To date with the PRAM have ratepayers reasonably been compensated for this risk shift under decoupling and the PRAM mechanism?

A. In my opinion they have not.

Q. So does that mean that the current authorized return for Puget, which I think is 12.85

percent if I'm not mistaken, on equity, do you consider that too high under current condition?

A. Yes, I do. It's 12.89 percent.

Q. Pardon me. Now, am I correct that Dr. Lurito is proposing a rate of return in this case for the company of 8.91 percent?

A. Yes, the overall rate of return is 8.91 percent.

Q. And am I correct -- correct me if I'm wrong, but I believe that consists of a 10 percent raw cost of the equity plus a .8 percent for selling costs on ratio?

A. Yes.

Q. Now, as I understand it, Dr. Lurito proposes 41 percent capitalization ratio for equity; is that correct?

A. 41 percent.

Q. I believe that's the correct?

A. Yes.

Q. Now, I guess it was the original PRAM decision or decoupling decision you made a recommendation concerning the capital structure adjusting for the hydro risk, did you not?

A. Yes, I did.
Q. And, again, correct me if I'm mistaken, but

I believe you recommended a 39 percent equity ratio at that time?
A. It was about 39 and a half percent. And it was based on my analysis that I did at that time and basically moving Puget out towards the end of the published S&P ratings criteria for equity and debt ratios.
Q. Well, in light of that previous testimony do you support Dr. Lurito's 41 percent common equity ratio in this case and if so why since it's different from what you proposed several years ago?
A. Well, you will have to ask Dr. Lurito. I support his number. I think it's conservative and I think it's fair to Puget and I think it does do what I testify here and it does provide sufficient coverage. I think one of the reasons why I support it is tied to I think that there's -- to go where I think Puget needs to go we're still going to have to do a better job of educating the financial community about what PRAM does and what benefits accrues to shareholder and so that these rating agencies can start thinking about its coverage in its financial ratios with respect to debt ratings and recognize that the kind of ratios

that they're suggesting are not indicative of what would be fair for Puget given the PRAM.

Q. Are you talking about conservative to ratepayers or to the company or both?

A. I'm saying that if I were doing it I may have been a little bit more aggressive on the equity ratio. I didn't do the study but my gut reaction is I would have been a bit more aggressive but I think it's fair.

Q. You have done rate of return analysis and have testified on that subject in other proceedings, have you not?

A. Yes, I have.

Q. Turning to page 8 of your testimony, line, the sentence that begins at line 11. Says, "It not only protects" -- referring to the PRAM -- "not only protects Puget from short term earnings impacts due to efficiency investments, it protects Puget from short term earnings fluctuations resulting from virtually any cause." Do you see that?

A. Yes.

Q. When you say any cause, would that include weather variations or conditions?

A. Yes.

Q. What about free riders participating in

conservation programs?
A. Yes.

Q. And I gather it would include changes in secondary power costs, would it not?
A. Yes.
Q. Would it also include changes in contract terms for existing power supply contracts?
A. Yes.
Q. Do you recall or can you tell us -- I don't have the numbers directly at my fingertips but the increases that have been granted for the PRAM 1 and PRAM 2 filings?
A. Yes. It's approximately -- the sum of the two or you want them separate?
Q. Separate would be fine.
A. It's about $38 million for PRAM 1 and about $66 million for PRAM 2. In that PRAM 2, just a second I will give you the specific figures. I have the order here. Of the $66 million, 6.7 million were for conservation incentives and about $12 million was for one third of the first seven months of PRAM under-collections.
Q. Now, you're aware the company has, I guess last Friday, made a filing for its PRAM 3?
A. That is correct.

Q. And I have not seen it but I understand it's in the approximate amount of $76 million?

A. Yes.

Q. Now, in that PRAM 3 filing, are we also picking up deferred amounts from going all the way back to PRAM 1?

A. That's all the PRAM 3 filing is going back. If you look at my testimony on page 11 of my testimony beginning on line 7, PRAM 1 essentially does all that. It's two-thirds of the unrecovered portion of the first seven months of PRAM 1. It's a remaining five months of under-collection for PRAM 1 and it's the first seven months of under-collections for PRAM 2. So all of those things, all those deferreds in those periods of time, I believe it's my understanding represent $76 million of under-collections just for those periods.

Q. Would I be correct that in a subsequent PRAM the remaining five months of PRAM 2 would be picked up plus any other under-recoveries from PRAM 1 and PRAM 2?

A. No, there would not be any more under-recoveries. Well, take that back. There would still be half -- it's this rolling half, if you will. Whatever they've booked, as I understand it, has to be recovered within two years. So as I understand, as long as the deferred amounts that they calculate are

recoverable within two years then they can book the earnings in the year that they've under-collected them. I have not looked at the specifics of the filing. That's my understanding of how it's working. We'll have that issue fully before us in the PRAM in terms of exactly what's there. But it's $76 million. It's a big number.

Q. To the best of your knowledge, PRAM 3 does not include additional new resources other than those that are already included in this general rate case?

A. No, this general rate case has all the new resources; everything that's related, that would be resource related through the SDM, is included in this general.

Q. I think this was a paraphrasing or a quote from you earlier, I guess it was yesterday. The PRAM should be simple but implementation is problematic. I gather when you get into these kinds of dollars that is where some of the problems are?

A. That's precisely my point is the automatic adjustment mechanisms have inputs. You put the numbers in and it generates results and you get like what we saw in PRAM 2, approximately $110 million and you get these big deferrals and it's automatic. It's analogous to the kind of tracking increases we saw in

the late 70's and early 80's. Once you implement those kind of mechanisms they become very automatic in increases and the magnitude of them is what's problematic.

Q. Any amount of the 76 million dollars amount in PRAM 3 is cumulative or additive to whatever the company is requesting here, is it not, so that we're basically looking at 76 plus 117 million?

A. If we were to accept the company's filings it would be 110 million October 1, plus half of 76 million October 1. Now, the company has in this proceeding proposed rate moderation for that 117 million. So that's where my testimony, page 11, gets really confusing to explain to customers. You're going to have all these prior period deferrals, you're going to have $70 million of general rate increases and then you're going to have three years of the rate moderation proposal. Out in year 1995, '96 you're going to have all of these things flying all over the place and trying to explain that to customers I think is going to be very difficult.

Q. I think you may have misspoke when you said if the company was granted what it's requesting here

and I thought you said 110. You meant 117 million?
A.   Excuse me, 117 million with the rate

moderation proposal, yes.
Q.   Turning to page 11 of your testimony. Line 20. You say decoupling and resource recovery mechanisms are acceptable. Do you agree with the testimony of Dr. Blackman and Powers that decoupling can be achieved without protecting the company from weather and hydro?
A.   Yes. That was precisely what the staff least cost planning was all about. The least cost planning tracker, it was specifically designed to decouple, if you will, and my understanding of what the point of decoupling was is so that if the company in the short term invested in an efficiency measure they were made whole for those short term earnings losses associated with that.
Q.   When you refer to the tracker that was the proposal staff made in the original decoupling case?
A.   Yes, and I still think that it accomplishes that objective.
Q.   At page 13 of your testimony and referring you specifically to the sentence that begins on line 16 where it says Resource Acquisition, do you see that?

A. Yes.
Q. There you state that the prudence of recent

power purchases is an issue that the Commission should address in this proceeding, correct?
A. It was an issue that the Commission identified that Puget was to have addressed in this proceeding.
Q. Has the staff, then, reached any conclusion as to whether any of the new power supply contracts are --
A. No, we can't. There's not enough information. The purpose of the staff testimony was to put Puget on notice that in the next general rate proceeding that this kind of presentation would not be acceptable.
Q. I wanted to perhaps divert to some testimony that you gave yesterday concerning the integrated resource planning process. I think you indicated a number of what you considered flaws or drawbacks to that process -- not sure if it was in your testimony as in response to questions yesterday. Am I correct that you are not proposing that -- strike that.
Am I correct that you would propose a number of improvements to that process?

A. No. I think you've mischaracterized my
testimony. I did not say that the least cost planning

process was flawed. What I was suggesting is that the least cost planning process for what it is is not sufficient enough for the company to allude to as saying, well, what we did is consistent with our least cost plan and therefore our specific actions with respect to these contracts are prudent. What I am saying is that the least cost planning process is valuable for what it does.
Q. Again, correct me if I misunderstood it, but I thought you also indicated that there would be a number of things that could be done in that process which would be more informative to the Commission and all parties?
A. It was in the context that if that document were to in fact be the proof of prudence, it would have to be improved.
Q. Are you recommending preapproval through that process?
A. No. What I am recommending is that the Commission recognize what the planning process does in terms of its limitations, but that it is not sufficient enough with respect to refer to in saying what Puget did with respect to specific actions is in

fact prudent. The process is too general, it's not specific enough, it's not rigorous enough and it just

can't be used for that purpose.

Q. Do you believe that as part of that process it would be helpful to the Commission to have the rate implications of the various choices reflected in that process?

A. That would be a minor improvement that I think within the existing rule the company could, and I don't think that would provide any -- excuse me. It would not necessitate any significant addition of resources for the company to say, well, if we go down this path and we acquire under a medium high growth scenario we do these types of things, there's a connection between rates and a process, if we do this, this is what we're looking for. So there's a heads-up. That would be valuable and I think that the company could provide that without sufficient amount of additional resources.

Q. You would agree, would you not, that in the context of that process the advisory group, the input to that process has not centered on specific projects? In other words, Encogen is not up for review and the specifics of Encogen during that process, is it?

A. No. It would be a general statement. So, for example, if we got into another scenario where Puget had to acquire four to 500 average megawatts of

base load thermal, we would have some idea of what that would bode for rates.

Q. Would you agree that when the company comes and makes a filing with the Commission concerning a contract for a new resource at least generally these have been sealed? They've been considered confidential and not opened to anyone other than from the staff from the Commission?

A. It's my understanding they were all confidential. They are not available to the general public to review and it's my understanding on advice of counsel that they are available to the Commission staff, the Commission and public counsel for review.

Q. But the outside parties they are not?

A. No, they are not.

Q. Now, going back to your testimony, page 13, line 16, would you agree with me or accept subject to check based on Exhibit 530 a total of approximately 684 average megawatts of new power contracts are in this filing? I can list them for you.

A. What is Exhibit 630? Is that Mr. Lauckhart's?

Q. I don't have it in front of me but I believe it is.

JUDGE HAENLE: 530 is JRL-10, yes.

A. Yes.

Q. Do you know what the total proforma cost of these new contracts would be during the rate year?

A. Mr. Moast can answer that, I don't know.

Q. Would you accept subject to check it is approximately $195 million?

A. Sounds about right. $200 million sounds about right. Mr. Moast can provide you the specific figure.

Q. Just for a comparison, do you recall the amount of money that was involved in the WNP 3 Bonneville exchange decision in the company's last general rate case?

A. The total amount of the company's investment including AFUDC was $170 million.

Q. Right. And the revenue impact was approximately 16 million, would you accept that subject to check in terms of rates?

A. Yes. I will accept that subject to check. If you're talking just the WNP 3 portion, the return of that and the amortization of the part that was not given rate base treatment, or are you talking about the whole rate order.

Q. No, no. Just talking about the WNP 3 piece.

A. Accept that subject to check.

Q. Would you agree, and again I am asking in a general sense, that the total amount of money involved in the purchased power contracts in this case is significantly more than the amount of money involved in the WNP 3 issue in the last general rate case?

A. Yes.

Q. Can you briefly describe the nature and extent of the staff's analysis of these new power contracts? What have you done in terms of analyzing them?

A. We basically do couple of things and Mr. Moast can speak more specifically, but we look at where it is with respect to avoided costs. We also look at where the contract, where the power is and what kind of problems it might create with respect to transmission. We do look for security. In other words, if there's a significant front loading what kind of security and what's the maximum termination amount should the project developer fail and what kind of security is behind that.

We looked at fuel, what kind of risks were to Puget and ratepayers with respect to fuel. And just a general ranking criterias that are within the competitive -- Commission's competitive bidding rule,

assuming that it was a bid resource, and to some extent we looked at whether or not this was a lost opportunity.

Q. Do you have any estimate of the total staff time involved in that review?

A. We could go back and look at some time sheets but I would say eight hours of minimum, maybe on some contracts three or four days max.

MR. TROTTER: Excuse me, was this in the context of when they're filed in the Commission or in the context of this rate case?

MR. ADAMS: I did mean first in terms of this rate case was my inquiry.

A. I thought you meant in terms of when they were filed. I answered your question was with respect to when they were originally filed. You will have to ask Mr. Moast how much time he spent in trying to data request trying to get information about those specific resources, but I recall that there was quite a bit of cross-examination of Mr. Lauckhart on that and I don't know how much time Mr. Moast spent trying to get data from the company on those contracts for this proceeding.

Q. It would be fair to say that the staff has not looked at the issue of dispatchability raised by Dr. Blackman?

A. No, we have not.

Q. And would that be true both in the context of when those contracts were originally filed and in the current case as well?

A. Dispatchability is an issue that's one of the ranking criteria as part of the competitive bid rule, but I don't believe it was analogous to the kind of detail that Dr. Blackman provided.

Q. Page 16, turn to line 15 and there you're referring, I think, to the disaggregation by customer, do you see that?

A. Yes.

Q. In your opinion should the allowed revenues from -- let me preface my question, not sure whether you covered this with the prior attorneys or not, but as it relates to the revenues from PRAM 1 and PRAM 2, are you recommending or does staff take a position on whether the issue of disaggregation should be applied to true-ups or other deferred amounts that are resulting from prior periods?

A. No, we're not. We're just recommending on, as I understand what Mr. -- what we raised in the past is we tried to get the Commission to look at this issue prospectively. The Commission determined that a single revenue per customer figure was appropriate and

so all we've tried to provide is the calculation for the Commission as to how much this represents in over collections from prior periods. We're not recommending that we go back and undo that but on a prospective basis we think that it's an issue that deserves merit and the Commission should as part of their cost of service study, cost of service, establish those principles and calculate specific RPC's because the issue is growth and those various customers classes are not proportional and is providing an additional benefit to Puget that is, if you will, it's because of the way we've classified costs and aggregated them into one lump sum for a revenue per customer figure.

Q. As to PRAM 3 which does have deferrals, as you've explained already, from PRAM 1 and PRAM 2, are you suggesting that the Commission should apply this principle to those amounts?

A. No, we're not.

Q. So effectively it would only show up to anything subsequent to PRAM 3?

A. As a result of this order what the Commission would order prospectively.

Q. Looking at page 18, line 18 the general issue of revenues are lower under PRAM or higher,

which I gather you dispute with the company, correct?

A. Yes.

Q. Absent the PRAM, is it your opinion that the company would have to file general rate cases?

A. Yes.

Q. And I think you've agreed that general rate cases take time?

A. Yes, 11 months.

Q. Am I correct under the PRAM where they are allowed to defer these costs there is basically no regulatory lag?

A. There is none, no.

Q. Now, you've also indicated, referred to the warm winter and dry hydro conditions of '91/'92 and I think you've indicated under conventional rate making this would have resulted in lower revenues and earnings?

A. That is correct.

Q. Has the staff done any kind of quantification as to the amount of earnings that the PRAM, in other words, the amount of earnings that would have existed without the PRAM versus with the PRAM?

A. Well, the only analysis I've done is if you look at the company's 1992 annual report to

shareholders --

THE WITNESS: Your Honor, was that just previously marked as an exhibit.

Q. Exhibit 573(A)?

A. Exhibit 573(A). Let me find the footnote where they've buried it, if you will. They've described on page 28 they've got the number, it's 42,789,000 was recorded at December 31, 1992. That represents about 50 cents a share. That's significant.

Q. You have not done an independent verification of that number; is that correct?

A. Well, their auditors have. I assume that this is a good number.

Q. I want to turn briefly to a couple of questions on the Tanner Electric Nintendo testimony, which I think starts at approximately page 30. Is it your position that the cost of serving Nintendo based on Puget's avoided costs and associated transmission and distribution costs is greater than the revenue received?

A. No.

Q. It was my impression that you indicated that ratepayers should be indifferent to the addition of that load; is that correct?

A. Right. They should be.

Q. And what is the amount of that load, by the way, do you know? I think one time it was estimated approximately ten megawatts but I believe there's a lower current?

A. I think it's potentially up to a nine megawatt load. If you would ask Mr. Moast he could have that specifically. There is a company data request that provided the sales to Nintendo during the time period.

Q. Then, what exactly is your -- how have you determined the amount that you're suggesting be disallowed? Is that based on avoided costs?

A. No. It's based on -- it's got nothing to do with avoided costs. It's based on Puget has asked to be decoupled, and the purpose of the staff recommendation is while Puget was presenting an argument before the Commission that it should be decoupled, that it's in the public interest to be decoupled, it was in fact going out and serving a customer that it had no obligation to serve. And so what I am trying to do with this adjustment is make Puget responsible for that decision. So it's got nothing to do with avoided costs. It's got to do with what is the highest cost resource that Puget acquires

at any one time and that flows through the simplified dispatch model and that since Puget's decoupled the revenues that Puget receives from the sale it should be indifferent to and that the only revenue that it would be entitled to as it represented to the Commission during oral argument in the second PRAM is that it only gets $589 per customer. And so that that's from a rate making perspective we're going to put Puget where they said that's all we're going to make from it and that with respect from whatever resources that Puget requires to serve that customer, those will be removed from the SDM. So we're not looking at avoided costs, we're looking at the incremental costs of any resource Puget acquires to serve that customer.

Q. Why in a decoupled environment would the company add a load like Nintendo?

A. I don't know. It makes no sense. I could never understand it from the beginning. I communicated that to the company way back in November of 1990. It made no sense whatsoever to be asking the Commission for decoupling and at the same time saying that it had an obligation to serve this customer when there was a bona fide offer from another utility that had a service area agreement that said this other

utility should be providing the service.

Q. What I'm kind of getting at is the theory underlying decoupling, at least my impression was that it would remove this kind of incentive for growth and yet it's occurring. Do we have a structural flaw in the decoupling mechanism that doesn't deal with this issue?

A. Well, I don't think there's a structural flaw in the mechanism. I don't know why Puget wanted to serve this customer. The only evidence I have is if you look at another one of their annual reports, 1991 annual reports, Puget in its discussion with shareholders about what's happening to its load, it was addressing what's happening with Boeing and saying, Well, Boeing is slowing down, but there's good news. We're having additional growth in our service territory tied to these high-tech firms and Microsoft and Nintendo were specifically named in the 1991 annual report. So it strikes me is that part of it could very well be image why Puget -- but I don't know. Only Puget can tell us why they chose to serve that customer.

Q. One of your exhibits, No. 671, which is the article by Mr. Kihm has in it some references to the growth mentality and I didn't know if that was part of

the reason you attached that exhibit or not or is that totally different?

A. No. If I could clarify, for the record, with the Commission why I included this article. What I found interesting about this article was the fact that we're talking about incentives to shareholders. The proposition of this article is that maybe our focus is wrong. The focus for incentives should may well be directed to management. And that's what I found interesting and compelling in this article is that we may in fact be focusing on the wrong sorts of incentives. Because if a company does pursue least cost resources it will maximize shareholder value. The question is what does the impact of that type of changed attitude bode for management, and it may not be in the best interests of managers to pursue least cost resources.

Q. You've been using the term management in a broader sense perhaps than I think of it but would you not agree that sort of the bottom line or at least the last sentence of that article states in part that "if DSM incentives are to be used they should focus on the management and the employees of the utility, not the

stockholders." So it's more than just management.
It's the whole company?

A.   Yes. But the big -- the decision makers are the management. They're the ones who set the tone for the company.

Q.   You've indicated under your Tanner Electric Nintendo adjustment that you've removed expenses of the lawsuit. Am I correct that a $2.5 million judgment occurred subsequent to the test year?

A.   Yes, it did.

Q.   So to that extent it is not part of company's case nor the staff's case?

A.   No, it's not.

Q.   Is it your recommendation, however, that that not be allowed for rate making purposes whenever it is reflected?

A.   That would be the staff recommendation.

Q.   Mr. Elgin, if you would turn to page 34-35 which is your treatment of consultants and rate case expenses, and in that regard --

MR. ADAMS: In that regard I want to have marked as the next exhibit in line a one-page document entitled Response to Company Data Request 4530 which is the staff's response to Puget data request.

JUDGE HAENLE: The next number in line is

698. I will mark it with that number.

(Marked Exhibit 698.)

Q. Have you had a chance to look at that response that's been marked Exhibit 698?

A. Yes.

Q. And I gather this was prepared by you in response to a company request; is that correct?

A. Yes.

Q. Is it true and correct to the best of your knowledge?

A. Yes, it is.

MR. ADAMS: Move the admission of what has been marked Exhibit 698.

JUDGE HAENLE: Any objection?

MR. MARSHALL: No objection.

JUDGE HAENLE: Mr. Trotter?

MR. TROTTER: One question on voir dire.

Mr. Elgin, Exhibit 698 does not include any bonuses?

THE WITNESS: No.

MR. TRINCHERO: On that basis, no objection, your Honor.

JUDGE HAENLE: 698 will be entered.

(Admitted Exhibit 698.)

Q. So I understand the relationship of 698 to your testimony, am I correct that 698 depicts some of the expertise the company has, if you will, some of the

expertise the company has in-house and is already paying for?

A. Yes.

Q. As I understand your conclusion they needn't hire outside experts to this purpose?

A. Yes.

Q. A little further down in that same section you also address the company's legal expenses which I believe you indicated are approximately $515,000 for this case?

A. Yes.

Q. Is that an estimate that came from a Puget data request, staff data request of Puget?

A. The number came from Puget. I don't know how we got it.

Q. But I gather it's an estimate, a forward looking estimate?

A. Yes.

Q. And as I understand it, you are recommending that only half of this amount be allowed as a rate making expense chargeable to customers?

A. Yes.

Q. Do you agree that some of the major

utilities that are before this Commission regularly employ their own regulatory legal staff in house?

A. Yes, some do.

Q. Companies like US West, General Telephone?

A. I don't know about the telephone companies. I only know about the energy companies.

Q. But you would agree?

A. Yes.

Q. Has staff done any analysis of what legal costs the company would incur if it used regulatory attorneys paid a salary on staff rather than paying a law firm and the overheads associated therewith?

A. No, we have not.

Q. Is this something that you would believe might be looked into? Would you recommend that or not?

A. Well, I fully anticipate the company to do it, particularly given the fact that the staff is proposing this adjustment and given the fact that Towers Perrin registered some concern over Puget's inability to control these costs, I would think that a prudent management would look into ways to control these costs.

Q. One other area. Referring to your testimony at page 27 which is your concern that you raise in your testimony and you've been cross-examined at length concerning your concern of the inability of

the company to convince Wall Street that the PRAM basically is in stockholder's interest, I think, for reduced risk. You had referenced in cross-examination to a response of the staff to company data request No. 4022. Do you recall that?

A. Yes, I do.

MR. ADAMS: Your Honor, I would like to have marked as the next exhibit in line a multi-page document, five-page document which is the response of staff to that data request.

JUDGE HAENLE: I will mark the multi-page document with that caption at the top as Exhibit 699 for identification.

(Marked Exhibit 699.)

Q. Mr. Elgin, have you had a chance to review this document? I have included the corrected response and the supplemental response to the company data request, assuming that the original response has been superseded; is that correct?

A. Yes. Well, it's been actually supplemented and there were just three minor changes. There were a couple of just typographical errors on the corrected response and you can see that they are on page 2 of the document. The date was wrong. There was a typo on page 2, and I believe those are the only changes

that were corrected. And then since we only had five days and in an effort to pull this stuff back together in terms of all the information that I had looked at, I supplemented the response to look at some other things that took me some time to pull together to make it complete.

Q. But it's now -- the form I've given it to you then is your latest, if you will, version and it's true and correct to the best of your knowledge?

A. Yes.

MR. ADAMS: Move the admission of Exhibit 699.

JUDGE HAENLE: Any objection?

MR. MARSHALL: I do have an objection because it refers to Standard & Poor's, to Moody's and to Value Line reports which the witness then interprets and tries to characterize. I think those reports should either be introduced into evidence or, in fact, stand as the best evidence of what they say. I think this is argumentation and it's improper to introduce this as an exhibit. The reports state what they state and if those are to be the issues then those ought to be introduced as exhibits.

MR. ADAMS: Your Honor, the request was for basically the information that supported his assertion

specifically at page 27, lines 16 through 18 and that's my understanding of what this is, and you may recall that the company felt free to cross-examine him from this document just an hour ago. So they've used the same document and it's in the record. I think it is certainly probative and should be admitted.

JUDGE HAENLE: Any objection, Mr. Trotter?

MR. TROTTER: No.

MR. TRINCHERO: No objection.

JUDGE HAENLE: I will overrule the objection and enter the document into the record.

(Admitted Exhibit 699.)

MR. MARSHALL: Let me add one thing. It asks in the data request to provide copies of the documents. The copies have not been provided by Mr. Elgin. If he has those documents that he's referred to, the Value Line, Moody's report, Duff & Phelps and Standard & Poor's report, then I believe those documents should be provided and attached to this as a supplement.

MR. TROTTER: Your Honor, the typical course is when responses in the receiving party's view are insufficient, that they simply ask follow-up. No follow-up was asked of this request. If one was made we will provide it. These documents were in the

company's possession. I think that's the main reason we didn't provide them.

JUDGE HAENLE: If you want to request them, Mr. Marshall, I guess you can.

Anything else, Mr. Adams?

MR. ADAMS: Just a moment. I think I'm just about done. Nothing further. Thank you very much.

JUDGE HAENLE: We would ordinarily go on at this point with the Commissioners and then with redirect and recross. I have the sneaky feeling there's going to be some redirect and I know that you Commissioners have questions. Because we've been requested to let Dr. Lurito come on today and because he has about two hours of testimony, I would propose that we reserve the rest of Mr. Elgin, I guess, until tomorrow. He's going to be a week long witness if we keep it up at this rate but in order to accommodate Dr. Lurito that would be my suggestion. Is that all right?

MR. TROTTER: Go off the record, please.

JUDGE HAENLE: Off the record to discuss scheduling.

(Discussion off the record.)

JUDGE HAENLE: Let's be back on the record.

During the time we were off the record we switched witnesses now to Dr. Lurito for the Commission staff.

Whereupon,

RICHARD J. LURITO,

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

JUDGE HAENLE: Also during the time we were off the record I marked a number of documents for identification as follows:

Marked as Exhibit T-700 for identification is a 63-page document. In the upper right-hand corner is RJL Testimony.

701 for identification, RJL-1 in five pages.

702 for identification, RJL-2 in eight pages.

And 703 for identification RJL-3 in 17 pages.

Your witness has been sworn, Mr. Trotter.

(Marked Exhibits T-700, 701, 702, 703.)

DIRECT EXAMINATION

BY MR. TROTTER:

Q. Would you please state your name and spell your last name for the record.

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

Q. Would you give us your business address?

A. 6756 Old McLean Village Drive, McLean, Virginia.

Q. And you are the president of Commonwealth Consulting Group Incorporated?

A. Yes.

Q. And you've been retained by the Commission to provide testimony in this proceeding?

A. Yes.

Q. Pursuant to that effort, did you have cause to prepare exhibits and prepared testimony?

A. Yes.

Q. Is Exhibit T-700 your prepared testimony?

A. Yes.

Q. Do you have any corrections to make to that document?

A. Yes, just a few. On page 19, line 5, the 12 percent figure there should be 13 percent.

JUDGE HAENLE: Sorry, page?

THE WITNESS: 19.

JUDGE HAENLE: Line?

THE WITNESS: 5. The 12 percent figure

should be 13 percent.

A. Page 21, line 10, the word drought seems to

be draft here. Thinking about beer instead of water. So it should be spelled right.

Page 39, line 6, the "of" in that line should be deleted and on line 5 of the same page the word "of" should be added after the last word "risk." Page 39, line 5 it should read starting with line 5 "parameters must be adjusted to reflect the risk of its -- and then scratch the word "of" purchased power. On the same page line 23 the very first word "A" should be just deleted.

On page 40, line 2, the word "be" should be deleted.

On page 43, line 14 --

COMMISSIONER CASAD: Page 40, line 2?

THE WITNESS: Just delete the word "be."

COMMISSIONER CASAD: You don't care about grammar. The debt -- I was looking at someplace else. Page 40?

THE WITNESS: Yes, the word "be" should be deleted.

CHAIRMAN NELSON: It's line 1.

A. Page 43, line 14, there's the second "is" in there should be "are."

And page 44 the top line the word "portion" should be put in after the word "capacity." And in

the next line the words "portion of" should be deleted.

That's all I have.

Q. If I asked you the questions that appear in Exhibit T-700, would you give the answers that appear there?

A. Yes.

Q. In the course of that testimony you refer to Exhibits 701, 702 and 703; is that correct?

A. Yes.

Q. Were those prepared by you or under your direction?

A. Yes.

Q. Are they true and correct?

A. Yes.

MR. TROTTER: Move for admission of Exhibits T-700 and Exhibits 701, 702 and 703.

MR. MARSHALL: No objection.

MR. ADAMS: No objection.

MR. TRINCHERO: No objection.

MR. FURUTA: No objection.

JUDGE HAENLE: Exhibits T-700, 701, 702 and 703 will be entered into the record.

(Admitted Exhibits T-700, 701, 702, 703.)

MR. TROTTER: Witness is available for

cross-examination.

CROSS-EXAMINATION

BY MR. MARSHALL:

Q. Good afternoon, Dr. Lurito.
A. Good afternoon.
Q. Do you prefer Doctor or Mr.?
A. Either is fine.
Q. You're under contract, as I understand it, to testify for the staff in this proceeding?
A. Yes, sir.
Q. Do you have a copy of that contract?
A. I don't. I think staff probably does. I don't have them with me, that's for sure.
Q. What hourly rate are you charging?
A. I think it's about $175 but I may be wrong about that.
Q. In his testimony Mr. Elgin has proposed to deny Puget the cost of using Dr. Charles Olson as an outside expert in this case on cost of money issues. Do you know Dr. Olson?
A. I do.
Q. Is Dr. Olson generally regarded as a well-qualified expert in the same field as yours?

A. Yes.
Q. Has he testified as an expert in rate cases

in the same subject area that you're testifying?
A. Yes.
Q. Your Exhibit No. 1 to your testimony lists the cases that you've testified in, including the ones you've testified in in Washington state rate cases?
A. Yes, that's true.
Q. And about how many Washington state rate cases have you testified in?
A. I really don't know. Perhaps you've got. I will accept your estimate.
Q. Will you accept 17?
A. Yes.
Q. Going back to about 1980?
A. Yes.
Q. And then going forward?
A. Yes, sir.
Q. And, in fact, except for testifying on behalf of Western Union, haven't all of the occasions on this exhibit that you've listed here been against a regulated entity?
A. Well, I don't like to think about it as for and against. I like to think about it as an independent view of what ought to happen.

Q. You've been retained to testify in a proceeding where the other side was representing the

regulated utility?

A. That's true.

Q. You're president, as I understand it, of the Commonwealth Consulting Group?

A. Yes, sir.

Q. And the contract is actually with Commonwealth Consulting Group?

A. I think that's right.

Q. And before it was called Commonwealth Consulting Group it was called Kosh Louisell Lurito and Associates?

A. Yes.

Q. And you were, of course, with Kosh Louisell Lurito and Associates?

A. I was, yes.

Q. And before you began testifying for staff, was David Kosh testifying for staff here in Washington state?

A. Yes, sir.

Q. About how many years back did that go?

A. Gosh, I don't know. Probably into the 60's, I'm sure.

Q. It may have been as early as the 50's?

A. Might have been.
Q. And so for the firm that you're now with

and the the predecessor firm it could have been much more than the 17 times that I mentioned that your firm had been retained to testify?
A. Sure.
Q. And I take it you just haven't added it up anywhere?
A. No idea. I don't know.
JUDGE HAENLE: Can you concentrate, Dr. Lurito, on speaking loudly and slowly to be sure we get the entire statement onto the record.
Q. Do you remember the time in the 1970's when one of the telephone companies appealed a case based on the contract that Mr. Kosh testified for the staff? Does that ring any bells?
A. It really doesn't ring any bells.
Q. Do you have a recollection when the state hired Dr. Olson to help assist Mr. Kosh in a rate case with a telephone company?
A. I don't recall that.
Q. Mr. Elgin has indicated that Puget should have on its staff a person with the expertise equivalent to yours or Dr. Olson's and that Puget should not use outside experts. Did you understand

that?

A. Really, I didn't. I didn't read that.

MR. TROTTER: We're going to object to this line of questioning as beyond the scope of this witness' testimony.

JUDGE HAENLE: Mr. Marshall?

MR. MARSHALL: I believe this is relevant. I don't believe it's beyond the scope. This witness has been retained by the state. I think we're fairly entitled to inquire.

MR. TROTTER: About what?

JUDGE HAENLE: The issue is relevance. If you feel it's relevant, tell me why.

MR. MARSHALL: I believe it's relevant to the purpose of the case, Dr. Olson, in response to what the state has done retaining this witness here.

JUDGE HAENLE: How do the two tie up?

MR. MARSHALL: The two tie up in the recommendation made by staff that of course it's fine to have Dr. Lurito testify on behalf of staff but that the company ought to retain its own expert. I would like to have a follow-up question to find out how much that would cost to retain a fellow of this qualification on Puget staff.

JUDGE HAENLE: Mr. Trotter?

MR. TROTTER: It's beyond the scope of this witness' testimony.

JUDGE HAENLE: Overrule the objection and allow the question.

Q. If Puget were to hire someone on its staff with your background and qualifications and so forth, how much would Puget be required to pay that person?

A. I really don't know. That's a good question. I don't know the answer to it.

Q. If you took your annual income and added your overhead, your office space and so forth, what approximately would that be?

A. I don't know. Because the reason why I'm saying that is because I'm sure that Puget has certain guidelines, management guidelines, with respect to salary structures and typically what happens is that consultants work on a higher hourly rate but it's very difficult to annualize that, if you see my point. Because you're not going to be billing all 2,080 hours of a work year. It would depend on what the consultant wanted to do, whatever security he wanted, whatever fringe benefits he wanted, plus there is the problem of perhaps not fitting in, so to speak, with the salary structure as the the utility has it. So I really don't know the answer to your question. I'm sure it's not a small amount of money but I don't know how much it would be.

Q. In your opinion do you think it would make sense for Puget to have Dr. Olson or another similar expert on staff year round?

MR. TROTTER: Objection.

JUDGE HAENLE: I think that's a bit beyond the scope. You've been asking how much it's going to cost. I am assume you can use that to argue whatever you're going to argue on the brief but that's going beyond the scope.

Q. In your opinion doesn't it make more sense to have a person who will have specialized expertise to come in on an as-needed basis instead of being on staff the year round?

MR. TROTTER: Same question as before stated differently.

JUDGE HAENLE: I agree.

Q. As a matter of general principle, do you believe the company should have an equal opportunity to present its case with witnesses and experts as staff or other parties?

MR. TROTTER: Object again as beyond the scope of this witness' testimony.

JUDGE HAENLE: On what basis would this

witness be able to answer that, Mr. Marshall?

MR. MARSHALL: Again I think we're dealing

with a basic fairness principle.

JUDGE HAENLE: That could be but I think you need to argue that on your brief not get that from this witness.

MR. TROTTER: Not held this witness out as a policy expert on the hiring practices.

MR. MARSHALL: In respect to cost of money experts there are only a few around the country that has this sort of background. I have one now before me.

JUDGE HAENLE: You have a witness and you've gotten his testimony about how much he costs. You can use that information on brief to argue whatever you feel. I don't feel this witness is qualified to answer the other questions that you have so let's go on, please.

Q. Do you routinely testify as an expert in accident cases for attorneys for the plaintiff?

A. Yes, I testify in economic loss cases, that's true.

Q. And you've given literally hundreds of depositions in those cases over the years?

A. I would think, sure.

Q. And in those cases do you testify on

present value discount rates?

A. Yes.

Q. And those assume what the rate of inflation might be in the future in part by addressing the issue of interest rates?

A. The discount rate that I use would embody my view, among other things, of long term inflation rates, yes.

Q. In this case you've testified in favor of a lower rate of return and a lower percentage of equity in the capital structure than Dr. Olson; is that correct?

A. Yes.

Q. Can you tell me what impact your recommendations would have on the rate of return and capital structure in terms of dollars of Puget's rate request?

A. Well, I think Mr. Elgin testified -- if I heard incorrectly I apologize -- I think he said something about the difference between the company's case and the staff's case with respect to rate of return was in the area of $35 million. I believe that's what he said.

Q. He indicated you would have the background and knowledge to testify to that. Is that number

correct, 35.7 million?
A. I didn't check it. If you want me to I

could make the computations and tell you at break or something.
Q. You haven't done that computation?
A. No, I didn't do that.
Q. What is Puget's stock price now approximately?
A. Around $28 a share.
Q. And Puget market-to-book ratio is about 1.431, approximately?
A. Based on the first quarter of book value per share or year end book value per share?
Q. First quarter.
A. If you give me that figure I can tell you. I don't have the book value per share for the first quarter.
Q. For the moment will you accept that subject to check?
A. Yes.
Q. And the average for the industry market-to-book ratio is approximately what to date?
A. I would say it's around that area.
Q. Would you say 1.5 or 1.61?
A. I haven't done every single company but I

think it's in that area. 1.5 would seem in line with what it is.

MR. TROTTER: Clarification on what the industry is?

MR. MARSHALL: Utility industry.

Q. Is that what you understood I was referring to?

A. I think that's reasonable, yes.

Q. At page 10 of your RJL-3, Exhibit No. 703, you have said that your ratio, the ratio your recommended rate of return, rate of return on equity would produce would be, what, 1.01 to one?

A. A market-to-book rate of 1.07, yes.

Q. What would happen to Puget's stock price if your recommended rate of return for equity is adopted and that results in a market-to-book ratio of 1.07 to one?

A. Well, Puget's stock price would fall.

Q. How far would it fall? What price would it fall?

A. If you give me the book value per share at the end of the first quarter I could tell you.

Q. Did you look that up?

A. I have it at year-end and that's fine with me. I can use that. It's going to be very close.

Q. Why don't you take the year-end book value?
A. Sure.

JUDGE HAENLE: If that calculation is going to take a few minutes perhaps this would be a good time to take our afternoon break. Why don't we take 15 minutes, be back at five minutes after, please.

(Recess.)

JUDGE HAENLE: Let's be back on the record after our afternoon recess. While we were off the record I asked the witness if there were one additional correction to his prefiled testimony at the bottom of page 29, in line 23. Did you have that, sir?

THE WITNESS: Yes, I do. The 11 percent figure should be 10.8 percent and thank you for noticing.

JUDGE HAENLE: Go ahead, Mr. Marshall.

Q. Dr. Lurito, have you come up with that calculation?
A. Yes. At year end 1992 Puget's book value per share was $17.76. At 1.07 market-to-book ratio the market price would be about $19. And that would imply a decrease from its current levels of around 28, which by the way is also consistent with Dr. Olson's testimony in that same manner. So he and I agree

about that.

Q. That drop would be about what did you say

it would be from the current price, last close to what?

A. It would be about a 30 percent decline if my arithmetic is correct.

Q. It would be from approximately $27 a share to $19 a share?

A. From about $28 a share. I believe it closed yesterday at 28. So if you take that as the starting point then it would be around a 30 percent drop down to around 19.

Q. Do you consider dividends declared to be cost-free capital?

A. Dividends declared?

Q. Right. When a company declares dividends and before it actually cuts the checks, sends them out the door, are dividends declared in your view appropriate to be considered as cost-free capital?

A. See, I would have to know the context. Are you talking about in the context of some kind of a working capital study? What context might you have in mind? It really depends.

Q. Do you think it's appropriate to discontinue to pay rate of return on equity for dividends declared before they're actually paid out to shareholders?

A. Boy. I really don't know how to answer that. I truly don't know how to answer the question.

JUDGE HAENLE: Answer it slowly.

A. I don't know the context in which the question is being asked.

Q. You mean you would have to have -- you can't answer it as a general principle?

A. No, I can't answer it as a general principle.

Q. Turn to page 15, lines 23 to 25. There you note that the logic of the DCF method in general or the rationale for the form that you used is set forth in one of your exhibits?

A. Yes, sir.

Q. And if you turn to -- which exhibit is that? That's Exhibit 2?

A. Yes.

Q. Would you turn to page 12 Roman numeral III.

MR. TROTTER: This is in Exhibit 702.

MR. MARSHALL: Yes.

Q. Would you agree that you discuss the issue of discrete and continuous compounding models for the

dividend and conclude that the appropriate dividend
yield to use is the DO over PO?

A. Yes.

Q. And without going into the math, you use that approach because you believe that the investors benefit from compounding that takes place during the year, don't you?

A. Yes, because when the Commission sets a rate of return the company begins to earn that rate continuously at a daily rate until it pays its dividend and then it drops down and then its earnings build up again, pays its dividend, the retained earnings drop down, et cetera. That is the real world in how it works. It's different than the DCF model calculates per force because investors are viewing this world differently than the rate at which the company earns.

Q. They are benefitting from the compounding then? That's factored in?

A. The company benefits from the compounding, yes.

Q. And you explain at page 6 that what a good example of that is going on. A 10 percent interest compounded daily is really a 10.51 percent in interest; isn't that correct?

A. Right.
Q. And you admit at page small 8 that the

dividend yield you use for Puget perhaps understates the equity capitalization rate?
A. Yes, it does from the point of view of the forward looking dividend concept, yes.
Q. Let me ask you a hypothetical related to this. Suppose that a recommendation is made that would take away some of the benefits of daily compounding that you suggest. In other words, if part of this case says let's make a rate case adjustment to remove some of the compounding. Should the Commission then alter the calculation of your DCF or disallow the rate making adjustment?
A. If there were an adjustment proposed which would change the way the company would earn, then it would have to do one of those two things.
Q. And have you discussed this with staff, the proposal to remove any of the ability to compound after dividends are declared?
A. I don't know the adjustment you're referring to. I haven't studied it.
Q. You haven't recommended that adjustment, I take it, because you don't know anything about it?
A. Excuse me, that's right. I know nothing of

it.

Q. Now, going back to the calculation that you

made about Puget's stock, you say that at the close of trading yesterday it was $28 a share and that your recommendation would drop the stock to a market-to-book ratio of 1.07 which would produce $19 a share for a $9 a share difference. $9 would be dropped, stock would drop in price by $9 a share?

A. Yes. As I say that is consistent with Dr. Olson's testimony and my testimony.

Q. That is, as you've testified, a 30 percent drop?

A. Yes.

Q. Is that drop, dropping the stock that far that fast, desirable?

A. Well, the question is first, is it reasonable to recommend a return on equity sufficient to produce a market-to-book ratio of between 1.05 and 1.10. The answer to the first part of the question is yes, I think it's reasonable. The second part of the question has to do with the timing, that is how fast this might happen in the market. And that I don't believe would be an instantaneous reaction. That is what would happen if the cost of equity maintained itself at the level I believe is appropriate and if the company earned the return on equity I'm recommending over some period of time it would happen.

Now, I can't tell you it would happen in a month or three months but it would happen.

Q. Let me ask you this. A 30 percent drop in Puget's stock price over a three-month period would be undesirable, wouldn't it?

MR. TROTTER: Going to object to this question. He's impeaching his own witness. His own witness testified that based on the company's recommended return.

MR. MARSHALL: Your Honor, I object to the speaking objection here. I believe the question format is fine. I am not impeaching anybody's witness. I am asking this witness what his result would produce.

JUDGE HAENLE: I would like to hear Mr. Trotter's objection.

MR. TROTTER: He's asking whether it's desirable and the company itself is proposing it. So either it's not cross or it's impeaching his own witness.

JUDGE HAENLE: Mr. Marshall.

MR. MARSHALL: The company is not proposing this type of drop, not by any means.

MR. TROTTER: That's what Dr. Olson -- I will find it in the transcript.

JUDGE HAENLE: I will allow the question. Go ahead, sir.

A. The answer is that yes, it should be done. I don't know the rate at which this would occur but it is not undesirable because it is time that ratepayers in this jurisdiction get for themselves the benefits that they have been paying for under the regulatory treatment that this Commission has been allowing this company. This is called the regulatory bargain. In other words, consumers get something, investors get something. That's how regulation should work. There is no magic to maintaining a 1.4 market-to-book ratio. The point is that because the company has not been in for a rate change recently and because capital costs have fallen market-to-book ratios have risen to inappropriately high levels. There's nothing wrong with bringing market price in line with regulatory reality. Your witness says we should, I say we should, and I don't think there's any dispute about this on the record. So my answer is yes it should be done because how else can ratepayers get the benefits of what they're already paying for? And Mr. Elgin spoke very eloquently to this this afternoon and this morning about the costs of PRAM and the fact that rates are going to be going up and consumers are going

to be paying for this regulatory bargain. They have to share it. It's not a one-way street.

Q. Are you finished with your answer?

A. Yes.

Q. What is the total capital value of Puget stock at today's market price?

A. Do you mean if I multiply the market price by the number of shares outstanding?

Q. Correct.

A. I know you haven't sold that proposed number of shares. So year end 1992 the company had outstanding 58,575,000 shares at $28 a share it would be about $1.6 billion.

Q. And if under your proposal Puget stock dropped to $19 a share, as you've indicated, 30 percent decline, how many million dollars of capital value would be wiped out, approximately?

A. About $492 million.

Q. $492 million?

A. Yes.

Q. Half a billion dollars of value?

A. Right.

Q. Do you know if Puget's market-to-book value drops to 1.07 to 1.0 and that the industry average for electric utilities remains at 1.6 to 1.0 how far below

the industry average this would put Puget in percentage terms, have you done that calculation?

A. I think it speaks for itself. That's not what's going to happen. But if you're asking me to do as a matter of arithmetic, if the average is 1.06?

Q. 1.6.

A. Then it would be around 50 percent.

Q. And isn't it true that investors in other utilities see Puget Power as being in the middle of a regulatory experiment designed to encourage conservation by decoupling revenues from electric sales? What you have indicated Mr. Elgin spoke about today?

A. Well, what we have here, I think, is an attempt to have very, very rational regulation. What we have here is I was talking about the regulatory bargain, if we want to have an integrated resource planning program, then it's incumbent upon us to institute a mechanism which severs the link between kilowatt hour sales and profits. Unless we can do that we're not going to go anywhere with the program. If this Commission and the company and everyone is committed to that program, then we must decouple, and

PRAM has gone even further than that to stabilize the company's earnings which is a way of reducing risk.

When you reduce the risk the ratepayers who are now having to pay for stability in earnings need to get their side of that bargain, which is an appropriate cost of capital, a lower market-to-book ratio and an appropriate capital structure. That's the other side of the coin.

Q. So you're tying this change in the market-to-book value to this regulatory bargain involving decoupling. In in your mind it's linked and in investor's mind it may also be linked. True?

A. Rather put it this way. As you know I consistently testified certainly in recent years to a market-to-book ratio in the 1.05 area to 1.0 area. That's been my testimony for quite a while. What I'm saying is in response to the issue of the drop in the market price that would be attendant upon that return on equity and that market-to-book ratio, I am saying to you that it is simply -- it can be viewed simply as the other side of a regulatory bargain which this Commission has struck in instituting demand-side management decoupling and PRAM.

Q. And so isn't it likely that many investors would tie the PRAM decoupling experiment to a huge drop in the capital value, drop of half a billion. They would tie that in their minds, isn't that fair to

say?

A. I don't know if they would tie that in their minds. What I would say they are doing right now is, they are -- the market price of Puget stock in my opinion reflects the expectation that PRAM or a PRAM-like mechanism and decoupling will be maintained. I believe that.

Q. And if they find that their stock value this time next year is 30 percent less and half a billion dollars of market value has been wiped out won't they in their minds tie that to the PRAM decoupling experiment? Isn't that fair to say that many of them would?

A. Well, I can't speak for what might be in their minds but that would not be a rational conclusion because rates of return on equity that are being allowed are falling all over the country as interest rates have fallen. So that it would not be surprising if we see now in the next three or four years, assuming capital markets stay reasonably constant, that market-to-book ratios of the great majority of utilities will be fallen into the area that I am indicating.

Q. Isn't it possible that if Puget stock drops so far to $19 a share that investors could overreact

and drive the stock price down even further?

A. No, I would not suspect that that would be the case. We saw what happened -- I think it was described this morning -- that the market price dropped and then came back. So that -- I'm talking about as an example Washington Natural Gas, we were talking about it this morning. The stock price fell after the staff's rate case and then went back about halfway to where it was.

Q. You were talking about that this morning?

A. Yes, I'm sorry.

Q. I don't believe was --

A. It was at a hearing. What I am saying here is that if Puget stock falls I wouldn't expect it to go below the $19. It may stay for a while until investors see this is going to be a long term determination as to what allowed return on equity will be.

Q. If Puget's stock drops from $28 a share to 19 as you say that it will if your recommendations are adopted, then the stock is at $19 a share, let's assume interest rates begin to go up after that. What would happen to Puget stock if interest rates start to go up after your recommendations have been accepted and $19 a share results?

A. It depends of course on how much they go up. I've already allowed in my return on equity an interest rate experience typical of what we've seen on average over the last year and those rates are higher than what we see now. Tried to build in a cushion for Puget should interest rates rise. I've already built that in but as you know I focused on a 12-month dividend yield, not a spot dividend yield because Puget's spot dividend yield, as you know, is 6.57 percent and the dividend yield that I relied on is 6.76 percent. So I've already allowed for about a quarter of a point change there in any case.

Q. If interest rates went up just one percent, that would drive Puget stock down even lower below $19 a share. Is that fair to say if your recommendations are adopted?

A. If interest rates go back to levels higher than they have been over the last year then I would expect that to be the case, the market price, at least in theory would fall below $19, yes.

Q. Have you reviewed Mr. Elgin's testimony in this matter?

A. Read it quickly, yes.

Q. Mr. Elgin testified at page 26 lines 1 to 3 that investors abhor uncertainty and that investors

need assurances of stability from the Commission on the PRAM decoupling experiment. Do you agree?

A. I agree that it's important to maintain a regulatory course. You can always have some deviations in that course meaning by that you may want to change the mechanism somewhat or what have you but fundamentally I agree that you reduce uncertainty by staying the course, and I think I recommended that in my testimony that the PRAM mechanism largely be maintained, that decoupling largely be maintained.

Q. If as a result of this proceeding your recommendations are adopted, Puget stock drops 30 percent, the market value, total market value goes down by $492 million, do you think that that would create investor uncertainty and would tend to increase fear in the investment community about what would further happen?

A. No, I don't, because I think that rational investors are expecting allowed returns on equity to fall because interest rates are falling. Look, the reason why the company's stock is trading at 1.5 or thereabouts, market-to-book of 1.5, is precisely because there's a large gap between the investors' required rate of return and the return on equity the company has earned and that investors expect the

company to earn. They're already inviting us because they're telling us that their cost of capital is not anywhere near 12 or 13 percent.

Q. You agree, don't you, that capital is movable in publicly traded stocks?

A. Capital is movable, of course.

Q. Do you agree that investors will flee with their capital if they perceive a significant increase in risk?

A. This is not an increase in risk. This is a recognition of reality. Where we are now is in an unrealistic situation. We are in a situation where a utility is earning at a level sufficient to produce a 1.5, thereabouts, market-to-book ratio. That's what's unreal.

Q. That's slightly below the industry average for electric utilities, correct?

A. Yeah, but the industry average itself is going to be changing as the reality of lower costs of equity begin being reflected in lower allowed returns and in turn lower market prices.

Q. And you've already testified your recommendation will result in Puget being 50 percent

below industry average on market-to-book value?
A. Yes. As I say, myself and your own

witness. Your witness and myself are saying the same things. No difference here whatsoever.
Q. In order to get to your lower market-to-book ratio of 1.07 to 1.0 do you propose a rate of return on equity on the stock of 10.8 percent?
A. Correct.
Q. The state of California sets the rate of return on equity for utilities every year?
A. That's my understanding.
Q. Last December what rate of return equity did they set for their largest utilities?
A. I don't know.
Q. Subject to check wasn't it around 11.7, 11.8 percent?
A. That analysis could have been based upon -- I don't know how long it takes to do these rate cases or to set that rate of return is another way of putting it, and what I'm saying is they could be working on data that's anywhere from 12 to 18 months old, so that that wouldn't surprise me for that period of time.
Q. Would your 100 basis points, one full percentage point, be below the rate of return allowed

last December in the state of California?

A. Okay.

Q. What's been the average rate of return for electric utilities on equity allowed in the past year? Do you have those numbers?

A. No.

Q. Has any state set a rate of return for any major utility last year as low as the 10.8 percent you're recommending here?

A. I don't know.

Q. Let's turn to capital structure. With regard to capital structure you testified that a capital structure of 41 percent equity is all that is needed to maintain an A rating for Puget bonds; is that correct?

A. That is correct.

Q. And who determines what rating a utility will receive for its bonds?

A. Various rating agencies.

Q. And it's fair to say that utilities are very capital-intensive businesses?

A. Relative to a typical business, yes.

Q. And therefore their need to borrow and finance their infrastructure is higher than most industries, correct?

A. They do a lot of investing, sure.
Q. Are utilities, electric utilities, gas

utilities, the most capital-intensive industries in the United States?
A. I don't think so.
Q. Are they more capital intensive than the automobile industry or the steel industry?
A. I don't know. I don't know if they are or not.
Q. The state of Washington like Puget Power issues bonds for a number of large capital projects, correct?
A. Sure.
Q. And those state bonds are given a rating set by a rating agency?
A. Yes.
Q. And the state can't order an agency to give a rating of a certain level, they don't have any control over the rating agencies?
A. That's right.
Q. The rating agencies are independent of any influence by the state? Not only not under their control but you can't pay them some money or do anything to influence their decisions, can you?
A. I wouldn't think so.

Q. The rating agencies are also completely independent of what Puget might want them to do or to

tell them to do, correct?

A. No, I don't think so.

Q. Does Puget direct or control what the rating agencies do?

A. No, but they can inform and they can have meetings which they do on a regular basis.

Q. And the state does --

A. Let me finish. The point is that it's not a matter of Puget being in a position to effect the ultimate decision they might make. The issue is what facts are put before the analysts at these agencies and whether that information is sufficient for them to make an informed judgment. That's the issue.

Q. And that's no different than what the state of Washington does, correct?

A. No. I would think so. I would think that the state of Washington would at least try to do a similar thing, I hope.

Q. That's what I mean. State of Washington tries to inform rating agencies and Puget Power tries to inform rating agencies?

A. Yes. But there's a big difference here. State of Washington is different than a public utility. Very different. What I am saying is that Puget is in a unique position because it has unique

regulatory treatment to inform regulatory -- excuse me -- rating agencies about the regulatory treatment to which it's subject. It's not always well understood by these analysts and I think it's clear in this case Puget isn't.

Q. Have you spoken directly to any rating agency analyst about this case?

A. I read the testimony of Mr. Abrams.

Q. My question is have you spoken to any rating agency analyst in this case?

A. No, not in this case.

Q. Do you know what the bond rating is for the state of Washington?

A. I think it's double A.

Q. Are they seeking a double A plus rating now, are they in the process of trying to do that?

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

Q. Puget rating for its bonds is only an A minus, a weak A rating, correct?

A. Yes, right now. That's right.

Q. Do you know why the state of Washington tries to keep its bond rating at a double A level?

A. To minimize the cost of borrowing capital.

Q. And a double A rating of course is higher rating than an A minus rating?

A. Correct.
Q. Isn't it true that once a rating agency lowers a bond rating it can sometimes take many years to regain the higher rating?.
A. I haven't made any studies. I would think that they change the rating as often as they think appropriate. Whatever time.
Q. Do you have any history of what happened in the state of Washington bond rating here in the recent past when it got downgraded how long it took to get back up?
A. I don't know.
Q. In an A minus rating how many steps is Puget from a double A rating? At their current A minus rating what is Puget --
A. Do you consider the movement from A minus to A as one jump?
Q. I'm asking you.
A. If you consider it that way then it would be three steps away.
Q. What's the highest rating to have?
A. Triple A.
Q. How many steps is Puget away from having

what's known as a junk bond rating below investment grade rating?

A. I believe four.

Q. What sorts of things do rating agencies look at to determine what rating to give? For example, do they look at the amount of debt the company has compared to its equity?

A. Among other things, sure.

Q. Do they look at the capital structure which measures the level of debt to equity?

A. Yes.

Q. And, again, you indicated that you have read Mr. Abrams' testimony?

A. Yes.

Q. And you know he works with a rating agency?

A. Yes.

Q. Which one is that?

A. Duff & Phelps.

Q. If a rating agency professional such as Mr. Abrams testifies that Puget must have a minimum of a 45 percent equity in its capital structure in order to maintain a weak A rating and you say 41 percent will be enough for the rating agencies, who should the Commission believe?

A. Me.

Q. In the California case that was just concluded you talked about earlier, the utilities

Commission there just set the capital structure last November, December at the same time they set their equity -- rate of return on equity, what do the three largest utilities there have as their equity component of the capital structure?

A. Haven't looked at it. The answer that you're going to give me, does it include short term debt?

Q. I'm not going to give you the answer, I just wondered if you knew what it was. Do you know what the amount is in California?

A. No. I think that question had to do with the capital structure, the equity ratio. I don't know what they have now.

Q. Do you have access to any of the various surveys that report the allowed equity component of the capital structure of utilities in the United States?

A. That's sometimes reported in the public utility reports, yes.

Q. Do you have anything that compiles the most recent compilation of what the capital structure is for various utilities across the United States?

A. No. I would look at them as a matter of analysis. I don't have anything in my possession in

that regard.

Q. Have you tried to compare what the capital structure is of various utilities across the United States with their bond rating?

A. The last time I did this -- I've not done it in this case -- there's a slight correlation between the equity ratio, positive correlation between the equity ratio and the bond rating.

Q. Have you looked at Dr. Legler's testimony in this case?

A. I have.

Q. And he does analyze the various bond ratings compared to the percent of equity capital structure of various utilities?

A. If we're referring to the same exhibit I believe he relied on Value Line data in that compilation and that Value Line does not include short term debt. Consequently, it would be very important if you used his exhibits as a guideline to recall or to know that short term debt is not reflected in those equity ratios.

Q. Have you created a similar exhibit for your testimony either with or without short term debt?

A. For my companies, yes, but not -- I believe he did it for all A rated utilities, as I recall.

Q. So you haven't done a comparable just for a short list of companies?

A. No.

Q. Turning now to the purchased power issue. You have read the testimony of Mr. Abrams on the purchased power issue?

A. Yes.

Q. Do you agree that Puget Power has a higher percentage of its power as purchased power than any other utility in the United States?

A. That would seem right, yes.

Q. Do you know what that percentage is?

A. Yes, I have an exhibit, in one of my pages, on page 53 of my testimony I show that in 1992 64.7 percent of Puget's total energy output was accounted for by purchased power.

Q. What's the next highest utility in the United States?

A. I don't know. I don't know what the number is.

Q. Do you know what the average percent of purchased power is for electric utilities in the United States?

A. As I recall it's somewhere in the 10 to 15 percent area.

Q. But Puget is above 60 and the average is around 10?
A. 10, 15, in that area.
Q. Purchased power contracts are typically long term contracts, correct?
A. Typically, yes.
Q. And some of Puget's contracts for purchased power are for 50 years; is that right?
A. Some of the take or pay contracts, is that what you're talking about?
Q. Yes, you understand that?
A. Yes.
Q. And a lot can happen in that period of time, isn't that fair to say?
A. Sure.
Q. For example, do you follow the regional developments of the Endangered Species Act?
A. It's not nighttime reading, no.
Q. Kind of nightmare reading that some of us have. You wouldn't therefore know what sort of risks are inherent in that act in the application of that act to some of the mid Columbia dams from which Puget Power purchases its hydro power?

A. No, but let me say this, that I'm sure that
it's reading for Puget's management or at least it

should be. And if they've made a decision to enter
into these contracts and to maintain these contracts
as part of what they consider to be a least cost
planning process then I would think that they've
assessed the relative risks and have found that the
program they're pursuing is the most rational.
Q. Dr. Lurito, are you aware that those
contracts were entered into in the 1960's?
A. Yes, of course. What I'm saying to you is
that Puget is and has pursued a purchased power
program. It's part of their resource planning
program, not only take or pay, which a lot of those
contracts would be, but take and pay contracts. What
I am saying is that Puget has made a determination, I
assume, that this is a rational program and it's a
least cost program. So whatever the risks of the
trout or the salmon or whatever it is we're trying to
protect, I assume that Puget has assessed that against
building nuclear plants or some other program and
found it to be the most rational viable alternative.
Q. Do you know where those projects are
located from which Puget purchases its hydroelectric
power?

A. On the Columbia River, sure.

Q. Do you know when those contracts were

entered into?

A. Some of them in the 50's and in the 60's.

Q. Did Puget have a least cost plan at that time?

A. I would hope so.

Q. If there's uncertainty regarding whether a Commission had approved its purchased power contract, is there risk?

A. There is risk in anything management might do, whatever decision might be made. Prudence is always an aspect of regulation be it a purchased power contract or a construction project, what have you. It's sort of a constant in the regulatory equation. Always there.

Q. Purchased power contracts are not what you would therefore call risk-free contracts, are they?

A. They're not, that's correct.

Q. Are you familiar with a legislation that Puget helped bring before the Washington state legislature regarding conservation bond financing?

A. There was mention of that this morning. I was not aware of that before that particular point in time.

Q. Do you understand generally because of your review of Puget's financing that Puget has nearly 200

million of conservation resources on its books in the form of regulatory promises to pay for conservation measures installed in customers' homes and businesses?

A. Yes, that's right.

Q. And you also understand because Puget doesn't own those conservation measures because there are things that are installed in customers' homes that they can't borrow on their first mortgage, they can't mortgage those assets, correct?

A. They can't serve as collateral for a mortgage issue if that's what you're asking.

Q. In your opinion, if that 200 million of conservation could be used to back bonds triple A rating, would that result in less expensive cost of money for Puget compared to financing conservation with some other higher risk form of financing, such as unsecured financing?

A. Well, if I understand the question, it answers itself.

Q. Right.

A. So the answer has got to be yes.

Q. Do you know how much potential that has to save ratepayers if they're able to get financing at a triple A rating by using conservation bonds on the $200 million that it has?

A. Relative to an A rated bond?
Q. Relative to an unsecured type of an issue.
A. Like a medium term note or some such?
Q. Sure.
A. I haven't made that computation.
Q. Could that well be very substantial?
A. It could be a couple of percentage points, sure.
Q. And that would result in millions of dollars of savings to customers?
A. Over some period of time, I'm sure.
MR. MARSHALL: I have no further questions.
JUDGE HAENLE: Have you questions, Mr. Trinchero?
MR. TRINCHERO: Yes, just a few.

CROSS-EXAMINATION

BY MR. TRINCHERO:
Q. Good afternoon, Dr. Lurito.
A. Good afternoon.
Q. Beginning on page 17 of your testimony in Exhibit T-700, you discuss dividend growth rates and in part your estimate of the cost of common equity for

Puget is based upon your estimate of prospective dividend per share growth rates; is that correct?

A. Yes, sir.

Q. And in developing your growth rate estimate you looked at the annual growth rate for Puget and six comparable utilities in the categories of dividends per share and booked value per share; is that right?

A. Among other things that's true.

Q. And the time period you selected was between 1983 and 1992 with special emphasis on the years 1987 through 1992; is that correct?

A. Yes, sir.

Q. And on page 19, line 6 of your testimony, you estimate a 3.5 percent dividend growth expectation for Puget; is that correct?

A. Yes.

Q. And in your opinion, the six comparable electric utilities which you analyze would also show an estimated growth rate or estimated growth rates ranging between 2.5 percent and 5.25 percent; is that correct?

A. Yes, that's true.

Q. In performing this exercise, would it be fair to say that you tried to put yourself in the place of an investor and tried to gauge investor expectations?

A. Yes, that's correct. What we tried to do

is to put yourself in the place of a rational investor, looking at the data that is before -- could be before him, and then asking yourself from an analytical point of view what is a reasonable expectation.

Q. And isn't it true that there are selected groups of analysts which are -- who are surveyed in order to produce consensus growth rate forecasts similar to those that you have developed?

A. Yes. There is the IBES and Sac's investment service both of which I believe publish what they call consensus five year earnings per share growth estimates.

Q. And how would you characterize the estimates published in Value Line?

A. They're not consensus because obviously it's the opinion of whoever is analyzing that particular company. It's not a consensus but rather it's the opinion of a person.

Q. Did you analyze any of these forecasts in developing your growth rate estimates?

A. Yes. I looked at some of the numbers that were done by IBES and the Value Line numbers. My numbers are somewhat higher than the IBES forecasts and about in line with the Value Line forecasts.

Q. You stated that your numbers are about in line with the Value Line forecasts. Is that on annual rates for dividends?

A. It's on their projection of the dividend growth.

Q. Is that for a long term projection between 1989-91 and '96-'98?

A. Right, it's their five-year projection.

Q. Would you accept subject to check that for Atlantic Energy you have forecast a 3.5 percent growth rate for dividends and Value Line has forecast a 1.5?

A. For dividends, sure, I will accept that.

Q. And IBES has forecasted a median estimate of 1.75 percent?

A. Yes, I will accept that.

Q. And for Boston Edison you have estimated a 4 percent growth rate and Value Line has estimated a 3.5 percent and IBES has forecast a 2.3 percent growth rate?

A. Yes.

Q. And continuing subject to check for Central Maine Power your estimated growth rate is 3.25 percent; Value Line is 3 percent; and IBES is 1.92

percent. For DQE you have an estimate of 5.25; Value Line has an estimate of 4.5; and IBES has an estimate

of 2.85 percent?

A. All right.

Q. These are all of course subject to check. For Idaho Power you have estimated a 2.5 percent growth rate; Value Line has estimated a 1 percent growth rate; and IBES has estimated a 2.1 percent growth rate. And for Kansas City Power & Light you have a 3.75 percent growth rate; Value Line has a 3.5 percent growth rate; and IBES has a 1.75 percent growth rate; is that correct?

A. Yes, sir, I will accept that.

Q. And would you also accept subject to check that the IBES estimate for the year ending 12-94 for Puget Power is 2.25 percent?

A. I'm a little confused about that. IBES makes a five-year earnings per share growth projection. Now is the 2.25 you're giving me is the most recent IBES forecast?

Q. Yes, as of 5-28-93.

A. Okay, I will accept that.

Q. Thank you very much.

MR. TRINCHERO: I have no further questions.

JUDGE HAENLE: Have you questions, Mr. Furuta?

MR. FURUTA: No, I don't.

JUDGE HAENLE: Mr. Adams.

CROSS-EXAMINATION

BY MR. ADAMS:

Q. Dr. Lurito, first off, do you know what Puget's earned returns were for 1991 and 1992?

A. Yes.

Q. Will you state those?

A. Yes. These are their earned returns on average common equity. In the 1991, 13.15 percent and in 1992, 12.45 percent.

Q. And am I correct this was during a time when the authorized return was 12.8 percent?

A. That is correct.

Q. And these rates were set in the last rate case -- I can't remember, I believe you were a witness -- U-89-2688?

A. I believe I was, yes.

Q. And these returns were earned during a period of very poor hydro conditions and warm weather; is that correct?

A. Yes, especially last year.

Q. Is that primarily, in your opinion, driven by the PRAM mechanism?

A. The fact that the earnings were maintained as opposed to dramatically dropping?

Q. Yes.

A. Sure. That and decoupling.

Q. Were these earned returns for those periods above what you consider to be a reasonable rate of return?

A. They are well above the investor's required rate of return and therefore above an appropriate rate of return because they produce market-to-book ratios far higher than the company's witness Dr. Olson and myself recommend be targeted by regulation.

Q. I think there's been testimony earlier there's been -- strike that. Turning to your computation of a number for the long-term debt costs of the company. Could you indicate how far out -- I believe you took it out into the rate year or to the rate year. Could you indicate how far that went?

A. Yes. I took it out to year end 1994.

Q. Year end 1994 or '93?

A. 1994.

Q. You had referred earlier that you believe that there was a cushion built into your numbers. Was that in the debt cost or was that in the equity cost?

A. Both.

Q. Why does it exist in the debt cost first?

A. Well, because the cost rates that I have used to pro-form, for example, I pro-formed $120 million of additional long-term debt this year at a cost of about 7 and three-quarters. That is very generous given current markets.

Q. What are current markets?

A. Well, I was noting that Central Maine Power on March 1, I believe of this year, which is a utility rated a little bit lower than Puget, namely triple B plus, sold $30 million issue -- $75 million issue at 7.385 percent net cost, meaning including all expenses. So that I believe I have pro-formed a cost of debt that is conservative in the sense that it is probably higher than what would be experienced. And as far as the cost of equity side is concerned, I mentioned that I relied on the dividend yield for the 12-month period ending in March of this year and in fact that yield is higher -- it's about 30 basis points higher than Puget's current dividend yield. So that I am allowing for some slippage, if you will, in interest rates on the upside in what I am recommending the Commission allow Puget to earn.

Q. Referring you back to the Central Maine Power, that is the same company, is it not, where the

Commission ended the decoupling experiment there, I think in around December of last year?

A. Yes. I am not sure, to be honest with you, that they really have done what was indicated. What they did was to say that they were going to allow the current what they call fuel clause balances and ERAM, as they call it, balances on the books to be paid off over a two-year period of time I believe, and I may be wrong, but I believe the issue as to whether or not their ERAM, which is similar to PRAM here, is going to be abandoned is still up in the air. I don't think that they have done that, that they have abandoned it yet.

Q. Weren't a substantial amount of the deferred amounts for fuel and various other costs that were incurred under their ERAM-type program written down? In other words, the Commission disallowed a certain -- let me back up a step. Was there not a settlement that was presented to the Commission which was accepted as opposed to a contested hearing in which the Commission came out with a final order?

A. That's not my understanding. Mr. Adams, I think that was done in a prior proceeding. I believe that under the current proceeding the company is being allowed to recover its booked level of ERAM and fuel

clause balances, the uncollected portion.

Q. Am I correct you were not a witness in that proceeding?

A. That's right.

Q. There was some questioning yesterday concerning dividend yield and equity returns. Do you believe that there's any positive relationship between dividend yield and cost of equity capital among electrical companies of comparable risk?

A. No, there isn't, and to argue that is incorrect theoretically and is certainly incorrect with respect to DCF theory. That's all you have to do is look at the dividend growth rates and dividend yields that I think we discussed earlier with Mr. Trinchero to see that. In other words, the cost of equity is made up of two components, a dividend yield and a growth rate, consequently a 10 percent cost of equity can be produced with a 7 percent dividend yield and a 3 percent growth rate and the 10 percent can be produced with a 5 percent dividend yield and a 5 percent growth rate. Consequently, to get the same 10 percent cost of equity. So there is no theoretical or empirical correlation between dividend yield and cost of equity for comparable risk companies.

Q. Am I correct that you relied upon the DCF methodology in determining your recommended cost of equity?

A. Yes.

Q. Did you review by any chance the testimony of Dr. Legler in this case who was a witness yesterday? I don't recall whether you were here in the room or not.

A. I wasn't here but I did review it.

Q. Now, he presented his opinion based on several different analyses, one of which was the DCF, but also he included the risk premium approach, the cap M model approach and I believe two other things referred to as earned returns from Solomon Brothers, which was I guess a compilation of earned returns, and 1993 projected returns from Value Line. You have not used those other methods. Is there a specific reason why you have not?

A. Yes. I did not use the cap M approach or the risk premium approach because, A, they rely on beta which is a measure of risk which is now under serious theoretical question; and two, because those approaches produce very, very volatile results depending on whether short term or long term interest rates are relied on and depending upon what period of

time is chosen to determine the equity risk premium. So that in my view those approaches are either theoretically flawed or empirically very difficult to apply consistently to produce reliable results.

Q. We had a little discussion yesterday, and actually since you were a witness in the Washington Natural Gas case, concerning beta and I gather, am I correct, that you are effectively referring to I guess it was the French Fama article concerning beta when you say it's not as well -- or it's in question?

A. Yes. That article appeared in the Journal of Finance in June of last year and as I understand it has been well received by the financial community in terms of its theoretical -- the validity of that empirical approach that they took to test the validity of the beta ratio as a measure of risk. And it seems that that particular approach, the beta approach, has got its problems. Let's put it that way.

Q. You didn't address in your prior answer part of my question which related to the use of projected returns from Value Line and the earned returns from Solomon Brothers?

A. Yes. Any comparable earnings approach is only -- is appropriate provided two theoretical criteria are melt. First, that the group of companies

selected for analysis can be shown to be of comparable risk to the company in question; and second, if they are comparable risk then it must be shown that the market-to-book ratio being generated by those earned returns is something that regulation should target. And that is very crucial. So that the comparable earnings approach can be used with those two caveats and most times you find that one or both of them are violated.

Q. Did you do that exercise in this case?

A. I didn't do a comparable earnings study in this particular case. But the companies that Dr. Legler relied on for his comparable earnings approach, those Solomon Brothers companies, even if one were to accept arguendo that they're of comparable risk to Puget, they violate the market-to-book ratio proviso requirement and consequently I would reject the result.

Q. I want to jump to another area and that is the imputed debt issue which I think was specifically addressed by Mr. Abrams. You've talked generally about that in your testimony, but do you agree or disagree with Mr. Abrams in how he recognized Puget's circumstances in his analysis of Puget debt?

A. The real problem here is that the analysts

that testified in this case -- and I'm referring to Mr. Miller and Mr. Abrams here -- my problem with their testimony is that I find it schizophrenic. On the one hand they want to impute debt and interest because they're arguing that it's off books financing that ought to be recognized and the impact of that recognition on Puget's financial health parameters such as capitalization ratios, interest coverages need to be reflected and recognized.

The schizophrenia comes in because they seem to want to ignore the way those costs are recovered in this jurisdiction. We all know that risk has to do with cost recovery, not cost creation. All companies create costs as a part of doing business. The issue is how are those costs recovered, what mechanism is used to recover those costs. In this particular jurisdiction between decoupling and PRAM we have a situation where purchased power costs are recovered dollar for dollar. Accordingly you cannot apply the same risk parameters and you cannot apply the same tests of risk through a purchased power expenditure as you can to an obligation on long-term debt. Why? Because the purchased power dollar of compensation is going to be recovered under the regulatory treatment in this jurisdiction. The

interest obligation is subject to risk because earnings can fluctuate. And that's the reason why bond holders require a coverage, a multiple of coverage to insure that they're going to get their debt obligation paid. That's the crucial difference and these analysts that were presented by the company in this case seemed to forget that critical difference. So it's not important that Puget's embarked upon a purchased power program of some size. The issue is how are those costs recovered. In other words, they've created a risk, a hypothetical risk, that doesn't in fact exist.

Q. Let me ask you kind of a practical question on this. Assume for the moment that they're wrong but they make such recommendations and ratings follow their recommendations. How is this Commission to respond in that kind of environment?

A. This Commission, as I understand it, has a public service responsibility, which I know they're certainly aware of, and that is to regulate the utilities under their jurisdiction in such a manner as to balance the interests fairly of investors and ratepayers. Rating agencies should not be allowed to dictate regulation to this Commission or any Commission because that is abdicating regulatory

responsibility and especially so in cases where rating agencies want to apply a mechanistic approach, such as this purchased power adjustment procedure, willy-nilly across the board to all electric utilities regardless of the cost recovery mechanism that the utility has in place.

For example, consider Idaho Power which doesn't have trackers and doesn't have a PRAM and doesn't have decoupling. Its earnings, as you know, fluctuate very dramatically with water conditions similar to what might have or could have happened to Puget last year absent PRAM and decoupling. In that environment the purchased power program that Idaho Power may have in place is of a riskier nature than Puget's. The problem is if you apply the same financial test to the two utilities you've missed the richness of the difference in the regulatory treatment and that's what these analysts have done. They seem unaware of the difference in the regulatory treatments.

Q. Question concerning conservation. You were asked just previously here concerning conservation, and I guess I want to ask you a question. Let's assume for a moment that conservation cannot be used for collateral for first mortgage bonds. Does that

mean that conservation by necessity is 100 percent equity financed?

A. Of course not. Any more than identifying any piece of rate base, if you will, and saying it's financed with particular type of capital. Capital is fungible. It is what it is and it finances rate base. As I understand it that particular item is in rate base. Consequently, it's no different than any other item of rate base which is not backed by some mortgage obligation. I mean, after all, not all of the company's assets serve as collateral for a mortgage bond.

Q. Does Puget have -- I think you've indicated Puget has short term debt in addition to long-term debt, does it not?

A. Yes.

Q. Does it also issue dibentures which are nonsecured?

A. I don't know if Puget has dibentures, let me just check. You mean the collateralized bonds. I don't think it has the dibentures per se if I understand what you mean by dibenture.

Q. I meant noncollateralized short-term bonds?

A. Yes, they have medium-term notes as I understand it are not collateralized.

Q. This is fairly typical of utilities, is it not?

A. Yes.

Q. Lastly I wanted to ask you a couple of questions concerning your adjustment to what I will call your raw cost of capital. As I understand it you come up with your opinion of a raw cost of capital for Puget is 10 and a quarter percent?

A. Yes.

Q. And then as I understand it you apply a 1.07 factor to that in order to account for market pressure flotation costs; is that correct?

A. Yes.

Q. And so ultimately your recommendation to the Commission for the cost of equity capital to the company is 10.8 percent or a number of .55 percent higher than than what I will call your raw cost of equity capital. Would you agree with that?

A. Yes.

Q. Would you agree that the -- can you quantify the annual effect of this .55 percent difference in rates? And I think the one ingredient you need is a rate base. Staff's rate base recommendation in this case is $1.994 billion or basically $2 billion. Could you indicate how much

money is accounted for by that .55 percent differential? And I am asking at the rate level.

A. The rate base was $2 billion is that what you said?

Q. Yes.

A. That would be about $17 million if I got my zeroes right.

Q. I want you to, since we had a little problem with that similar question in Washington Natural, I want to make sure we put the zeroes in the right place.

A. What I did is I marked up the .55 because it's a difference in equity by one minus the tax rate, and I got around .85. And then I multiplied .0085 times 2 billion. The reason why I'm spelling this out is because if I haven't done it right it's easily corrected by -- I keep getting that figure of $17 million.

Q. One question. Do you have to run that through your capital structure?

A. Yes, that's the problem. Thank you. Yes. That would be just about $7 million. I'm sorry, right.

Q. Sounds better than 17 million. That number, if your recommendation were adopted, then, would remain

in rates until the next general rate case when the issue of rate of return is reviewed; is that correct?

A. That is correct.

MR. ADAMS: Thank you.

JUDGE HAENLE: Commissioners, have you questions?

CHAIRMAN NELSON: Yes, just a couple.

EXAMINATION

BY CHAIRMAN NELSON:

Q. Dr. Lurito, following up on Mr. Adams' colloquy with you about earned returns and I think you used the term "richness" of regulatory approaches. I wonder if you could turn to page 7 of your exhibit, RJL-3. My inquiry, is there any generalization you can make about these comparable electrics and their treatment for purchased power or PRAM-like mechanisms and these earned returns say for 1991 and 1992?

A. Right. The only one of the six what I call comparable electrics that has a program similar to Puget's is Central Maine Power where they had an ERAM mechanism and also where their purchased power is recovered dollar for dollar, you know, ultimately, either through base rates or through some true-up mechanism. It would appear that what's happened here

with respect to Puget is that right now, I think Puget is of comparable risk to these companies and one might ask the question, well, if it's of comparable risk to these companies and these companies do not have a PRAM -- typically don't have a PRAM -- what are we doing?

The answer I think is this: The Puget experiment, if we can use that term, has probably not been in place long enough and during some of that period of time there was some question in the minds of investors as to whether it was going to be continued, A; B whether the uncollected balances, the deferred balances that we're building up, are going to be allowed to be recovered and if so over what period of time. I'm sure you've heard that testimony ad nauseum and I won't belabor it. But the point is that I believe that if the Commission stays the course on PRAM or PRAM like mechanism and decoupling that the benefits to ratepayers are going to be shown.

And I mentioned in my testimony that Puget's cost of equity, in my opinion, has come down to about 200 basis points since the last base rate case even though interest rates have only fallen about about 150 basis points. That suggests to me that PRAM has brought about and decoupling has brought about at least a half a point benefit in reduced cost of

equity.

The other thing is the Commission regulated this company as you know in the last case based on a 41 and a half percent common equity ratio. I am recommending 41 in this case, and I believe other witnesses are recommending even somewhat lower than that, I believe Mr. Hill about 40 percent if I recall his testimony, which is another benefit. In other words, because we have a stable earnings picture here for Puget now, because of the regulatory treatment we are going to be able to achieve the same coverage with a lower equity ratio and with a lower return on equity. That's the regulatory bargain I was discussing with Mr. Marshall. I think it would be premature to abandon or to radically change the regulatory treatment at this point because I think we're on the threshold of really reaping the benefits of this program. And ratepayers have paid for it, Lord knows, and I think it's time that they receive the benefits and I think they're there. I think they're there in a lower cost of equity which has come down significantly since the last case and a lower common equity ratio. There's a lot of savings here.

Q. Well, so let's say three years from now, if we continue to stay the course, to use your term, if

we were faced with a similar chart three years from now, we would see relative stability in the earned returns for Puget whereas we may continue to see the volatility in the other four to five, not including if Central Maine Power continues it, if it does, that would be the distinction between these comparables?

A. That would if we don't see any improvement in Puget's position vis-a-vis a comparable group two or three years from now then I would say at that point one might want to begin to question the efficacy of saying with the program. What I am staying to you is this, that in my opinion Puget's cost of equity has fallen faster than these other utilities even though now they're at roughly the same level, they've just come farther, if I can put it that way, so that I believe if what you say happens then I myself would question the efficacy of staying with it because it is a cost and a real cost to ratepayers. There's no question about it, and I would be the first to say, hey, let's rethink this but I think right now it would be premature to abandon it.

Q. But the benefit to Puget in the bargain is a stability in earned returns?

A. To Puget's investors, that's exactly right. That's why I was saying there's two sides to this.

Their investors benefit, their bond holders benefits because earnings are stable. Their stockholders benefit because that earnings level is going to be there, going to stay within a pretty narrow band. What I am now asking is where is the benefit to ratepayers and the answer has to be, A, in the cost of equity; and B, in the capital structure ratios that you use. Puget's 45 percent recommendation in this case is beyond the pale. This company needs to be managed, management needs to do something. With a 45 percent equity ratio, PRAM decoupling, there's really not much for management to do, you know.

Q. I follow you. On a related point do you have any familiarity with what the Georgia Commission has done with the purchased power adjustment?

A. No, sorry, I'm not.

E X A M I N A T I O N

BY COMMISSIONER CASAD:

Q. Like to follow along with the chairman's line of questioning. I was going to ask this question of Mr. Elgin tomorrow, and I will, but it's fortuitous that you're here today because I will ask the same question of you because you just focused on it and the issue that you focused on was the experimental nature

of the PRAM mechanism and the decoupling mechanism. And you indicated that you felt it really hadn't sunk in adequately. If that's the case then are the suppositions that are being made to shift risk allocation to adopt a financial approach for the treatment of the company, revenue approach for the treatment of the company as if in fact it had sunk in fair or reasonable?

A. Okay. Let me try to answer it this way. When I say sunk in what I mean by that is this. I think it's clear that investors generally are aware of the mechanism. But what happened was the hiccupping, if you will, in the regulatory continuity as to whether those balances were going to be recovered, I think -- I don't want to use the word "alarm," but let's say raised some doubts in the mind of some of the analysts that this Commission was going to follow its policy through, and that's what I mean by a little hiccup in it. If this Commission sends a clear signal that unrecovered uncollected balances are going to be recovered, albeit in some period of time whatever it is, and that it's going to stay the course in terms of not abandoning the policy, then what I am saying is I think the uncertainty will be dispelled -- the knowledge is there, what's the certainty of it -- I think the

uncertainty will be dispelled and that that is going to have even more salutory effects on the cost in the future, all other things the same, obviously.

Q. One of the hiccups that occurred was a product of nature and perhaps other factors and that simply was that the amounts of money to be recovered under the program were -- entailed rate shock which would have a traumatic effect on the ratepayers of Puget. So a mechanism to defer some of those costs had to be developed?

A. Right.

Q. And one would think you would have thrown a bomb in somebody's boudoir as a result of having to make that adjustment, which seemed to be a reasonable adjustment to make. We're looking at -- so that adjustment was made and the ripple effect flowed. We're looking at a five-year experimental program. It is an experimental program. And so I think investors recognize that as much and so that's what's troubling me. To place this thing in context, it's not like 25 years of rate of return regulation albeit commissions are composed differently, but the substance is the same. This is an entirely different new experimental approach. And it's difficult for me to measure investor recognition of that, and make me feel more

confident, will you?

A. Okay. Let me try to put it to you this way. While I am not a person who believes that the economy is going to go booming away -- I don't believe that, but what I do believe is we are probably crawling along the bottom and the bottom is a rather level bottom. What that means is that the increase in the balances are likely not to be anywhere near as severe as they were because of the weather situation and because of economic situation which conspired unfortunately in a short period of time working together. To create a big run-up in those balances, as I'm sure you're painfully aware. What I'm saying is if the economy right now simply crawls along the bottom we don't expect or shouldn't expect any significant build-up in the balances now.

So what I am saying is continuation of the experiment, and as I understand it, we had a decent water/winter here. Okay. But nowhere near like 1992, I think that's fair to say. What I'm saying is that right now it could well be we're now ready to reap some of the advantages of the program and if I'm wrong and the economy starts upward, even a little bit, then

we're going to start getting some of the advantages.
So I think this would be a bad time to abandon it

right at the time when we may be getting the payback from the program. Because I don't see any continued drop-off in the economy, not that I think there's going to be any boom -- and as I say if the water situation stabilizes here then I think you will start to see the advantages of the program and I don't want to say silly but I think it would be premature to abandon it now right at the time when we think there would be a payoff time.

Q. You're willing to jump into a $9 a share jump in loss in stock value on the thought that these situations will stabilize?

A. No. In fairness, I guess what I am saying to you is that $9 is not a loss. What it is is it's taking back a windfall. Investors have been reaping a windfall, this company has been trading at market-to-book ratios of 1.5. This Commission has never targeted a 1.5 market to book ratio in my memory. What I am saying is there has been a windfall for investors. What I'm asking is that ratepayers get back what they have been giving. It's not taking away something from someone who deserves it. It's righting what in fact is an inappropriate situation. And it's really important, I think, to understand that and both Dr. Olson and I see eye to eye in that regard.

Q. You wouldn't call that retroactive rate making?

A. That's prospective rate making because the cost of equity is down now. Interest rates are low. Let's take advantage of it. We shouldn't do less for ratepayers.

Q. I listen here as a layman and listen to very learned economists, there are three of them, and perhaps more, many more, but there are three of them, all outstanding in their field, all learned, but the results differ. And through a coincidence they seem to differ in relationship to those whom they represent. Why should your recommended rate of return, your capital structure, your approach be accepted in preference to those of the others who are testifying in the case?

A. In the first place Dr. Olson who testified on behalf of the company agreed that if he were to update his testimony today his cost of equity would be significantly lower -- hope I'm not putting it wrong, maybe "significantly" we should leave it out -- lower -- than what he testified to because the cost of capital has come down. So that the apparent spread between Dr. Olson and myself is not as great as might appear from looking at the testimonies.

He recommended, let me just get his words here. Dr. Olson recommended a 12 and a half to 13 percent return on equity and he testified on transcript page 742 that had he done a new cost of equity study at the time he was cross- examined it would likely be 50 basis points lower. That's his testimony. And I would submit, because we're moving forward in time, that if he had done it today it would be lower still. So that the apparent difference here between he and I is not as great as it might seem.

Mr. Hill, as I recall, found a bare cost of equity of 10 percent. I found 10 and a quarter. The difference between his return on equity recommendation and mine has to do with the treatment of financing costs and pressure -- I'm sure you're aware of that, but in terms of measuring the cost of equity we're very close.

Dr. Legler, as you know, his study showed the cost of equity was lower than what he recommended. His DCF's were in the 10 percent area just like mine were and yet he's a little higher. I don't know why he did that but his own studies show that it's lower than what he recommended.

So that in truth there's a fairly close
difference between the witnesses in this case,

frankly. I remember in the old days where there was three or 400 basis points difference. We're not finding that here. So I don't think the witnesses, frankly regardless of what side they're on, are that far apart and of course I know Mr. Parcells and I think Peseau, he also put in some testimony in the 10 percent bare cost of equity area. So I think there's a consensus forming somewhere between 10 and 11 and I think it's pretty hard to shake.

Q. Reminded of the old saying, close is relative of course using hand grenades.

A. It's the truth.

Q. Dr. Legler recommended a capital structure with 44 percent percent equity, did he not?

A. Dr. Legler did, yes, I know he did. But he also testified that anything above 40 percent or 40 percent and to his level was reasonable. I am at 41 percent so I must be reasonable.

Q. I would like to explore the purchased power situation just very briefly, and I have to talk to analysts about this issue. When you screw them down real tight they will tell you it's not a generic approach, that in fact it has to be done on a company-by-company basis. And that the fact that a company has a large amount of purchased power is relative to

the quality, deliverability of those contracts.

Would you agree with the view -- and I am trying to word this delicately -- that much of the analyst's approach to the issue of purchased power is hogwash, especially in view of the fact that the National Energy Act has created an environment in which exempt wholesale generators, independent power producers are going to make purchased power the norm in the industry rather than the exception. Utility generated power is going to shrink in proportion to the total amount of resources available without question. How are rating analysts going to handle that? Are they going to on an industry-wide basis say that purchased power is now so prevalent that we're going to drop everybody's rating?

A. Right. The answer is that I don't believe they will. As a matter of fact, Puget has maintained its rating even though -- even given the amount of purchased power it has, without Mr. Abrams coming in and telling us that we need to have a higher equity ratio because of the apparent risk of this, so I don't believe them. So, and let me say that while as you point out they have indicated that their approach be taken on a utility-by-utility basis and take into account the factors you spoke of, the extent of

purchased power, its cost, its availability, the type of contracts, but what I am saying is the most important factor which is how those costs are recovered was totally ignored by Mr. Abrams and Mr. Miller. With all due respect these gentlemen should have certainly found out how Puget is regulated. Mr. Abrams never even inquired what the capacity portion was of Puget's purchased power expense, even though he sat here and told us that that was the relevant piece of information. So frankly I was appalled by their testimony, too because I found it somewhat self-serving.

During the years when this company was building nuclear plants, and we don't have to revisit that, when in fact a higher percentage of Puget's output was accounted for by purchased power than today these analysts weren't here telling us, oh, gosh, we have to recognize this off books financing right in the middle of nuclear construction. Now that these things are better they show up with another aspect of risk and frankly I don't buy it either. I don't think that Puget's purchased power program is risky. I think it's a least cost approach. I think it's rational. I think it should be pursued and certainly if the costs recovery mechanism is preserved by this

Commission, something near it, there's no risk to this program, and this Commission should ignore any attempt to increase the equity ratio and penalize ratepayers twice. They're already paying for the program to reduce risk. Now is not the time to penalize them again by raising the equity ratio to 45 percent as the witnesses say is necessary to maintain an A rating. I don't buy it.

Q. You mentioned on page 48 of your testimony, first paragraph you say "Mr. R.E. Olson testified that he can't explain why Puget's Mid Columbia purchased power is assigned a risk factor 1.7 times larger than its other purchased power." If that's true, considering the large proportion of purchased power that this represents in Puget's portfolio, could it possibly be because these contracts are due to terminate shortly?

A. As I understand it, the duration of those contracts is somewhere between 12 and 20 years remaining. These are the take or pay mid Columbia contracts that is being referred to and those contracts were assigned a 25 percent risk factor by Standard & Poor's whereas Puget's take and pay contracts were assigned a 15 percent risk factor. So I divided the 25 by the 15 to get the 1.7 times, and

Mr. Olson was asked that during cross and he couldn't explain it because Puget's mid Columbia contracts cost about a cent a kilowatt hour. It's wonderful power, it's fairly consistent power, it's readily dispatched power. Where is the risk in this? I am talking obviously relative to the alternatives, and I agree with Mr. R.E. Olson in that regard. I don't understand why that they're assigned a risk factor of 25 percent. I dare say that's a creation of someone at Standard & Poor's.

Q. I'm certain the company will respond to that --

A. I wish they would.

Q. -- those contracts when they're due for renewal. It was indicated that with conservation bonds or with the conservation bond proceeding or approach I think Mr. Marshall postulated that as a product of that Puget would have a triple A rating and to ask you a question about costs, and do you agree with that triple A rating?

A. Well, I frankly took the question as a pure hypothetical. I mean, he never indicated to me that he thought it had any basis in fact. He simply asked

me if it was triple A rated relative to an A rating
would the cost be less. I don't think he ever

explicated in the question the basis for the assumption of the triple A rating. If you heard it I didn't hear it.

Q. What I heard was the use of the triple A rating and you didn't take exception to it and I wondered if maybe you agreed or disagreed with it. Obviously you disagree?

A. I thought it was a hypothetical question and I was simply answering in that form what if it had a triple A rating wouldn't there be savings and I said sure.

COMMISSIONER CASAD: That's all I have.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

Q. We've been hitting this issue of the market price and risk from different directions. I would like to come back to that in some of the questions that Mr. Marshall had asked you in that area. I believe Mr. Marshall said that the average market-to-book ratio for electric utilities is about 1.6 or something in that area. And you're recommending 1.07 for Puget. Is it your testimony or your position that the general pricing for electric utilities in the country then today is excessively high?

A. Yes. And let me try to answer it this way. In the last base rate case in this jurisdiction the Commission allowed Puget to earn 12.8 percent on equity which is, as it turned out, happened to be my recommendation in the case, but at that point in the time not foreseeing the drop in interest rates I thought a 12.8 allowed return on equity would be sufficient to produce just the 1.07 or thereabouts market-to-book ratio. But what happened when the Commission put in that 12.8 percent rate of return and Puget earned around there, suddenly interest rates started down so market price started up. And that's what I meant when I said windfall.

What happened was investors obviously didn't expect this. It was a windfall to them. Suddenly they found the market price of Puget rising and because there's regulatory lag, or whatever you want to call it, between the time the market-to-book ratio began to rise in this hearing and when rates might go into effect, of course we have these high market-to-book ratios. It's my testimony, Commissioner Hemstad, is that what will happen is that if I'm right capital market conditions now maintain themselves reasonably constant over the next year or two that as utility commissions reassess those

prior allowed returns, we will see a general decline in market-to-book ratios as it should be because it would be inappropriate to maintain a 1.5 or 1.6 market-to-book ratio. No utility commission that I know of has targeted such a market-to-book ratio. But it's going to take time because interest rates have fallen.

Q. And you would see those ratios coming down then across the country?

A. Absolutely.

Q. Would you see them coming down in essentially this area of 1.07?

A. If capital markets were to maintain themselves as they are now, then in the longer term, and I mean, as I said to him, I can't tell you about timing but I would suspect, yes, they would do that maybe in the period of a year or two.

Q. Some of the testimony that has been presented, and I think this is your position, too, is that the risk has been shifted from the company to the ratepayer, and therefore that the return on the investment in the Puget Power securities ought to be lower than for, what, the other electric utilities in the country that don't use PRAM and decoupling?

A. Yes. What I am saying is that in my

opinion the institution of decoupling and PRAM has brought about a decline in Puget's cost of equity faster than what would have been expected based on interest rate declining, et cetera, et cetera since the last case. That to me is a good, and I am saying investors have gotten theirs, now it's time for ratepayers to get theirs.

Q. Well, if other regulatory agencies around the country don't adopt something equivalent to decoupling and PRAM, then would it be your position that there ought to be a differential between the rate of return for decoupled utilities and those that are not?

A. Absolutely, and I think Commissioner Nelson was alluding to that and if I don't see that in the market in a reasonable period of time then I would say something is seriously wrong and there's no sense having ratepayers pay for a program where there's no apparent benefit.

Q. In the long run, then, if you were to put yourself into the shoes of Puget or a similarly situated regulated company, would they be better off under traditional regulation?

A. I happen to believe that this form of regulation is a very good experiment to try at this

time because given where people are in terms of unemployment, economy, they need every opportunity to have rates come down and this mechanism I think is promising in that regard and that's why I support it, and that's why if it doesn't, and I think it has in the past, but even if it doesn't come down a little bit more then I will say to this Commission I will rethink.

Q. I really meant, you're saying that from the public interest perspective this approach is desirable, but from the private interest perspective of the company is it undesirable?

A. No. Investors will -- believe me, investors always set market price to get theirs so they're going to get their required return. The question is will that required return compensate ratepayers, if you will, for the risk they're assuming, which is kind of a resource question. That's why I think Commissioner Casad correctly pointed out that this is a very radical experiment from the point of view of traditional regulation. We are reversing roles. It's ratepayers who have taken on the risk and now the question is will there be something in it for them and that is the right question to formulate.

Q. I believe it was the burden of Mr. Elgin's

testimony that Puget hasn't adequately informed the investor community of the benefits of decoupling and PRAM. I think you're saying that they are perfectly aware of it but are still uncertain as to what this Commission on a long term basis will do. Is that a fair characterization of the difference in your views?

A. I don't think Mr. Elgin and I have a difference in view. I think what he is saying is this, that Puget could do more in terms of educating analysts about Puget's specific situation with respect to purchased power as an example and how the PRAM mechanism ultimately allows a true-up and a recovery of those costs. That's what I was saying. It didn't seem to me that Mr. Abrams understood it very well and if he did understand it very well, then I am somewhat shocked to hear that he didn't think it had much effect on risk. What I am saying is explain its unique situation with respect to regulation on that matter and I don't think that job has been successfully done. Witness the testimony that we've heard from Mr. Miller and Mr. Abrams in this case which somewhat shocked me.

Q. Back to the market mechanism for a moment. If investors with lower inflation and lower interest rates are willing to take a lower rate of return, would it follow under your arguments about a

lower market-to-book ratio that the stock price would necessarily drop by $9?

A. When I answered that question I was answering it in an honest theoretical fashion. The theory would suggest that once we reach equilibrium, which could take a year, I don't know, that that's what theory would indicate it would do. As I said, Dr. Olson and I agree in that regard. Whether or not it would do it and how fast it will take or how long it will take, I don't know, but I think that is the direction, yes. But as I said it's not a loss. It's simply taking back of a windfall.

Q. I have one other question in the area of your response to the questions about imputed debt. I think you said that there was a significantly different risk level between long-term debt of the company than the situation where you have the purchased power program and substantially less risk. Is that a fair statement?

A. What I was trying to say is that the purchased power program has been painted by some of the analysts that this Commission has heard as being somehow risky. And what I am saying is the alternative, which is native construction of one form or another, be it nuclear, coal, I don't know, is in

my opinion, clearly riskier. I believe Puget has chosen the right path. I think the integrated resource planning program is working, and what I am saying is that the company is behaving, in my way, in a rational manner, and yet we have these analysts coming in and somehow telling us that what we all view in this room as rational somehow is risky and that we need somehow to have a higher revenue requirement because of this. This is what amazes me.

Q. Let's take the circumstance. Ignoring the perhaps shorter term remaining time on the purchased power contracts that Puget may have. Assuming that a new contract for a 50-year purchased power arrangement with the supplier on a take or pay basis. Is the risk any lower there than for the company to build a plant that would have a 50-year life span?

A. I think in today's world if you're telling me that power is mid Columbia power, I would say absolutely.

Q. But assuming the same kind of power generating source.

A. You mean the same cost? I just want to understand what you're asking me. If it's the same cost then it's hard to answer the question.

Q. I am trying to compare the risk in a long

term in a take or pay contract where someone else builds the plant or whatever as against the company itself building the plant with a 50-year life span.

A. What I am saying is that if those two programs have an identical cost per kilowatt hour, total cost per kilowatt hour, then I don't think it makes any difference one way or the other.

Q. The risk would be the same?

A. Of course what I was trying to contrast is the alternative that Puget faced, namely the constructed plant that would have a higher cost as to certain of its take and pay rates or its existing take or pay contracts, I think it's clear it made a rational decision. I have no problem with it.

MR. HEMSTAD: No further questions.

JUDGE HAENLE: Commissioners, anything else?

Redirect, Mr. Trotter.

REDIRECT EXAMINATION

BY MR. TROTTER:

Q. Dr. Lurito, when you're talking about the company's purchased power program you were talking about it in general terms or were you talking about the prudence of any specific contract?

A. I was talking about it in very general terms.

Q. With respect to some questions about a generic approach applied by the rating agencies, based on your review of Mr. Abrams' and Mr. Miller's analysis, what interest or debt rate was applied to the purchased power amounts that they refuted?

A. 10 percent, if I think I understand your question.

Q. Is it your understanding that that rate is applied generically?

A. It's applied generically, yes.

Q. Is there any support for a 10 percent debt or interest rate in today's markets?

A. Absolutely not, and if you look at Puget's proforma cost of long-term debt it's 7.89 percent. That's just an example of what happens when you apply an approach mechanistically like this.

Q. What was your pro forma cost rate for the $120 million additional long-term debt that you pro-formed for Puget?

A. 7.75 percent.

Q. Did you testify earlier that that was conservative on the high side?

A. Yes.

Q. With respect to the closeness of the common equity analysts in their estimates, you referred to Dr. Legler and that his DCF analysis was fairly close to yours. If he testified that one of the reasons he went higher than what his DCF implied was because of his cap M and risk premium analysis, is that a justification in your mind to have a higher equity cost than DCF implies?

A. No. The reason for it is because, as I mentioned, in my opinion, the cap M approach and the risk premium approach are both flawed because of the use of beta and for other factors that I mentioned earlier that consequently had Dr. Legler relied on his application of the DCF he would be very much in the ballpark with Mr. Hill and myself and others in this case.

Q. Starting with capital structure could you turn to page 30 of your Exhibit T-700. Beginning on line 17 you answer the question whether you performed any tests to determine the safety of the capital structure you've recommended. Do you see that?

A. Yes.

Q. And your answer and analysis continues over the next few pages?

A. Yes.

Q. Is it your understanding that Dr. Legler performed such an analysis for his recommended capital structure or not?

A. I am not aware that he did, no.

Q. With respect to the conservation financing questions that the company counsel asked you. Did you assume in that hypothetical that the utility itself would be financing the conservation program in whole or in part?

A. Utility itself, yes.

Q. And if the program was different in that there was financing completely from the customer's side that question is not really an issue then?

A. Exactly. That's why I didn't understand the basis for the hypothetical. In other words, it could be financed that way. It could be financed another way and it wasn't clear in the question which way, and I was simply responding to the question.

Q. You were asked whether Puget was ranked number one or two in the country on purchased power. And you answered that you believed it may have been or words to that effect. Are you aware of any utility in this country that has more low cost hydro resources under contract than Puget Sound Power & Light Company?

A. I don't know of any.

Q. You indicated in response to a question by someone that there was a slight correlation between equity ratio and bond rating. Could you expand on that, please.

A. Yes. What I meant by that is that typically if you divided electric utilities up by their bond rating and then struck an average of the equity ratio in each bond rating class you would find that as the bond rating rose, improved, the equity ratio would also rise.

Q. Is that a one-for-one correlation?

A. Oh, no, I didn't say -- I just meant that that was the direction in which it would go.

Q. Would you recommend that the Commission base its equity ratio finding in this case based on an analysis of bond ratings?

A. No. The equity ratio that the Commission should use should be based on the economy and safety of the capital structure. That's why it's crucial that the analyst perform studies to show the economy and the safety of the capital structure being recommended. In other words, test it. And I think I've done that fairly and I think there's a combination of PRAM decoupling and the return on equity and capital structure I am recommending should

easily allow Puget to maintain its A bond rating or A minus, but I mean, stay in the A class.

Q. Turn to Exhibit 703 which is your RJL-3, page 3?

A. Yes.

Q. There you show on lines 1 through 6 the comparable electrics that you used in your DCF analysis?

A. Yes.

Q. And are those the same group that Dr. Olson for the company used?

A. Yes.

Q. You are asked some questions about some California utilities. I don't recall whether they were identified by name but do you recall that question?

A. Yes, I think they were, and I do recall the question.

Q. None of those are included as comparable electrics in either yours or Dr. Olson's analysis?

A. That's right.

Q. You were asked some questions about the state of Washington and its bond rating. Does the state of Washington have any equity capital, to your knowledge?

A. Of course not.

Q. You were asked a number of questions about this market-to-book ratio issue and stock price. What market-to-book ratio did you use?

A. A 1.07 target market-to-book ratio.

Q. What was the target market-to-book ratio that Dr. Olson for the company used?

A. I believe it was between 1.05 and 1.1. Think it was around 1.1.

Q. Did I hear you correctly that he testified that if the Commission accepted his cost of capital determination that the decline in stock price would be in the same range that you're talking about?

A. Sure, because he is targeting the same market-to-book ratio as I am. The only difference between us is he thinks a little higher return on equity is necessary to achieve that but he would have exactly the same decline in the market price as I would because that's what's necessary to put balance back into the regulatory process.

Q. Now, if there is a concern that investors might tie -- let's assume the Commission adopts the company's number -- ties that recommendation to the

PRAM and that's somehow a negative thing could that problem be solved by complete and accurate information

provided to the investment community?

A. Sure.

Q. And finally, and I am almost embarrassed to get into this but you were asked some questions about your compensation in this case and I want to make sure the record is clear. Am I correct that you are paid at an hourly rate but up to a contract maximum?

A. Yes.

Q. And if you expend additional hours beyond the contract maximum would pay, what happens if the contract is not renegotiated?

A. Well, it rarely has been in this jurisdiction. I just do whatever is necessary to complete my task and given the size of this case I guarantee I'm already over budget.

Q. So you eat the difference?

A. That's what happens.

MR. TROTTER: Those are all my questions.

JUDGE HAENLE: Brief recross.

MR. MARSHALL: Yes, just a few questions.

RECROSS-EXAMINATION

BY MR. MARSHALL:

Q. You were asked about the return, earned return on equity, for 1991 and 1992. And that I

believe is on page 7 of your Exhibit 3?

A. Yes.

Q. When you refer to that?

A. Yes.

Q. The PRAM decoupling mechanism went into effect when in 1991, do you recall?

A. I believe it was April of 1991?

Q. That was the order but when did it go into effect?

A. I believe in the fall of the year.

Q. So only the last three months of 1991 were covered by the PRAM decoupling mechanism?

A. I believe that's right.

Q. Do you know what the hydro and weather conditions were for the early part of 1991, the first quarter of 1991?

A. I don't know.

Q. Would you accept subject to check that the water was very good, temperatures were very cold?

A. (Nodding head.)

Q. Would you also accept then that that was the reason why there was an earned return above a 12.8 percent for 1991?

A. Sure.

Q. You weren't implying or trying to imply

that because there was a PRAM decoupling mechanism in place in the last three months of 1991 that accounted for the earnings that you see there; is that right?

A. I did not try to -- if that came across I did not intend that to come across.

Q. Under PRAM decoupling the company gives up the ability to earn in a good water year and in an exceptionally cold winter; isn't that true?

A. Above the allowed return?

Q. Right. It's set for normal water and normal weather and if you have next winter is very wet, very cold, as it was in the winter of 1990-91 the company doesn't get the benefits it would have in the traditional regulation setup, correct?

A. That's right.

Q. When you refer to your discussion about why you thought we should stay the course, as you put it, and you said the ratepayers were -- I believe I got this correctly -- about to reap the advantages of the program, did you have in mind that the last two winters that have been unusually dry and warm would not probably repeat themselves and you would get more normal weather you would get the build-up in the balances?

A. What I meant by their reaping the

advantages is that regulation, if it follows my regulation and others in this case, with respect to the allowed return on equity, that allowed return on equity captures whatever risk reduction at this point in time is embedded in the market price reflecting the reality of PRAM and decoupling. And what I am saying is that what I meant by reaping the benefits meaning that ratepayers in 1992, which was a bad year from a weather point of view and the economy certainly wasn't booming -- the balance is built up and ratepayers are going to have to pay that tab. But what I am saying is that the benefit that they reap in exchange for that is having this Commission allow a return on equity which is consistent with the lower risks attendant to this regulatory treatment. And a capital structure that reflects the risks of this experimental program. That's what I am talking about. So that we have a balancing, investors get stability in earnings, ratepayers get lower costs of equity and more leveraged capital structures so that the benefits are shared.

Q. But you would agree that the company would never be able to earn the kind of returns that it made in the winter of 1990-'91 when you would have a wet winter and a cold winter?

A. Sure. But you and I both know that those kinds of things are ephemeral. In the long run presumably we will have normal water, that's the premise and so that the question is, is there a benefit to reducing the volatility of the earnings and I say there is a benefit. And that benefit is lower risk to everybody.

Q. There is a symmetrical risk here. The company gives up the benefit of a high water/cold winter and the ratepayers also have a low water/warm winter, correct?

A. Sure, I have no problem.

Q. For the ratepayers, too, that volatility is decreased in terms of what they might otherwise have, correct?

A. No, but what I am saying is if you, in the long run, if you have average water ratepayers are going to pay in present value terms the same amount they would pay with or without PRAM, but what you do by lowering the cost of equity and because the earnings volatility is lower, both investors and ratepayers benefit. Investors benefit because the earnings volatility is reduced. Ratepayers benefit because the cost of equity comes down because of that phenomenon.

Q. Is the trade-off for the investors that they have some volatility but that the good news is that volatility will be reduced but the bad news is that their earnings will be knocked way down, knocked flat?

A. Mr. Marshall, there is no free lunch. Risk and return are related. Investors are not being derived of a return if their risk is lower. I don't understand the theory behind your question. You know that investors are going to set market price to get the return they require given the risks they perceive. If the risks they perceive have been reduced because of regulatory treatment, believe me, investors will get theirs. What I am saying is that we have to look now to what that reduction means for ratepayers and share these benefits. Investors are cool. No problem.

Q. Investors under your approach are going to be giving up the so-called windfalls, they're going to have a lower rate of return on equity, they're not going to have the upside potential for a wet winter and a cold winter. Commissioner Hemstad asked whether Puget investors wouldn't be better off if they just stayed under traditional rate making rather than go to this system. How would you answer an investor who a

year from now looked at a 30 percent decline in their stock, looked at a no chance for upward earnings, what would you say to that person?

A. What I would say to him, I would say to him that the return that is being applied to the company is fair and reasonable in the economic climate in which we exist. When market prices went down in the 19 -- early 80's, late 70's and early '80's company witnesses got on the witness stand and said, My heavens, market prices are plummeting, we need big rate increases. No one made any apologies. No one said, My Heavens, poor ratepayer, the rates are going up. Your answer was, and I'm not saying it was inappropriate, that's what the market is dictating. That's what we need. So what's wrong with a little what goes around comes around. I mean, is that a sin or is this a one-way street here.

Q. In terms of this rate case do you understand that the Commission staff is proposing also a series of adjustments so that the revenue request of $117 million from the company will be, if the Commission staff's recommendations are adopted, a negative $1.7 million, are you familiar with that?

A. Yes.

Q. Do you understand that that was at least in

Mr. Elgin's testimony, said that the PRAM 1 and PRAM 2 are about $100.7 million of rate increase?

A. I think the relationship between the two is a pure fortuity. I don't think they have anything to do with each other.

Q. You don't think investors will interpret this experiment as giving them on the one hand some PRAM money and taking it away on the other hand?

A. You have to educate them, Mr. Marshall. You and I both know that it's a fortuity that those two numbers are the same. I can't help it if it worked out that way. Your job is to advise them the way it happened.

Q. Have you looked into the reasons for, apart from the cost of capital, the recommendations of the staff for a decrease?

A. I am not a revenue requirements person, as you know. But I know that a significant portion -- I think it was $35 million -- let's accept it for purposes of this -- 35 million of that difference is rate of return difference, which is certainly justified. The rest of it, I mean, I haven't looked into because it deals with other revenue requirement analysis that's beyond the scope of my testimony. But it's not my understanding that staff has done anything

different than it traditionally has done with respect to test year pro-forming and what have you.

JUDGE HAENLE: Do you have much more, Mr. Marshall?

MR. MARSHALL: No, I don't. Let me check my notes.

Q. When you said you don't expect a build-up in the balances of PRAM what did you mean by that?

A. What I meant by that if -- if, of course -- if weather returns to some sort of normalcy, and if the economy continues to crawl along the bottom, if you will, as opposed to continuing down, then I wouldn't expect a build-up in those balances. I mean, it wouldn't build up. It wouldn't build up.

Q. That was the expectation when PRAM decoupling was first initiated that you would have normal weather and normal-like conditions, correct?

A. No, I think just the opposite. The reason why PRAM and decoupling took place was A, to sever the relationship between rational planning, integrated resource planning and kilowatt hour sales; and B, to allow some earnings stability. It was precisely because we have volatility, have volatility because of abnormal weather fluctuations, that we have a mechanism to smooth these fluctuations out. So it was

the opposite of what you're saying.

Q. Was that average set between the median of volatility from the high and the low?

A. From the weather point of view?

Q. Weather and water.

A. That's my understanding of what the test year does but that's beyond my expertise but that's certainly my understanding of what the attempt was, yes.

Q. So in the long term the investors would be, if that average held true, would be okay if they held their stock on a long-term basis?

A. Without decoupling is that what you're asking?

Q. Right, yes.

A. As I say, investors will get theirs in the long run if they hold on long enough but the problem is volatility creates risk and risk costs money and if you don't have to bear that risk why not pass on the benefits. I thought that was the purpose of this program. Investors are not being made worse off, Mr. Marshall.

MR. MARSHALL: That's all.

MR. ADAMS: No further questions.

JUDGE HAENLE: Anything else,

Mr. Trinchero?

MR. TRINCHERO: Just one clarifying question.

RECROSS-EXAMINATION

BY MR. TRINCHERO:

Q. Earlier this afternoon you were asked a question by public counsel regarding Central Maine Power and your understanding of what the Maine Public Utility Commission had done. Would you accept subject to check that on January 10th, 1993 the Maine Public Utility Commission adopted a settlement in which Central Maine Power indeed consented to the termination of the ERAM program as of December 1, 1993?

A. Yes, but what I'm telling you is since I do help do regulation in Maine, what I am saying to you is that right now there's a hearing going on as to whether or not it will in fact stop on December 1, because I'm involved, believe me, and I am telling you -- I am not saying there is incorrect, what I'm saying is it's not quite all of the facts.

Q. Thank you. That's what I wanted to

clarify.

JUDGE HAENLE: Mr. Adams. Mr. Furuta.

RECROSS-EXAMINATION

BY MR. FURUTA:

Q. I will be very brief. Dr. Lurito, is it your testimony that the cap M approach and the risk premium model have no value whatsoever in a cost of capital analysis?

A. I would hope I didn't convey that. What I said was that the theoretical underpinnings of those two approaches have been called into serious question, okay. And consequently -- and the approaches have some inherent -- let me call it volatility depending upon whether you choose short term rates as your riskless rates or long term rates as your riskless rates. I would never say they have no merit. I would say the DCF has shown itself to be a more consistent approach that is theoretically sound and why not rely on it. That's all I'm saying.

Q. I think the theoretical underpinnings that you referred to you're speaking in terms of the questionability of reliance on beta?

A. Among other things.

Q. Wouldn't you agree, though, that there is quite a range of opinions currently among financial analysts regarding the significance of beta?

A. Oh, yes. It's still in debate.

Q. So that you would agree that there are reasonable and respected analysts who might have differing opinions with you regarding its significance?

A. Yes, really not with me. It's with Dr. Fama and Dr. French. I didn't write that article but I would say, yes, there is debate going on in the financial community on that matter. Thank you.

MR. FURUTA: That's all.

RECROSS-EXAMINATION

BY MR. ADAMS:

Q. I think this is one question but it's going to be a little bit long in preamble. Dr. Lurito, you've indicated, I believe, basically that you subscribe to the, if you will, the underpinnings that lower volatility equals lower risk?

A. Yes.

Q. And Mr. Marshall has noted that the earnings upside is reduced by decoupling and PRAM. Now, if you look at your Exhibit 703, page 7, which shows the earnings on equity for 1992 for Puget Power.

It shows 12.45 percent?

A. That's right.

Q. Accept that. What would Puget's earnings have been in 1992 without a $66 million PRAM 2 filing and the recently filed $76 million PRAM 3 filing?

A. Well, Mr. Elgin indicated that it's about 50 cents a share in earnings per share last year and last year the company's earnings per share was $2.16. If it was 50 cents lower than that then the earned return would be about 9.5 percent instead of the 12.45 percent that the company actually earned, which is about a 25 percent decline. In other words, absent the regulatory mechanisms that have been put in place Puget's earnings would have been about 25 percent less than they were. I'm talking about the return on equity.

Q. And that figure that you gave cents per share was actually below their dividend payout, is it not?

A. Oh, absolutely, because their dividend last year was $1.79 on an average basis, and what did I say earning per share would be, 2.16 less 50, 1.66, so they could not have covered their dividend out of earnings. Their payout ratio would have been above 100 percent.

Q. That's the downside, if you will, to the upside, is it not?

A. That's the down side to the up side.

JUDGE HAENLE: Anything more of the witness?

All right. We'll break for the evening, sir, you may go ahead. We will begin at 9:00 in the morning. I want to remind you that we discussed that we may be going Tuesday and Wednesday of next week, depending on people's conflicts. I understand that Mr. Adams and Mr. Trotter have a conflict in the afternoon on Tuesday. Because we've announced those other days I think we should let you know that depending on how we do it may be some part of Tuesday and maybe Wednesday as well. Next week in addition to the Monday/Thursday and Friday we had already discussed. We will be in recess then until 9 tomorrow morning.

(Hearing adjourned at 5:20 p.m.)