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 CASE 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 XVII PAGES 2835-3052

A hearing in the above matter was held on June 7, 1993 at 9:00 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, 1300 South Evergreen Park Drive Southwest, Olympia, Washington 98504.

FEDERAL EXECUTIVE AGENCIES, by VASIO GIANULIAS, Associate Counselor, 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, 2300 First Interstate Tower, 1300 Southwest Fifth Avenue, Portland, Oregon 97201, and PETER RICHARDSON, Attorney at Law, 702 West Idaho, Boise, Idaho 83702.

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

PACIFIC CORP, by JAMES PAINE, Attorney at Law, 900 SW Fifth Avenue, Portland, Oregon 97204-1268.

WASHINGTON WATER POWER, by DAVID MEYER, Attorney at Law, Suite 1200, Washington Trust Financial Center, 717 W. Sprague, Spokane, Washington 99204.

I N D E X

P R O C E E D I N G S

(Marked Exhibits 789 and T-790.)

JUDGE HAENLE: Let's be on the record. The hearing will come to order. This is a 17th day of hearing in the consolidated Puget dockets. This is June 7, 1993 and the hearing is being held before the Commissioners. We're continuing with cross of staff, intervenor and public counsel expert witnesses today. I will take appearances just by going around and having you state your name and your client's name. If you've already given your appearance -- I would like to take a full appearance if this is the first time.

MR. VAN NOSTRAND: For the company, James Van Nostrand and Steven Marshall.

MR. TROTTER: Donald T. Trotter and Sally G. Brown, assistant attorneys general.

MS. GIANULIAS: Vasio Gianulias for the Federal Executive Agencies.

JUDGE HAENLE: Have you given an appearance before? Full business address, please.

MS. GIANULIAS: Naval Facilities Engineering Command, 900 Commodore Drive, San Bruno, California, office of counsel.

MR. PAINE: James Paine for Pacific Corp.

MR. TRINCHERO: Mark Trinchero on behalf of

WICFUR.

JUDGE HAENLE: Anyone else need to give an appearance?

MR. RICHARDSON: Peter Richardson also on behalf of WICFUR, your Honor.

JUDGE HAENLE: Mr. Meyer will be coming this morning to bring his witness, but they indicated they would be later than 9:00 so that they wouldn't have to fly in last night and stay over. All right. We're continuing, then, with Mr. Moast. Is there anything we need to discuss procedurally before we take that testimony?

MR. VAN NOSTRAND: Your Honor, I understood from my office this morning that NCAC has filed some sort of an emergency motion asking that a witness be cross-examined by telephone, but I have not seen it. I've just been told by my office that it was filed this morning.

JUDGE HAENLE: I have not seen anything of the sort. I will check down at the records center when we take a break. I had called Ms. Williams, had asked her to move one of her witnesses to Wednesday so that we would not have so many people crammed into Thursday and Friday.

MR. TROTTER: We received a copy of that

motion this morning.

JUDGE HAENLE: All right. We will -- perhaps we can take that up after lunch. I haven't seen it yet. Take it up later today. Thank you for bringing it to my attention, Mr. Van Nostrand.

Anything else?

Go ahead.

Whereupon,

PATRICK MOAST,

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

CROSS-EXAMINATION

BY MR. VAN NOSTRAND:

Q. Morning, Mr. Moast.

A. Morning.

Q. Do you have before you what's been marked for identification as Exhibit 789 and 790?

A. Yes.

Q. Do you recognize these as your response to company data request 4075 and 4076?

A. Yes.

Q. Your responses and then the questions concerned the determination of prudence of new

resources. Is that a fair statement?

A. Yes.

MR. VAN NOSTRAND: Your Honor, move the admission of 789 and 790.

JUDGE HAENLE: Any objection?

MR. TROTTER: No objection.

MR. ADAMS: No objection.

JUDGE HAENLE: Objection from any intervenor?

MR. TRINCHERO: No, your Honor.

JUDGE HAENLE: 789 and 790 will be entered into the record.

(Admitted Exhibits 789 and 790.)

Q. One of the points that you make in your testimony is that the integrated resource planning process cannot be used to demonstrate the prudence of a resource. Is that a fair statement?

A. As the integrated resource planning process is currently conducted by Puget I state that it's not adequate for proving prudence of specific new resources.

Q. Do you believe the company is currently complying with the Commission's least cost planning rule?

A. Yes.

Q. Your testimony also claims that resource prices below avoided costs do not necessarily imply least cost acquisition. Is that also true?

A. Yes.

Q. Do you know where the requirement arises for the company to estimate its avoided costs?

A. It is through WAC 480-100 -- I believe it's 060. I can check that if you would like me to tell the specific WAC reference.

Q. If you could.

A. I'm incorrect. That was WAC 480-107-050

Q. Doesn't the company also require under the PURPA regulations to estimate its avoided cost?

A. No, sir. Accept that subject to check.

Q. Do you know what it is taken into account on estimated avoided cost?

A. A number of things are taken into account when a company calculates its avoided costs.

Q. Do you know how avoided costs are defined for purposes of company's estimates?

A. Off the top of my head I couldn't provide you that criteria. I could get back to you with that.

Q. Isn't it defined in the regulations as the incremental cost that the utility would incur for additional energy or capacity?

A. Subject to check I will accept that.

Q. Are you familiar with Puget's avoided cost filings with the Commission?

A. Yes.

Q. And doesn't Puget update its avoided cost from time to time?

A. It updates them annually, I believe, in the support of its schedule 91 tariff.

Q. Do you believe the method followed by Puget for calculating its avoided costs is incorrect?

A. No. It's reasonable.

Q. And in Puget's most recent avoided cost filing, doesn't it assume that the combined cycle turbine is the most recent -- in the most recent avoided cost filing doesn't it assume that a combined cycle combustion turbine is the avoided resource for the period beginning in 1996?

A. I believe so but I will accept that subject to check.

Q. I take it from your answer you're not really sure what it is that Puget is using as its -- as the resource which it defines as the avoided resource for purposes of its avoided cost filing?

A. There were two things that I wasn't

absolutely certain that I could say with certainty

that I agree with your question. Number one, I don't recall whether 1996 was the starting date for your schedule, projects of short term avoided costs. I thought it was 1995 or '94. I will have to check that starting date.

Number two, I thought, as I had said in my response that I thought it was the combustion turbine but I just wanted to check that. I wasn't sure when that combustion turbine as the avoided resource would terminate.

Q. Well, isn't it -- do you know whether prior to 1996, isn't the company assuming that no additional resources are necessary and therefore there isn't an avoided resource identified, it's just nonfirm purchases?

A. To my recollection, that's correct. Again, I don't know when that short term lack of need for capacity terminates and when the short term need for capacity starts, whether it's 1995 or '96.

Q. And doesn't the identification and pricing out of the resources avoided by the company provide some basis for evaluating the reasonableness of Puget's resource acquisitions?

A. Yes. It provides some basis for

reasonableness.

Q. And would you agree that the competitive bidding rule -- and I think the regulation you cited in particular requires that the company update its estimate of avoided cost to reflect the results of competitive bidding solicitations?

A. I will have to say subject to check I will accept that for now.

Q. And didn't the company, in fact, recently update its avoided cost estimates to reflect the impact of the most recent competitive bid solicitation?

A. Yes.

Q. And the impact was to reduce the estimated cost of the gas supply for the assumed resource, the combined cycle combustion turbine; is that correct?

A. There were a number of factors that caused Puget Power to lower its avoided cost estimate.

Q. Do you know what some of those factors were?

A. Yes. Need. The fact that Puget has taken on a significant amount of purchased power contracts which lowered its -- again, its need for additional power. The extension of the fact that those things contributed to the lack of need in the short term for firm power.

Q. But in terms of pricing out the cost of the

avoided resource, would you agree that Puget's most recent cost estimate adjusts the cost of that resource to reflect the impact of the most recent competitive bidding solicitation?

A. Yes. And also as you had said earlier, lower natural gas prices.

Q. Another point you make in your testimony is that acquisition of resources through competitive bidding is no showing of prudence either; is that correct?

A. That is correct.

Q. Was it the company's idea to acquire resources through competitive bidding?

A. I wasn't a member of the Commission at the time that the competitive bidding rule was promulgated. I was not a part of the meetings that were conducted in determining the participation in the formulation of those rules.

Q. When was the competitive bidding requirement first proposed?

A. I believe it was around 1989, July of 1989.

Q. And do you know when the company's first competitive bidding solicitation occurred?

A. To my recollection it occurred in 1989.

Q. Is it fair to say that the competitive

bidding procedure was adopted because it was thought that this process would insure that resources would be acquired on terms most favorable to the utility and its customers?

A. Again, there were a number of reasons that the competitive bidding rule was promulgated. In addition to the priority for promoting the best terms for the company, they felt that the benefits also accrued to creating a market for alternate and other types of technologies that the company might not normally consider, including DSM and renewable resources.

Q. When you say that another reason the rule was developed was to avoid having to rely on estimates of avoided costs and instead have the market determine what the avoided resources are?

A. I don't recall that being ever cited to me as a reason.

Q. Are you familiar with the FERC rulemaking regarding the use of competitive bid instead of administratively determined avoided cost?

A. No.

Q. You would agree, wouldn't you, that the avoided cost estimates that the company prepares are used as a ceiling in the competitive bid solicitations

to insure that resources will be acquired at less than avoided costs?

A. I have heard that term applied by Mr. Folsom in conversations in describing the avoided costs. I would say -- subject to that I would say yes.

Q. Which term was it that you were referring to?

A. The word "ceiling."

Q. You reviewed the company's requests for proposals under its competitive bid solicitations, haven't you?

A. I was attendant at Puget Power's opening of the competitive bids in this last process in 1992, I believe, the bids were opened or fall of 1991. No, correct that. It was early 1992 that the bids were opened. And I was the person that was contacted by Puget as they gave briefings to the Commission regarding the status of their evaluations of the bids as they were reviewed for possible award group selection.

Q. Did you review the requests for proposal itself?

A. Yes.

Q. And wasn't the estimate of avoided costs

included as part of that package that went out to the bidders?

A. Yes.

Q. How was that estimate characterized? Is it fair to say that the estimate of avoided costs acted as a ceiling?

A. I don't recall if the word "ceiling" was used in the RFP document itself.

Q. Can you describe the process you said you were involved in where the company briefed the Commission staff in various stages of the competitive bidding process?

A. To my recollection, if you bear with me on this, the Commission staff was requested or it was suggested that the Commission staff monitor their RFP process from a distance but as an interested observer to evaluate the workings of the bidding process to observe the areas where the process was successful and where there was needs for improvement in the bidding process. So we did not evaluate specifically the -- on an ongoing basis the company's proposals, specific evaluations, but received summaries and all summary documents of the company's evaluations.

Q. And you were saying that you were present

when all the bids were opened in the competitive bidding solicitation; is that right?

A. Yes, I remember that.

Q. Were there subsequent briefings by the company to the Commission staff of how the various proposals were being evaluated and ranked by the company?

A. Yes. There was periodic updates as the company proceeded from the original openings and reviews to the first cut or what they call the short list criteria and eventually weeding out to the award group selection.

Q. And was it discussed with the Commission staff the basis for the company's decisions to weed certain projects out to the short list?

A. In a summary fashion the company summarized the projects that they proposed to move ahead with and in a summary fashion the criteria that was used for disqualifying certain proposals from evaluation.

Q. If I could combine the three pieces we've talked about a little bit this morning, the Integrated Resource Plan avoided cost, the competitive bidding, and just exactly what your testimony is saying, prudence. Is it fair to say that if Puget completed an Integrated Resource Plan which is consistent with

the Commission's least cost planning rule that it calculated its avoided costs in a manner which the Commission found acceptable, that it acquired a resource that was consistent with its integratedresource planning pursuant to a competitive bidding RFP that complied with the Commission's rule and was approved by the Commission and the price paid for this resource was less than Puget's estimate of avoided cost that compliance with all the steps of this process is not enough to establish a prima facie case of prudence for the resource acquired?

A. It's not enough of a basis to provide justification for prudence. The problem, as I've stated in my testimony, is that the Integrated Resource Plan itself is not adequate, does not adequately identify all the factors that need to be considered to justify prudence. There's a definite need to have a planning process so that the company can evaluate options. However, if the IRP process itself excludes certain factors or certain resources from consideration then from that point going forward through the avoided cost calculation and through the bidding process that process does not justify prudence. For instance, hydro firming, looking at the needs. The fact that the integrated resource planning

process completely ignores evaluation of capacity needs, that the integrated resource plan looks at energy and does not evaluate on a seasonal basis the need for winter energy, vis-a-vis what its needs are for summer energy, and this is one of the issues that we have concerns about is that the company may have overpurchased firm capacity contracts which are 100 percent take and pay and company may not need all of that power in the summertime. So, therefore, I don't feel that the Integrated Resource Plan, which is the cornerstone of the process, is comprehensive enough to justify the eventual prudence evaluation of specific resource acquisitions.

Q. If you recall from my question it wasn't just limited to the integrated resource planning process. It included integrated resource planning combined with the outcome of competitive bid and the process of estimating avoided costs, and would your answer be any different if we combined those two other aspects of the process?

A. No. I am aware of what your question was and again I am saying when you tried in your own words to bring those three processes together, I tried to be responsive and say that the first of those three processes is not enough to justify the prudence of the acquisitions. So, to say that since the first process provides some sort of quasi-evaluation or basis for avoided costs and that those avoided costs are the only thing that's going forward into the IRP process, in addition to the company's evaluations of what its needs are, I don't see that the IRP process is enough for justifying the prudence of specific resource acquisitions. The company must prove that each resource that it acquires is the best match to the company's needs and to show that if it isn't that there's no harm done to ratepayers, that if they acquire a resource that potentially puts ratepayers at risk of the resource plan process doesn't look at that.

Q. Look for a moment at the projects identified in your testimony, they would be the Sumas Encogen, Tonaska and March Point cogeneration projects; is that right?

A. First part again?

Q. Particular projects you identified --

A. Were you referring me to a point in my testimony?

Q. No. Just speaking generally of the projects rather than the general concept of prudence?

A. Yes.

Q. And you reviewed the information provided

by the company in response to data request 1141 through 1145; is that right?

A. Correct.

Q. And has the staff identified any problems with the location of these particular projects in terms of all being on the west side of the Cascades?

A. That is a factor that Mr. Lauckhart in deposition testimony identified as a virtue of the projects.

Q. And what is staff's view as far as the location of the projects? Is there a particular problem with the location?

A. That's a broad question. I don't know if I am suitable to identify at this point in time or Monday morning quarterback the locational decisions that Puget uses in selecting its resources. I think that Puget's -- the burden of proof is on Puget to prove that those locations are the best. I don't think that I can answer that for you.

Q. Would you have any basis for disputing Mr. Lauckhart's characterization of the location as being a virtue?

MR. TROTTER: Object to the question. The very -- one of the main points that the staff is making here is that the staff asked for information

and the company did not supply the information. Now we're being asked do we have any problems with various aspects of it and we can't respond because we didn't get the information. So I am going to object to the question because it lacks a foundation, foundation being that the company did not provide the information in the first place.

JUDGE HAENLE: Mr. Van Nostrand?

MR. VAN NOSTRAND: I think Mr. Moast knows where these projects are. I am not going to be asking him any questions about information that he doesn't already have. I do believe he knows where these cogeneration projections are located.

MR. TROTTER: But the data request that are exhibits in this case asked the company to provide the basis for their selection of these projects and basically the prudence of these projects and we didn't get anything. And so if the company had given us detailed analysis about location of these projects and how that is an asset or an evidence of prudence that would be one thing, but we don't have that, so it's very difficult for the staff to respond based on information that was asked for and not provided.

JUDGE HAENLE: Well, I will overrule the

objection in terms of the reference to testimony

that's already come into this hearing by Mr. Lauckhart. Do you have any thoughts on that aspect of it, Mr. Moast?

THE WITNESS: I will try to be responsive to the question if you bear with me.

A. The location of these powered projects are within Puget Power's service territory. To my knowledge, Puget is undergoing extensive transmission and distribution upgrades in construction to take advantage of the location of those projects within their territory and it's one of the reasons that we think that the 6.1 percent line loss assumption is valid since it is those projects would contribute to the reduction of line losses. However, I do think that there are other locations that should also be considered in need of local distribution within Puget Power's service territory. So, since all of these projects are in the northern part of Puget's service territory in Whatcom and Skagit County, it doesn't necessarily mean that locating 600 megawatts of capacity in the top half of your service territory is a virtue in and of itself, if you exclude all the other parts of your service territory.

Q. As far as the particular developers which

Puget has contracted with to purchase the output of

these projects, has staff identified any particular problems with using developers such as Enserch and Mission Energy?

MR. TROTTER: Your Honor, if I could have a continuing objection to this type of question.

JUDGE HAENLE: Mr. Van Nostrand, has that been addressed by your answers?

MR. VAN NOSTRAND: That's certainly part of the information that was provided that bears on this issue is who the developers are.

JUDGE HAENLE: My question was: Have your witnesses addressed this issue of who the developers are and why the company might feel that that's an advantage?

MR. VAN NOSTRAND: It's in Mr. Moast's own exhibit. As far as --

JUDGE HAENLE: Let me try this again. Have your witnesses addressed the issue of who the developers are and why that might be an advantage or disadvantage?

MR. VAN NOSTRAND: We have addressed who the developers are, yes.

JUDGE HAENLE: And why that might be good or bad?

MR. VAN NOSTRAND: I believe that's part of

the information in response to data request 1141 through 1145 which is Mr. Moast's exhibit. That's part of this information that was provided.

MR. TROTTER: Maybe we can go to an example, your Honor. If you look at page -- turn to Exhibit 784 and, I guess, attachment 1, which is the final results ranking information and we have, on the second page of that, a summary of the evaluation criteria which includes the ability of the project to respond to deliver as promised. We have that information. We understand that it was examined but we don't have the type of detailed analysis of that which we asked for and didn't get. And we could go down to the same type of information on many of these issues were asked for and all we get is extremely general categorical responses. So to ask this witness what he thinks about the developers when you ask for detailed information and didn't get it, combined with the exhibits that were entered today that indicate the staff did not do prudence evaluation on its own, it had to rely on the company for the information and didn't get it, this is just -- it's very difficult for staff to respond to this kind of question in that context.

MR. VAN NOSTRAND: My point, your Honor, is

to try to determine what it is in terms of shortage of information when the company provides a description of Enserch Development Corporation and says this is a developer of a project is that should we be -- I mean is staff expecting us to go into some detail about who Enserch is and we identified that Mission Energy and Texaco developed the March Point project. And I think I am trying to discover whether or not staff believes that there is a burden to go into some detail about who Enserch is and who Mission Energy is and who Texaco is as part of this process. If I could get some indication that the staff has a problem with these particular developers then we would have some idea of what it is the burden of proof that we have to satisfy regarding that issue. I am trying to narrow the issues in terms of where it is staff feels the showing has been insufficient.

JUDGE HAENLE: I would overrule the objection as long as some information has been provided. However, I don't know the manner in which the Commission will evaluate that information. I would like to hear if the staff has comments on those aspects of the projects, but that doesn't shift the burden from the company to demonstrate their prudence, obviously. Go ahead, sir. Do you recall the

question?

THE WITNESS: Yes, I hope I do.

A. If my answer doesn't reflect responsive, please let me know. One of the criteria that the company should review in any project proposal, be it if it's building its own project and it's looking to subcontract out to constructors, or builders of a power project, or if it's looking at going on out and buying power, it should evaluate the reliableness, the credibility and the track record of any vendor to perform. So to that extent I believe that Puget should review these criteria with any vendor be it to build a project for them or to build a project that is going for a third party that is going to ultimately be sold to Puget Power. With regard to Mission Energy, Texaco and Enserch, I personally have not reviewed the credibility or the reliability of the track record of these project developers. I assume that Puget has, although they haven't displayed that review to me.

Q. Would you agree that the track record of the developer is an evaluation criteria in the competitive bidding process?

A. Yes. It is not the only criteria but it is one criteria.

Q. As far as the security arrangements for the projects where the purchased prior is levelized front loaded, has there been any particular problem identified with security arrangements?

A. There's a history to that question with each of the projects that you referred to. To my recollection there have been contract amendments made and filed with the Commission regarding Enserch, and Tonaska in particular with regard to changes in the security provisions and the right to cure as required by the banks, the lending banks, that are financing these projects. So, to that extent, it is an important issue and I am familiar with it as those amendments have come into the Commission.

Q. As far as the steam host for these particular projects, the oil refineries for Tonaska and March Point, does staff have any particular problem with these hosts as criteria for a cogeneration facility?

A. Good question. One of the virtues of the bidding process is that the company go out and identify high efficiency cogeneration, and to my knowledge these projects are not high efficiency cogeneration. The steam hosts also include Sumas which was originally proposed just prior to the first

bidding process as a wood waste burning process at 50 megawatts and after the contract was signed I believe a year and a half later, thereabouts, the contract amendment came in upgrading the project to 110 megawatts and converting it to a natural gas facility and using the steam, waste steam, as a kiln drying facility to dry lumber in a warehouse located on the site. So in response to your question about my opinion on steam hosts, I have mixed feelings about the issues associated with high efficient cogeneration and to what extent these facilities do, in fact, meet the criteria of the contracts for qualifying them as cogeneration units as opposed to PURPA machines in the spirit of the bidding process, and some of these projects, by the way, including Sumas and Tonaska and March Point were not part of the bidding process. To my knowledge only Encogen was signed under the bidding process.

Q. You would disagree that it's a requirement of the contract that the facility be a qualifying facility at the time that it enters service?

A. That's one of the contract provisions.

Q. As far as the length of a particular contract for these resources, does staff believe that the company should be contracting for longer or shorter periods than the lengths chosen?

A. I think the company should be contracting for resources that it needs regardless of what time horizon. And those time horizons of the contracts should match the company's needs in a least cost manner.

Q. Are you familiar with the particular fuel supply arrangements for these contracts as far as the firmness of the gas supply?

A. To some extent. Again, I think those supplies have changed over time. To my recollection since I've been here at the Commission I understand that the Encogen gas supplies have changed at least once, maybe twice, with regard to who the gas supplier was going to be and we did have some concerns that the changing of the suppliers compromised the reliability of Encogen to perform under its contract.

Q. How about the other projects?

A. I don't know who is providing the natural gas to Tonaska. To my knowledge Sumas has lined up a firm supply -- well, put it this way. Sumas has lined up a certain amount of capacity or deliverability from a proposed developing field up in Canada. To my knowledge, I don't know if it's been proven out that the field that's slated to supply natural gas to Sumas has been proven -- has developed prudent reserves for

the full term of the contract but that Sumas is hoping that eventually the field will be able to provide adequate deliverability for the duration of the contract but I don't think it's been proven yet.

Q. As far as the risks of construction or permitting and licensing the various projects, is staff satisfied that the way the risks are allocated under the company's power purchase agreements is acceptable?

A. Would you please clarify that with regard to risk of permitting vis-a-vis the terms of the contract. I don't think I understand your question.

Q. Does the developer bear all the risks of construction and of paying the necessary permits and licenses to construct and operate the project?

A. I am not sure to what extent it's the developer's obligation to obtain all permitting process. I think that is the case but I don't recall. I know through my reviewing of these contracts in PRAM 2 with regard to Encogen and Sumas there was a litany of permits in these projects. Some of the permits they received, some of them they were in the process of receiving, some of them they hadn't applied for. The fact that they're paying for all of these permits and that if they don't get the permits they're liable

for the costs of not -- having paid for the development of the project and not being able to sell the power, I assume that's the case, subject to check.

Q. And in staff's view is that an acceptable way to allocate the risks of permitting and licensing the construction?

A. Yes.

Q. And these contracts typically include contract deposits to secure performance of the developer prior to commercial operation; is that right?

A. You mean as security provisions?

Q. Yes. Actually, there's a security provision for the whole payment amount and there's also the contract deposit to insure that the project comes on-line around the commercial operation date; isn't that right?

A. Not as clear on the contract deposit terms for all of those projects but I will accept that subject to check.

Q. Your testimony addresses the contract deposit provision as far as the Tonaska project, though, doesn't it?

A. Yes.

Q. And is staff satisfied that these contract

deposit provisions are adequate?

A. I don't recall.

Q. If we could look for a moment at your Exhibit 780 which discusses the payment that Tonaska would have to make in the event the project doesn't come on-line by the anticipated commercial operation date. And doesn't this exhibit show that the six months -- that if Tonaska is six months late, that it would be required to pay $1.2 million?

A. Yes.

Q. So you're somewhat familiar with the contract deposit provisions?

A. This does not refer to contract deposits. This is referring to the extension payment that Tonaska would be paying or crediting against their bills that they would be rendering to Puget if they were late in bringing -- if their project achieved commercial operation after April 1, 1994.

Q. Regardless of what you want to call it, you're fairly familiar with the provisions that relate to the payments that the developer would have to make if it doesn't bring the project on-line by the anticipated date of commercial operation?

A. Yes.

Q. In staff's view, are these provisions

adequate?

A. No. To the extent that the amount of revenue that the developer over the life of the contract will be expected to recover from Puget, this amount probably is insignificant in the big picture over the life of the contract.

Q. Would you agree this amount has some relationship to the damages that Puget would incur for the project coming on-line late?

A. Puget hasn't displayed to me that there's any connection between this extension payment calculation and any damages that they would be looking at.

Q. In your view the extension payment should be tied rather to what the developer would make as a profit over the life of the contract. Is that what you stated earlier?

A. Would you restate that question, please.

Q. Yes. I am trying to determine, in your view you believe that payment should be measured according or by reference to what the developer would make as a profit over the life of the contract? Is that what you stated earlier?

A. No. My exhibit is provided in support of the argument that there is not -- this extension

payment does not provide financial incentive to Tonaska to be timely in the bringing of its project into commercial operation in a timely manner. That's the purpose of this exhibit.

Q. A $1.2 million penalty for being six months late is not sufficient in your view, is that your testimony?

A. As my exhibit shows, for one month's sale --

JUDGE HAENLE: I'm sorry, let's start with a yes or no and then explain, please.

THE WITNESS: I'm sorry.

A. Would you please restate the question.

Q. It's your testimony that a $1.2 million payment for being six months late is an insufficient penalty; is that right?

A. That's correct. I would like to go further then and say that as I show in my Exhibit 780 that $1.2 million is approximately 20 percent of the bill that Puget will be paying to Tonaska for one month of power sales. So in other words, Puget, for the life of the contract -- for the first year of this contract will be paying to Tonaska $6 million a month a year for the entire contract year and that those rates -- the rate that those purchases are based escalate over time so that that $6 million a month that Puget pays

to Tonaska for power goes up over the next 20 years of the contract.

JUDGE HAENLE: How much more do you have, Mr. Van Nostrand?

MR. VAN NOSTRAND: I believe I'm finished, your Honor.

JUDGE HAENLE: Have you questions, Mr. Trinchero?

MR. TRINCHERO: One moment. No questions, your Honor.

JUDGE HAENLE: Have you questions, Mr. Meyer?

MR. MEYER: No questions.

JUDGE HAENLE: I indicated when we went on the record that you would be appearing, as we discussed, later than 9:00. You are now here and you are representing Washington Water Power?

MR. MEYER: I am.

MR. PAINE: No questions.

JUDGE HAENLE: Does the Navy have questions?

MS. GIANULIAS: Yes.

CROSS-EXAMINATION

BY MS. GIANULIAS:

Q. Mr. Moast, the company's proforma

adjustment for the revenue effect of -- adjustment for the revenue effect of normalizing temperature assumes line losses of 7 percent; is that correct?

A. That is correct.

Q. I take it that the staff does not agree with Puget's 7 percent line loss assumption?

A. That is correct.

Q. Am I correct in stating that the percentage of line losses realized by Puget has declined steadily since 1989?

A. You're correct.

Q. The company's actual 1992 line losses were 6.1 percent; is that correct?

A. Yes.

Q. Is it true that line losses for Puget have not been at or above 7 percent since 1989?

A. Yes.

Q. Generally speaking, improvements to transmission and distribution facilities typically result in decreases in line losses; is that correct?

A. Correct.

Q. Since 1989 the company has improved and added to its transmission and distribution facilities within its service area and continues to improve these facilities; is that correct?

A. Yes.

Q. So taking into consideration Puget's improvement in its transmission and distribution system, in your opinion, is it likely that Puget's line loss percentage will increase to the 7th percent level projected by the company?

A. No.

MS. GIANULIAS: No further questions.

CROSS-EXAMINATION

BY MR. ADAMS:

Q. Morning.

A. Morning.

Q. Like to pick up on that same topic of line losses and referring you to the top of page 6 of your testimony where you indicate the staff's proforma temperature adjustment. Are you the staff witness responsible for the staff's temperature adjustment?

A. Yes.

Q. I believe that's reflected as item 2.04 in Mr. Martin's results of operations?

A. Yes.

Q. Now, as I understand it staff's adjustment -- this is the temperature adjustment, would increase revenues by $25.6 million, correct?

A. Subject to check, correct.

Q. And the effect on net operating income is an increase of $16.2 million. Would you accept that subject to check?

A. Yes.

Q. And as I understand it, these amounts are different from the temperature adjustment shown by the company in Mr. Storey's exhibit. Would you agree?

A. Yes.

Q. My understanding of the similar proposed adjustment for the company reflected in Mr. Storey's Exhibit 558 would be a revenue increase of $28.4 million and a net operating income increase of $17.9 million. Would you accept those subject to check?

A. Yes.

Q. Is the difference between the staff adjustment and the company adjustment the difference on the line losses that you just discussed?

A. Yes.

Q. With respect to the temperature adjustment itself, did you make any change to the adjustment for temperature on the amount of energy generated, purchased and interchanged?

A. We made recommendations that certain

projects be excluded from the PRAM 3 process, but

other than that, no, we have not made any changes.

Q. With the change in line losses that you recommended, do you believe that the temperature adjustment method used by the company is a reasonable method for calculating weather normalized loads and revenues?

A. Based on the review that I did, I couldn't come up with anything to dispute with it. I would say yes.

Q. Now, would you turn to page 20 of your testimony. Actually just a general reference to the area you discuss secondary sales and secondary purchases of PRAM simplified model. Do you recall that?

A. I have it.

Q. Would you agree that your concern with the company's method of calculating average secondary power rates is that it overstates the cost of secondary purchases and understates the revenue from secondary sales?

A. Yes.

Q. And you recommend that separate purchase rates and sales rates be used in the simplified dispatch model to set PRAM rates, correct?

A. Yes.

Q. Would you agree that you and Dr. Blackman have identified the same problem in the company's simple dispatch model in that in recommending the use of separate purchase and sale rates you are proposing similar solutions to the problem?

A. Yes.

Q. Now, is it correct that you proposed to calculate separate secondary purchase and sale rates by developing price spread factors using historical prices and applying those factors to the average secondary rate for any particular month?

A. Correct.

Q. If you would look at your Exhibit 782, PJM-4 -- page 4, in this exhibit you calculate the secondary sales factor at 107.4 percent; is that correct?

A. On page 4?

Q. I may have given you the wrong page number.

A. Page 6?

Q. Yes. There you calculate the secondary sales factor at 107.4, correct?

A. Yes.

Q. Does that mean that on average over the years 1991 and 1992 the secondary sales rate was 107.4

percent of the weighted average of sales and purchase

rates?

A. Yes.

Q. And you used the same method to calculate the secondary purchase factor of 87 percent?

A. Yes.

Q. These price spread factors would be used for the purpose of projecting secondary purchase costs and secondary sales revenues for each upcoming PRAM period; is that correct?

A. Yes.

Q. Now, looking at page 8 of this exhibit, the box at the top section contains projected secondary purchase and sales rates for the first three months of the PRAM 3 period, correct?

A. No. I would like to clarify that. This table here is provided only to show that as simplified dispatch model as it's currently programmed already is fully capable of handling secondary sales and secondary purchases that are separate and distinct. These are not numbers that I use -- only for no other purpose than examples. These are not based on any sort of projections but I would be glad to provide those.

Q. Were those numbers calculated using the price spread factors?

A. These numbers that are shown in the boxes weren't but other prices that would be -- could be used that are based on the price spread factor. Again these numbers are only provided for examples and I believe I used Puget's numbers and just differentiated a two mill ramp-down, I think, for secondary sales rate. That was just for example purposes.

Q. Have you prepared projected secondary rates for the PRAM 3 period?

A. No, I haven't.

Q. As I understand your testimony, these price spread factors would be used solely for projecting future secondary rates; is that correct?

A. That is correct.

Q. And the secondary rates used in PRAM true-up would be based on the actual secondary purchase and sales transaction?

A. Yes, under recommended modification of Puget's current way of identifying and distinguishing between the factors that contribute to secondary sales versus secondary purchases.

Q. Could you turn now to page 7 of Exhibit 782 and is your proposed method of calculating actual secondary rates for PRAM true-ups illustrated on page

7?

A. Yes.

Q. As I understand it the company's method of calculating a weighted average secondary rate is illustrated in part 1 of that page and your method of calculating separate purchase and sale rates is illustrated in part 2; is that correct?

A. Yes.

Q. Looking at part 2, your method where your method is illustrated, do you see line 8 which is marked CT total load?

A. Yes.

Q. And the amount for the month of October 1991 is 3,747, correct?

A. Correct.

Q. Am I correct that represents energy from the dispatch of the company's combustion turbines?

A. Yes.

Q. Do the amounts on that line include operation of combustion turbines for emergency backup service?

A. Subject to check I will say yes.

Q. In general, would the cost per kilowatt hour of emergency backup energy be more or less than the cost per kilowatt hour of normal combustion turbine energy?

A. I don't know. It could be higher for emergency backup purposes.

Q. Would you not assume that it would be?

A. I would rather not assume that it would be. It depends on market conditions at the time that the gas is being purchased but it could be.

Q. In a month when the company is purchasing a lot of secondary power or running its combustion turbines to a large extent, would the inclusion of emergency backup costs produce a large distortion in the average secondary rate?

A. Yes.

Q. Why would it?

A. I'm sorry, maybe I misunderstood your question.

Q. You're running it a lot already and now you have to use it for emergency. Would you not agree that you would not?

A. I misunderstood you. I thought you were asking me if you had to use a lot for emergency purposes only would it cause a distortion in the rate.

Q. No. Assume that it's being run a lot and you have to use it for some emergency use, would you agree that it would not?

A. Then it would not. I misunderstood your

question.

Q. On the other hand, when you have a month when the company is purchasing or generating very little secondary power, in that situation could the emergency backup costs distort the average secondary purchase rate?

A. Yes.

Q. Now, it is correct, is it not, that the simple dispatch model and in that model some amounts are included at their projected levels rather than being trued up to actual; is that correct?

A. To my recollection I thought all CTs were in the true-up period process were trued up to actual, but I will have to --

Q. I'm sorry. I didn't mean to tie it specifically to CTs, but there are some things that are projected and not trued up, is that not correct?

A. In the company's total resource mix certain resources are not trued up but remain as projected.

Q. For example, it is possible that in a month the company might be purchasing a small amount of secondary power but the simple dispatch model would calculate a larger amount of purchased power; is that correct? Let me give you an example. For example, if coal plants produced more power than projected the company's actual secondary purchases could be less than the purchases calculated by the simple dispatch model. Would that not be correct?

A. If coal projects provide more power than projected, the simplified dispatch model could, in fact, show that the company was buying secondary power when in fact it really wasn't?

Q. Correct, or overstate the amount of purchase.

A. Yes.

Q. Do you believe that the costs per kilowatt hour of emergency backup energy is a reasonable estimate of the rates that Puget would be likely to pay for secondary purchases from other utilities?

A. No.

Q. Do you believe that the company can or should operate its combustion turbines on an emergency basis instead of purchasing power on the secondary market?

A. I'm sorry, I don't understand the logic of your question.

Q. Would you agree that rather than running combustion turbines when secondary energy is available at a lower price, the company should buy secondary energy?

A. Yes.

Q. Now, looking at page 3 of the same exhibit, as I understand this page shows the company's actual historical secondary purchases and sales; is that correct?

A. Correct.

Q. And at the top of the page what is designated as 293 and 193 are January and February of this year?

A. Correct.

Q. Now, looking at the secondary transactions in the month of January 1993, the line 193, would you agree that the company purchased 24,648 megawatt hours of energy in that month and sold 41,762 megawatt hours?

A. Yes.

Q. So the net -- for the month as a whole, the company had a net sale of 17,114 megawatt hours, correct?

A. Yes.

Q. And would you agree that in the simple dispatch model only the net amount of 17,114 megawatt hours would show up because the simple dispatch model does not allow for both purchase and sales in the single month?

A. We're talking about in the true-up portion of the simplified dispatch model now, not on the projected portion?

Q. I think we're talking about the projected portion.

A. Well, if you were using these numbers for projects all other things being equal I suppose you could say that that would be the amount that would be shown as secondary sales.

Q. Well, the model does not calculate both purchases and sales in a single month, does it?

A. No, it does not. It just balances the amount of energy that comes from all of the resources on a projected basis versus what Puget's projected needs are going to be and that delta, or difference, would be either a secondary sales or a secondary purchase.

Q. So it reflected either a purchase for the month or sales for the month when, in fact, there were both purchases and sales?

A. Yes.

Q. Now, in January of 1993 the company had a net secondary -- was a net secondary seller in the amount of 17,114 megawatt hours and your exhibit shows that the average secondary sale rate for that month

was 55 mills; is that correct?

A. Correct.

Q. Now, is it accurate to say that in a month like this one where secondary sales exceeds secondary purchases your proposed method of calculating secondary power costs in the PRAM would involve multiplying the secondary sale rate by the net secondary amount for the month?

A. Correct.

Q. So in this instance, that is January of 1993, the secondary sale amount of 17,114 megawatt hours would be multiplied times the 55 mill KWH rate yielding a revenue of $941,270. Would you accept that subject to check?

A. Correct.

Q. And under your method of including secondary power in the simple dispatch model a net revenue amount of $941,000 would be included for that month; is that correct?

A. Correct.

Q. Now, looking again at your exhibit. Would you agree that the company's actual secondary sale revenue for January 1993 was $2,297,622 and its actual secondary purchase cost was $862,106?

A. Correct.

Q. If we do the subtraction would you agree that the company's actual net secondary revenue that month was $1,435,516?

A. Yes. And in my proposed method in the true-up portion those differences would be reflected.

Q. In the true-up?

A. In the true-up.

Q. Because there you would be reflecting actual?

A. Yes, sir.

Q. But in the projected, looking ahead, it would not; is that correct?

A. Correct.

Q. So in terms of the projection would you agree that the net secondary revenue calculated by your proposed method is $494,246 less than the company's actual net secondary revenue in the month of January? That's just the mathematics?

A. All other things being equal, subject to check, I would say yes.

Q. I think you indicated that would be trued up when the actuals reflect --

A. Yes.

Q. Now, finally turning to the area of

prudence, and you discussed this with Mr. Van Nostrand,

where you state that the staff disputes recovery of some purchased power contract costs not on prudence but on other grounds, does that statement mean that you believe that the contracts are prudent or that you have not reached a conclusion with regard to prudence based on the evidence that the company has supplied you?

A. We have not received enough evidence from the company to allow us evaluation of prudence.

Q. Based on your testimony and your included exhibit that shows a response from the company, do I gather that the staff had difficulty in getting this detail when requested?

A. The data responses that we received to our data requests did not provide us the documentation we needed.

Q. At page 31, starting at line 14, you state and I quote, "What is needed is a demonstration that the resource that was acquired from a bidding process is least cost and that all relevant factors (e.g., dispatchability, transmission impacts, other bids, building options, financial and rate impacts) were considered in selecting the bid resource."

In your opinion has the company made such a demonstration with respect to any of the new purchased power agreements that it is seeking to include in this

proceeding?

A. In our opinion it has addressed certain of them to some extent but has not addressed all of them to a satisfactory extent and on some basis these certain things were not evaluated virtually at all.

Q. So basically you don't believe they've made such a demonstration?

A. Yes.

Q. Thank you.

MR. ADAMS: That's all I have.

JUDGE HAENLE: Commissioners, have you questions?

CHAIRMAN NELSON: Yes.

EXAMINATION

BY CHAIRMAN NELSON:

Q. Follow up on that last question from Mr. Adams being concerned about simplification and the flexibility of the regulatory process. I am a little concerned about what standard staff is requiring the company to meet. I guess I am concerned with that same sentence, Mr. Moast, that the staff is not trying to establish a kind of gotcha game. At page 33 the question answered there from line 16 to line 22, I think you elaborate and you say "fully

provide documentation of its decisionmaking process." I am just wondering what level of detail would really satisfy the staff because at some level of decision making one enters the realm of the intuitive and I am sure at some point there's a judgment from a CEO about what resource is going to be acquired and so on. And so I guess that would be the first question is if you can describe with more specificity what level of detail would satisfy the staff. And then, second, I would like to ask a following question but maybe I will wait, how this will interface, if I can use that awful term, with market forces. You haven't enough in this case but can you give me an example of what level of detail would be satisfactory in this prudence question?

A. Yes. The concerns that we have are not to argue that resources should be disallowed because they haven't been shown to be prudent. Our concern more is going on a forward-looking basis setting and establishing a level of expectation for responsibility in evaluating the broad range of resources that are available to the company, in addition to building or converting existing facilities to combined cycle. Looking more thoroughly at what the company needs going on out to the future. Does it need 100 percent capacity factor, purchased power contracts through the

year or does it really need winter energy and capacity? And we don't think that the company has fully explored these considerations prior to entering into these contracts, and while we're not looking to disallow them now, we think that the tone should be set for a level of expectation that a much higher level of rolling up the sleeves, doing the hard work, documenting your evaluations is needed in the future.

So, with regard to specific examples of areas where additional work is needed to justify prudence, we think that identifying what its loads and energy requirements are going to be in the future is going to be needed to better identify a good match between specific resources. Certain resources are 100 take and pay, certain are much more flexibly dispatched on a ramp up and ramp down basis and better match the company's needs, and by looking at these things the company may see opportunities for identifying lower cost resources that positions them to serving their needs now and also in the future.

Where we stand now is that since they haven't done that we're in the context of a PRAM we have a system where these exceedingly high levels of surplus secondary power being sold off at a secondary rate through the simplified dispatch model. And it

doesn't seem logical that that should be the way that that's appropriate in ratepayer's interests. So we're looking to trying to avoid that in the future.

Other areas where the company can do more is that we feel --

Q. Let me just stop you there. Now, you see you've just called it simplified dispatch model and you went through a long line of questioning with Mr. Adams about secondary energy instead of running CTs. How could we have gotten at that in the planning model at all? As a post hoc review, Mr. Elgin, when he was on the stand, said he wanted the Commission to address reform of a planning process but when you get into these prudence questions you get into this post hoc review question and I will tell you it's anything but simple to listen to you two go at this colloquy and try to come up with the appropriate system of what regulatory oversight is in a fast-moving market environment.

A. I agree.

Q. There needs to be specificity, I expect, from the company but we also need to have some specificity and some rigorous sort of analysis of how chronologically we go through from the planning process to the state where we are now with this post

hoc review for the future. And that's what I'm trying to get at. I don't need a long lecture about where we are now. What I am trying to get is where we go in the future with our administrative process. Because, as we've constructed the least cost planning role of the competitive bidding rule, which as I seem to recall, has some notion that the avoided cost will have some factor, some recognition of what actually turns up in the competitive bid, to factor into the next avoided cost determination, we're trying as we've been doing in the telephone world to navigate between the good things that the competitive market has produced and arm's length transactions produce and the old system of making sure that the company is efficient and effective for ratepayers.

A. I agree. And I believe and I fully support the market competition recognizing that market competition and promoting innovation and creative marketing practices, resource acquisition options, as well as regulatory review. The world is changing and the world is fluid, but we -- at the same time I feel that we cannot let that, allow the company to feel comfortable that they can collect full recovery of resource costs if they hadn't reviewed it fully. So we want to just establish a level of expectations that the

company should be comfortable doing a lot of documentation as far as what their decisions are based on, and let us have that, and we haven't received that information in this rate proceeding vis-a-vis the reference to acquisitions being consistent with the least cost plan and leaving it at that. So I agree with you, it's a fine line and we have to be flexible and I would like to see now, since they have acquired all of these resources, to trying to pull together some sort of firm summer sales package that they can get a high price for this excess power in the summer and lowering customers' rates by it.

Q. Mr. Moast, we also want to avoid being micro managerial you would agree, I'm sure?

A. I agree.

Q. And that's what I am trying to find some standard for the future. Now, let me just ask you this as a hypothetical. Could we have a standard in this jurisdiction where resource is acquired under the competitive bid are prima facie deemed prudent?

A. Yes. With assurance that all of the factors leading up to the bidding process were thorough, again, as I said earlier with Mr. Van Nostrand, that I -- I like to make sure that whatever is being identified as to need that the bid is going

out to acquire was pretty rigorous with regard to winter versus summer needs as opposed to peaking needs. I would like to see some real specificity in the bid process as far as what they want to get.

Q. So once again, the staff's oversight then would be factored in, you would want a rigorous documentation of the process leading up to the bid?

A. Oh, yeah. Like the IRP process, for instance, because as it stands now be, that's the basis for creating the avoided costs which is the nexus that goes into the bid.

Q. Thank you. I will ponder all of this. No easy answer.

COMMISSIONER CASAD: We're all heading down the same path here so I would like to extend the discussion of prudence.

EXAMINATION

BY COMMISSIONER CASAD:

Q. And I get the impression, staff is indicating that company has provided inadequate documentation to demonstrate prudence, and I am wondering what standard is required of the staff to demonstrate imprudence? Is it a given that if the

company does not demonstrate prudence, therefore, every resource acquisition for which that demonstration is not made is automatically imprudent? What standard exists to demonstrate imprudence?

A. It would be a question of -- I don't think that the first example you cited, Commissioner Casad, is appropriate for disallowance or a demonstration of imprudence, I agree. But I do think that a question of degree would be the consideration as far as to what extent was there a negative consequence to ratepayers or to the environment or whatever, but we will use the example of ratepayers, if a certain acquisition resulted in some sort of excessive negative consequence to ratepayers, we think that that would be something that we would hope would have been caught before it occurred so that things got weeded out.

Q. I share your view or I expect that that is your view. I share your view that it is improper to attempt to provide preapproval. I think that's improper. I share your view that the Integrated Resource Plan in and of itself isn't enough to demonstrate prudence. I don't believe that's true. But conversely, there is an obligation to determine realistic prudence and by realistic prudence I do not mean Monday morning quarterbacking, reasonable

decisions that utilities managers made at the time that they made them. I mean, let's take an example. If a prudent utility or reasonable utility manager made a resource acquisition decision which, at the time it was made, was reasonable, and then circumstances which occurred thereafter demonstrated a loss for reasons which were beyond that reasonable utility manager's control, I would not consider that imprudence. Would you consider that imprudence?

A. I would not consider that imprudence.

Q. How do you differentiate, then, that which is a reasonable decision? And these are difficult issues. Talking about secondary power source and you're talking about capacity contracts. If capacity were acquired or secondary sales were made at a rate that was advantageous to the ratepayer that would be a very reasonable prudent decision on the utility manager's part?

A. To be commended and expected.

Q. And if for some reason the secondary sales resulted in a loss or there was no requirement for that capacity for some reason, then that would be a bad imprudent decision on the utility manager's part?

A. You're using the word "imprudent" without disallowance, not connoting disallowance at this

point, yes.

Q. A lot of things can go either way, can they not? Depending on things that are really not within the control of the utility. The utility manager has an obligation to serve, he has an obligation to insure that he has adequate energy and capacity to serve the needs of those within his franchise area. To fulfill that obligation to serve would you rather fudge a little bit on the side of having too much or too little?

A. If the energy manager was really trying hard to keep costs down I would be more comfortable with him fudging on the side of acquiring a little bit too much, but it hasn't been shown to me that the company has rigorously tried to keep costs down.

Q. Now, what's the correlation between those two factors?

A. Well, if you try to not acquire resources that are a bad match to your system needs, if you try to acquire resources that are --

Q. I was trying to -- you're applying a cost factor -- when you say hold costs down, you mean hold costs down in resource acquisition or do you mean hold costs down generally?

A. Both, but I am specifically referring to

resource acquisition.

Q. Okay, I'm with you now.

A. So with regard to resource acquisition costs, if a company is very aggressive in monitoring secondary sales market or spot market, looking at what its resource supplies are and seeing that it has some surplus that it can sell at a profit and it's aggressive, has a track record of trying to do these things and it's proven through its actions that these are things that it places priority on with regard to keeping or crediting ratepayers' costs with these benefits and benefiting ratepayers then and occasionally does something that would be deemed possibly imprudent or didn't -- proof of the pudding did not turn out the way they thought it would, I think that's fully acceptable and understandable and reasonable.

To the extent that a utility manager bases his decisions or her decisions on what they know at the time I think then the question is what have they looked at and have they really tried hard to look at all of the issues or have they said, Well, this is an acceptable list of criteria and let's not go any further, let's make a decision. And then something doesn't pan out and I said you didn't really do all the

upfront work. And then if something turns out that it's to the detriment to the ratepayers to be incurring higher costs that flow through the rates I would have to to say that next time you should have looked at more issues and been more thorough in exploring all the options before you make a similar decision. And if they don't and that same mistake occurs again, then we're moving into the realm of is the utility supply planning process adequate and is it -- or is it actually displaying imprudence. And again, not on a first mistake but on a track record of repeatedly not being rigorous enough in the planning process.

Q. So what you're kind of recommending, if I understand you correctly, is that the fool-me-once-shame-on-you, fool-me-twice-shame-on-me?

A. Yes. It's a more than a Monday morning quarterbacking it's more of a --

Q. Two strikes and you're out. In view of your approach and your indication that there are some things that are to be commended, if the utility aggressively pursues least cost resources and the same utility demonstrates a particular skill in acquiring purchased power at extraordinarily reasonable rates and they demonstrate great skill in moving their secondary power or whatever and power exchanges, whatever kind of

arrangements exist, they do an extraordinary job there, is it your view that there should be some incentive or some reward that utility should receive for doing an exceedingly good job if, on the other hand, you're willing to penalize them if they do apparently an exceedingly bad job?

A. That's a good question. Since I'm only a utility rate research specialist I wouldn't want to profess policy for the Commission, but I think it's something that should be reasonably considered, but I wouldn't want to state policy.

Q. That's all I had.

A. But I think it's reasonable.

Q. Thank you.

A. You're welcome.

JUDGE HAENLE: Commissioner?

EXAMINATION

BY COMMISSIONER HEMSTAD:

Q. You may well have answered this question in your response to the questions of Chairman Nelson and Commissioner Casad but I am not sure I understand it. It's your testimony that the company has not demonstrated prudence in its resource acquisition program. All right, then, what is, quite

specifically, the remedy or the consequence of the sanction for that failure to demonstrate?

A. In this rate case?

Q. In this rate case.

A. We're not recommending disallowance on basis of prudence of any of the resources. There are specific resources that are new and haven't come on-line yet but the company has included in their rate filing as being projected to come on-line. And they're recommending that where the costs of those for on a project specific basis we have found that there's other reasons that specific projects should not be included in rates through this proceeding which, actually will be the PRAM 3 year which runs from October 1, 1993 it starts, because one of the things in this rate proceeding is to settle upon a level of agreement of power resource costs and assumptions that will be used in the PRAM 3 filing which we've just received.

Q. So in your view even though they haven't demonstrated prudence they, in effect, get over that hurdle anyway?

A. Yes. With regard to Encogen and Sumas, for instance, which are two projects that are either just starting and ramping up or imminently going to be

coming on-line, those projects we are not arguing the prudence of, and they are going to be in PRAM 3.

Q. But with respect to the others, at some future date they would be able to --

A. Recover costs.

Q. -- recover the costs but not -- at least not in this particular proceeding?

A. Correct.

Q. Well, if the company has overpurchased resources, then it has access to the secondary market to sell that overproduction, and that, I assume, is what -- on page 3 of your Exhibit 782 is showing of the excess of sales overpurchases in the secondary market, isn't it?

A. That's one way of doing it. That's what's shown there in the simplified dispatch model as it's currently constructed. There's another way where if there was a substantial amount of, say, summer power that was not needed by the company, the company could consider marketing it as a package of firm or reliably available power to sell at a higher price than the secondary prices in that model. And those firm sales could also be slotted into the simplified dispatch model as a credit against resource costs.

Q. Well, what ultimately benefits from those,

let's assume, excess sales of secondary power --

A. It depends.

Q. -- as between the ratepayers and the shareholders?

A. It depends on whether the price that the power is being sold for is higher or lower than some of the costs incurred in generating the power in the first place.

Q. Well, I'm looking at this exhibit again, page 3. In each of the years except 19 -- as I read it, each of the years except 1988 there's a substantial surplus of power sales over power purchases?

A. That is correct.

Q. And but for the exception of 1988 then those excess power sales would be of benefit to the ratepayers?

A. Not necessarily, sir. If you turn to our recommendation, for example on the Nintendo sale in Exhibit 783, page 1, I selected in my cross-examination with Mr. Van Nostrand that for purposes of an example the highest price resource that would be backed off as a credit against Puget's option to sell or decision to sell firm power to Nintendo, in this example is the Koma Kulshan hydro project, and

subject to check I could be wrong, my recollection is that on an average kilowatt hour basis or, I'm sorry, mill basis, the Koma Kulshan is costing Puget around 55 mills. So in this example, for instance, going back to your reference on page 3, Puget is paying out 55 mills for power from selected resources, and that is higher than what they are getting in secondary sales. So, to an extent that Puget has gone out in its decision-making process and acquired resources that they didn't need at higher prices than the secondary sales, ratepayers are being hurt. To the extent that they can go out and sell that power for higher prices than what it is costing them for these resources ratepayers would benefit.

Q. If I understand you, the differential between the overall purchase price and the sales price should have been even higher than what is reflected in this exhibit?

A. Secondary sales is what you call a nonfirm sale. It's like an instantaneous dumping onto the marketplace of what's not needed or going on out and trying to buy on an instantaneous basis what you need. That's just one factor.

Q. My point is, if they were let's say

imprudent in acquiring those resources then the cost

or the secondary purchase price or cost would have lower and the differential then would have been higher?

A. I see. The cost of the resource that Puget or any utility buys doesn't really have an isolated resource specific basis, doesn't have an effect on the secondary sales and purchase. Secondary sales and purchases is more of a market force dynamic that reflects a lot of resources, all the coplants, hydro availability.

Q. Let's say that Puget, from your perspective, has had an element of substantial good luck with respect to the reality that their sales have been very attractive over the last several years?

A. Could be. It may also be that their secondary sales are occurring at more desirable times and at the point in time that they have surplus power maybe it's more on peak available surplus power, they can market it at a higher price, but I couldn't justify that, but there may be many reasons as well as marketing expertise, although I have seen through my discovery questions in conversations with the utilities, other companies seem to be successful in selling their secondary sales at higher prices than what they're buying. Washington Water Power, for

instance.

COMMISSIONER HEMSTAD: I have no further questions.

JUDGE HAENLE: Anything else, Commissioners?

Have you redirect, Mr. Trotter?

MR. TROTTER: Yes.

JUDGE HAENLE: Can you estimate how much?

MR. TROTTER: 10, 15 minutes.

REDIRECT EXAMINATION

BY MR. TROTTER:

Q. Mr. Moast, you were asked questions from Mr. Adams and Commissioner Hemstad about secondary purchases and secondary sales. Am I correct that the essence of your Exhibit 783 is that there have been -- excuse me, 782 -- is that Puget has consistently sold secondary power at a higher rate than it has purchased secondary power?

A. Yes.

Q. Is your proposal here a refinement on the SDM model?

A. Yes.

Q. With respect to the new contracts coming into rates, Sumas, Encogen, Tonaska and March Point,

would you identify which of those were not obtained through the competitive bidding process?

A. Sumas, Tonaska and March Point, I believe, phases 1 and 2 were not acquired through the competitive bidding process.

Q. Has Puget always purchased the lowest priced power or DSM that was offered in the competitive bidding process?

A. I don't think so.

Q. Commissioner Casad identified a prudence review that the review would be made of the decisions made by the company at the time they made it. Do you recall that question?

A. Yes.

Q. Have you attempted to undertake that inquiry in this case?

A. Yes.

Q. And am I correct that Exhibit 784 contains a data request essentially asked for that type of information?

A. Yes.

Q. Mr. Van Nostrand asked you a series of questions regarding features of certain of Puget's contracts. Were your responses based on the information that you were able to obtain from the

company?

A. Yes.

Q. One item was security and contract -- you mentioned various contract amendments. Were those amendments -- what contract did you have in mind in that context?

A. Specifically the Tonaska project and the Encogen projects.

Q. And did you ask -- were those amendments filed with the Commission?

A. Yes.

Q. Did you ask the company to explain the purpose of them?

A. Yes.

Q. Were you provided an explanation or were you told to read the contract?

A. The contracts were provided to us without any cover letter explaining what was in the contract amendments and in the case of the Tonaska these amendments were substantial.

Q. Did you ask for an explanation?

A. Yes.

Q. Were you told -- were you given an explanation or were you told to read the contract?

A. Upon calling up Mr. Lauckhart I received an

explanation of the spirit of the amendments, but I felt that there's many ways of interpreting a contract amendment as far as who is bearing the risk, and with regard to these contracts it wasn't always clear that ratepayers were being sheltered from additional risk. And these were not explained to me by Mr. Lauckhart.

Q. One housekeeping matter. You were asked from public counsel whether there was any difference between the staff and company temperature adjustments other than the line loss -- other than what was impacted by the line loss calculation. Do you recall that?

A. Yes.

Q. Would you accept that there is a difference between the way staff has treated the impact of PRAM schedule 100 revenues compared to the company?

A. Yes.

Q. On Exhibit 785 you were asked a question about proforma adjustments to rate base being inappropriate. Do you recall that question?

A. Yes, I do.

Q. Is it your understanding that the objection there is that the proforma adjustment to rate base alone is inappropriate and needs to be measurements of offsetting factors?

A. Yes.

Q. Is it your understanding that the staff's adjustments to rate base meet the proper definition of a proforma adjustment to the extent they are proforma adjustments?

A. Yes.

Q. Staff is concerned that the Black Creek adjustment does not meet that definition?

A. Yes.

Q. Would it be fair to say that a demonstration of prudence would be for Puget to demonstrate that it adequately considered all available resource options?

A. Yes.

Q. Would one such option be the conversion of Puget's existing turbines to combined cycle?

A. Yes, on an individual site-specific basis each of them has potential. Some of them may be more beneficial than others.

Q. Would another be a hydro firming strategy?

A. Yes.

Q. Did Puget provide any studies comparing either of those two options?

A. No.

Q. Turning to your coal price adjustment. You

were asked a question as to whether or not the adjustment that staff proposes would encourage the company to negotiate lower price. Do you recall that question?

A. Yes.

Q. In your view should the company operate at the lowest cost regardless of whether a rate making adjustment would be made?

A. Yes.

Q. And similarly, Commissioner Casad mentioned the prospect of a company that's extraordinarily successful in purchasing low cost resources. Do you recall that question?

A. Yes.

Q. To the extent that that company is correct that it has concerns about its competitive position, would its ability to purchase any commodity at an extraordinarily low price have a reward of improving its competitive position?

A. Yes.

Q. Mr. Van Nostrand asked you whether you considered a visit to the Tonaska site before or after you distributed your direct testimony. Would you tell us upon referencing your calendar over the weekend, do you have the date upon which you made the request?

A. Yes. I made the request to visit Tonaska on April 21 when I visited Puget and met with Mr. Lauckhart. That date precedes the filing of my direct testimony.

Q. Turn to page 10 of your testimony. This question regards your testimony regarding the uncertainty of Tonaska's commercial operation date. On lines 3 to 5 you refer to a prior delay in commercial operation?

A. Yes.

Q. Are those dates correct, September 1, 1993 to April 1, 1994?

A. Yes.

Q. That would be somewhat in the neighborhood of 18 months?

A. Eight.

Q. Excuse me, eight months?

A. Subject to counting the months.

Q. Did you ask the company to document its estimate of Tonaska's on-line date?

A. Yes, I did.

Q. Was any documentation provided?

A. No.

Q. Apart from the on-line date, you have a concern about the synchronization of recovery of this

adjustment; is that right?

A. Yes.

Q. And that concern was reflected by the Commission in the PRAM 2 order where it adopted your recommendation regarding Encogen and Sumas?

A. That is correct. In my PRAM 2 testimony I expressed concern that if these projects -- these projected project costs were included in PRAM rates prior to the power plants becoming commercially operable, ratepayers would be paying eight months in advance of when the power plants would be delivering -- first began delivering power and that, in fact, through schedule 100, these costs would be substantially paid for by ratepayers prior to the plants coming on-line, because of the timing of the PRAM year, the PRAM runs from October through September, therefore, a project that's projected to come on-line in July at the end of the PRAM year, July, August and September, last three months of the PRAM year, are nonheating months. So very little electricity is needed and sold on Puget's system. But that those costs would have been paid for throughout the winter heating season even before the ratepayers received any benefit from these power plants.

Therefore, it was better to address the issue in the

following PRAM filing and include the costs in the true-up portion in the following PRAM year.

Q. Finally you were asked some questions about the proposed 358 megawatt purchase. Do you recall that?

A. Yes.

Q. Has such a contract for purchase -- has such a contract for purchase been signed as of today?

A. No.

MR. TROTTER: Nothing further, thank you.

JUDGE HAENLE: Will there be recross?

MR. VAN NOSTRAND: No.

JUDGE HAENLE: Recross from anyone?

MR. ADAMS: I had one question.

JUDGE HAENLE: Go ahead.

RECROSS-EXAMINATION

BY MR. ADAMS:

Q. Perhaps following up a little bit on questions from Chairman Nelson and Commissioner Casad. Would you look at Exhibit 784, response to your data request 1141. And I am looking at page 3 of the attachment 1 and page 4. There are a series of, if you will, specific factors of both price and I think there was some nonprice factors listed on those pages.

Is it -- is one of the documents there or some of the information that staff is seeking basically on a specific project basis an analysis by the company telling us why, how it rated dispatchability for this project or not dispatchability, how it looked at environmental -- in other words, go down the list so that one knows how the company analyzed each one of these various criteria?

A. Yes, but certain of those issues are more important than others in the big picture so therefore certain issues should be reviewed more extensively than others. Using the word list, I'm kind of not comfortable with the word list as far as a checklist as opposed to saying each resource is unique and provides different benefits and potential risks, and those benefits and risks on their own merits should be individually addressed.

Q. Am I correct that part of your frustration was not being able to find that kind of specific analysis to find out what the company thought about and analyzed when it made its decision?

A. It wasn't provided.

Q. And so that is part of your frustration in trying to review the prudence of these projects?

A. Yes.

MR. ADAMS: Thank you.

JUDGE HAENLE: Anything more of the witness? Thank you, sir, you may step down. Take our morning recess at this time, be back at five minutes after.

(Recess.)

(Marked Exhibit T-791.)

JUDGE HAENLE: Let's be back on the record after our morning recess. During the time we were off the record another staff witness has assumed the stand.

Also during the time we were off the record I marked for identification a multi-page document. In the upper right-hand corner has APB-testimony, T-791 for identification.

Whereupon,

ALAN BUCKLEY,

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

DIRECT EXAMINATION

BY MR. TROTTER:

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

A. Alan P. Buckley, B U C K L E Y.

Q. What's your business address?
A. 1300 South Evergreen Park Drive Southwest, Olympia, Washington.
Q. You're employed by the Washington Utilities and Transportation Commission as a utility research specialist; is that right?
A. Yes, I am.
Q. In the course of your duties as a utility rate research specialist did you have cause to prepare testimony in this case?
A. Yes, I have.
Q. Is Exhibit T-791 your direct testimony?
A. Yes.
Q. If I asked you the questions that appear in that exhibit would you give the answers that appear there?
A. Yes.
MR. TROTTER: Your Honor, I would move for the admission of Exhibit T-791.
JUDGE HAENLE: Any objection, Mr. Van Nostrand?
MR. VAN NOSTRAND: No, your Honor.
JUDGE HAENLE: Any objection from intervenor?

Exhibit T-791 will be entered into the

record.

(Admitted Exhibit T-791.)

MR. TROTTER: Witness is available.

CROSS-EXAMINATION

BY MR. VAN NOSTRAND:

Q. Good morning.

A. Morning.

Q. Your testimony addresses the company's proposed elasticity adjustment?

A. Yes.

Q. Would you agree that a fair definition of that is that it attempts to capture the anticipated response of customers to price changes?

A. Yes.

Q. And a simple example would be that perhaps a 10 percent price increase does not result in a 10 percent increase in revenues because customers may adjust their usage in response to a change in prices?

A. Yes, with emphasis on the word "may."

Q. Would you agree that estimating elasticity depends upon the analysis of a number of factors?

A. Yes.

Q. Some of these would be the ability of customers to change their usage, would you agree?

A. Yes.

Q. And the availability of alternative energy sources?

A. Yes.

Q. Prior to your testimony in this proceeding, did you ever analyze elasticity or make any estimates regarding the demand elasticities of customers?

A. I have not made any adjustments to the actual elasticity itself. I have used the elasticity.

Q. In what context?

A. In my previous employment with R.W. Beck and Associates, I carried out studies where elasticity estimates have been incorporated into rate design whenever those were for nonregulated entities, small PUDs, municipal systems, various other small nonregulated entities that they did not have the opportunity to recover monies under a regulatory process and at the discretion of the personnel in charge they were incorporated into the rate design.

Q. And have you previously presented testimony anywhere regarding elasticity adjustments?

A. No.

Q. Have you reviewed the order in the decoupling proceeding which established the PRAM?

A. No, I have not.

Q. And have you reviewed the orders of the Commission in the PRAM 1 and PRAM 2 proceedings?

A. I have generally, I guess I would have to say, reviewed or looked at both of those orders. I am relatively new at the Commission and have not been involved in the decoupling proceedings. In a general sense looked at them but not in any detail.

Q. Do you understand how -- strike that.

Doesn't the PRAM mechanism incorporate estimates for future periods as part of the annual adjustment process?

A. Well, it's my understanding that the process includes proforma adjustments, which under the Commission's definition, under the WAC rules is known and measurable. However, as I say in at this testimony I think the point my recommendation that this adjustment be rejected is it doesn't meet those requirement under the proforma rules.

Q. So you are aware as part of the PRAM procedures, does it not include projections for a number of customers' power costs and expected conservation expenditures for a future period?

A. Yes, it does.

Q. And are these the type of adjustments what you would characterize as being proforma adjustments?

A. Well, no. I am not testifying here on whether those particular adjustments are proforma. What I did here is looking specifically at the elasticity adjustments as testified by Mr. Hoff and in the context of this proceeding I looked specifically at those and felt that they did not meet the proforma requirements under WAC 480-09-330. And so that's one of the reasons why of my recommendation in my testimony that they be rejected.

Q. Would the estimates included as part of the PRAM filings for number of customers, power costs and expected conservation expenditures, would those meet the definition of being known and measurable?

A. I don't know. I didn't look at those. Again, I will say that I specifically in this proceeding looked at price elasticity only.

Q. By estimating amounts for future periods for number of customers, power costs and conservation expenditures, isn't the effect to reduce the amount of deferrals, in other words to align as closely as possible the receipts and allowed revenues in the PRAM mechanism?

A. That's generally my understanding, yes.

Q. And you understand the difference between receipts and allowed revenues under the PRAM; is that

right?

A. Yes.

Q. Would you agree that the company's proposed elasticity adjustments are made also with the intent of reducing the amount of deferrals under the PRAM?

A. That's the result of cross-examination by Mr. Hoff, I believe is one reason he stated is there being a reason for that. However, I stated in my testimony I don't feel like an arbitrary decision or an arbitrary factor to reduce deferrals is in keeping in the spirit of either the PRAM or the requirement under the proforma adjustment requirement.

Q. What do you understand the spirit of the PRAM to be?

A. Well, I go back to your last few questions. I think those are regarding customer counts and such all I'm saying here that a reason for incorporating the price elasticity adjustment I do not feel like the stated intent of reducing deferrals should be a proper reasoning for the incorporation of the price elasticity adjustment, the deferrals are the result of a number of things, temperature, hydro, economic conditions, they are municipal availability, growth, customer count. Number of issues.

Q. Is your testimony as far as the PRAM goes

that increases in the price of electricity will not cause any changes in usage by customers in response to those price changes?

A. I am saying that the increases -- first of all, let me go back and state that under the staff's proposal there is no revenue requirement increase, but in the event that there was, I am saying that it is not known and measurable under the proforma requirements.

Q. And on this point your testimony cites a previous Commission decision which found that elasticity adjustments were not known and measurable; is that correct?

A. Yes, I reference Cause U-75-40 which is a Pacific Northwest Bell filing in 1975 where there was significant discussion and testimony and discussion in the Commission's orders regarding price elasticity.

Q. And that proceeding involved the application of the Bell Labs' suppression model to Pacific Northwest Bell service territory?

A. Yes, and that's one of the points why I chose that particular case was trying to point out that in that cause at the time the Commission specifically stated that there was a ponderance of testimony about price elasticity. There was three expert witnesses,

two statisticians, I think an economist statistician, there was two models, one Bell model, one by the company to point out that in spite of the volumes of testimony that it still came to the bottom line that these were estimates. They are not known and measurable and that the Commission, as I state in page 6 of my testimony, there's several quotes there regarding that order, that the Commission found that the pre-elasticity adjustments should be rejected. Again, recognizing that there was a ponderance of testimony on the subject in that particular proceeding.

Q. Didn't that testimony attempt to present elasticity on something other than a nationwide basis?

A. I am not sure of the exact geographic description of the particular case. Again, I did not read the testimony in that particular case. I believe we are trying to get that out of the archives now in response to one of your data requests, so I would have to say I don't know.

Q. Wasn't the basis for the Commission's decision that nationwide averages were insufficient proof of a specific level of demand elasticity in Pacific Northwest Bell's service territory?

A. I think they may have stated that. Whether that's the exact reason for rejecting the elasticity

adjustment was more on the basis, as far as I read it, that in general they're estimates and they don't meet known and measurable requirements.

Q. Are Hoff's elasticity adjustments based on nationwide averages or on circumstances particular to Puget's service territory?

A. I would have to say my understanding of it might be a little bit of both. I know particularly the econometric model that was used specifically to develop the elasticity factor, but there was also assumptions regarding end use elasticities in particular to air conditioning or heating or other factors that might be the result from nonspecific Puget customer territory numbers. I would hazard a guess that it might be a mixture of both but I realize it's a Puget specific econometric model used to develop the general price elasticity factors. But where the actual end use assumptions, end use numbers that were used, whether they're Puget specific, I cannot say.

Q. And back to the Pacific Northwest Bell proceeding. Was there a revenue recall adjustment mechanism in the case of that company that would have captured any over- or underrecoveries in the event the estimates proved to be wrong?

A. I don't know.

Q. Do you not believe that would be a relevant consideration in determining whether or not an elasticity adjustment would be appropriate?

A. Well, I think if I take the source of that. I know in the Puget case there is a mechanism for capturing the effects of price elasticity if it indeed occurs. So I didn't figure it was necessary to go back and explore in too much detail the particular proceedings of the Northwest Bell whether there was or wasn't.

JUDGE HAENLE: Can you concentrate on speaking slowing for the reporter, please.

A. I am assuming under the regulatory process that there would be, but again, I am looking at the Puget case and knowing that under decoupling that there was a mechanism to recover those revenues, as Mr. Hoff has stated.

Q. And so you don't -- your testimony is that it's not important to deciding whether or not to adopt elasticity adjustment whether or not if that adjustment proves to be correct, the over- or underrecoveries to be captured, that's not a relevant consideration?

A. No. I think I stated that it was a

consideration. I think the point is again at this

particular time it's not known and measurable, that under decoupling the mechanism is there for recovery of revenues that are deferred as a result of not only price elasticity but all the other issues of it. Again, that's one reason for my recommendation.

Q. Have you done any sort of independent analysis of the potential revenue impacts that Mr. Hoff estimates in making his elasticity adjustments?

A. I have looked at the company's responses to data requests and the information they have regarding the $3.3 million revenue impact.

Q. And have you made any sort of analysis of them to determine whether or not you believe they're correct?

A. No. I again made the decision in this case to not go back and redo Mr. Hoff's work regarding the use of the econometric model, the use of the assumptions, the use of his estimates. That does not form the basis for my rejecting the proposed elasticity adjustments. Again, I look at his reasons for making them and to me they backed up my recommendations. For example, if I look at the optional tariffs, schedules 30 and 48, and looking at this in light of whether it's known and measurable, I notice that these are new

schedules. We don't know the customers that are going over to them. The customer has calculated the elasticity adjustment by applying -- I have my notes -- they calculate the difference between the tail block rate and an average rate and then they apply an elasticity that's derived from an econometric model, and when those are applied to the estimated number of customers that are proposed to take that schedule, I don't consider that a known and measurable amount. But, no, I did not go back and redo Mr. Hoff's work papers or studies regarding the derivation of the $3.3 million.

Q. Without having done that, how did you conclude that a substantial overcollection of revenues from ratepayers might arise in the event the adjustment were adopted?

A. That was primarily a result, as I believe I stated in a data response, was from the bench request No. 510, I believe, where the company was asked to rerun an exhibit that was presented incorporating the effects of revenues if rates were developed incorporating the proposed elasticity adjustments, but applied to billing adjustments not adjusted for elasticity, and that would give you essentially an upper end, if you will, of $3.3 million.

It's sort of a reverse calculation of the way Mr. Hoff calculated the $3.3 million. What I've said in my testimony was that is the potential for overcollection in the event that the customers' response to price elasticity does not occur as the company projected.

Q. So it's the $3.3 million figure which you refer to as being substantial?

A. I consider that substantial, yes.

Q. And if it turned out the customers didn't react in the way that Mr. Hoff anticipated and this revenue were collected, do you understand that it would be returned to customers through subsequent recoveries under the PRAM?

A. Yes, I understand that that's the mechanism as well as for other costs that go into it.

Q. Did the company make a proforma adjustment to the revenue requirement for the elasticity impact?

A. Did the company? Yes.

Q. Is the company's adjustment a proforma adjustment to the revenue requirement?

A. No. I'm not an accountant, but no, I don't believe that they did.

Q. It just affects the billing determinants?

A. Yes, the billing determinants were

adjusted.

MR. VAN NOSTRAND: No further questions.

JUDGE HAENLE: Before we continue with the cross-examination let's go off the record to discuss scheduling, please.

(Discussion off the record.)

JUDGE HAENLE: Let's be back on the record. During the time we were off the record we discussed scheduling and I noted that Pacific Corp and Water Power, although they were scheduled to go today it looks like we probably won't get them today. They have indicated they would be willing to come back on Wednesday and we appreciate very much their flexibility. We then agreed that we would take Mr. Blackman and Mr. Winterfeld on Friday, the other witnesses on Thursday so that they would not have to come back three days in a row but only two. Did you gentlemen have anything to add?

MR. MEYER: Just thank you for accommodating us.

MR. PAINE: That will be fine, thank you.

JUDGE HAENLE: I agreed to call you gentlemen and let you know what time we were starting on Wednesday after the open meeting. Thank you for your courtesy.

Mr. Trinchero, have you questions of the

witness?

MR. TRINCHERO: No, your Honor.

JUDGE HAENLE: Have you questions?

MS. GIANULIAS: No, your Honor.

MR. ADAMS: No questions.

JUDGE HAENLE: Commissioners, questions?

CHAIRMAN NELSON: No.

JUDGE HAENLE: Do you know how Mr. Hoff measured any offsetting factors to reduce sales due to elasticity?

THE WITNESS: No, I don't believe he just adjusted the bill determinants and applied that to the revenue requirement to determine the rates. I don't believe there was any offsetting adjustment.

JUDGE HAENLE: Thank you.

Anything more of the witness?

MR. TROTTER: Just one.

REDIRECT EXAMINATION

BY MR. TROTTER:

Q. You were asked a question by Mr. Van Nostrand to the effect that if elasticity -- the elasticity estimate didn't work out the dollars that were collected would be returned to the customers. Do you recall that?

A. Yes.

Q. Would the company have use of that money and the customers would not have use of that money until it was returned?

A. Yes.

MR. TROTTER: Nothing further.

JUDGE HAENLE: Anything more of the witness?

Thank you, sir. You may step down. Let's go off the record to changes witnesses, please.

(Marked Exhibits T-792, 793, T-794 and 795.)

(Recess.)

JUDGE HAENLE: Let's be back on the record. Before we take the next witness, I might indicate that what we have just discussed with regard to scheduling, in my opinion, makes Ms. Williams' production of a witness on Wednesday unnecessary. I therefore feel that her motion has become moot. We're going to have plenty to do without her and so I will call her and let her know that we do not need to have her produce her witness on Wednesday but that her witnesses must be available on Thursday. So I am not going to rule on the motion one way or the other. I expect that because we don't need her to bring a witness in, that is not necessary.

I had marked for identification a number of documents as follows:

Marked as Exhibit T-792 is a multi-page document, HL-1 in the upper right-hand corner.

793 for identification, HL-2 in 35 schedules, plus an index and some other things.

T-794, supplemental testimony in 11 pages HL-3.

And 795, HL-4 which includes schedules, 1, 2, 35 and 36.

Looking at this, as I understand the last schedule of 795 says "confidential" in the upper right-hand corner. As I understand from the company, I inquired while we were off the record, Mr. Van Nostrand has indicated this does not indeed contain confidential information in the form that it is set up; is that correct?

MR. VAN NOSTRAND: Correct, your Honor.

JUDGE HAENLE: On the official copy I will cross out the confidential indication and ask everyone else to do the same.

Whereupon,

HUGH LARKIN,

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

DIRECT EXAMINATION

BY MS. GIANULIAS:

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

A. Hugh Larkin, Jr. Last name is spelled L A R K I N.

Q. Please state your business address for the record.

A. Business address is 15728 Farmington Road, Lavonia, Michigan 48154.

Q. Mr. Larkin, are you the same Hugh Larkin whose qualifications are set forth in appendix 1 of Exhibit T-792?

A. Yes.

Q. Were Exhibits 792, 793 and 794 and 795 prepared by you under your supervision?

A. Yes, they were.

Q. Do you have any corrections to make to those exhibits at this time?

A. There are two typographical errors that I noted. On page 6, line 20, schedule 4 should be schedule 3. And on line 12 -- excuse me, on page 12, line 14, schedule 9 should be schedule 8. Other than that I haven't noticed any other corrections that are

necessary at this time.

Q. If you were asked the questions set forth in these exhibits, would your answers be the same as today?

A. Yes, they would.

MS. GIANULIAS: Your Honor, I request that Exhibits T-792, 793, T-794 and 795 be entered into the record.

JUDGE HAENLE: Have you any objection to the entry of the documents?

MR. VAN NOSTRAND: The company does not object to T-792 and 793. I would like to ask a few questions of the witness with respect to the supplemental testimony.

JUDGE HAENLE: You may.

VOIR DIRE EXAMINATION

BY MR. VAN NOSTRAND:

Q. Mr. Larkin, on what information is your supplemental information T-794 and 795 based?

A. It's based in part on updates and in part on information we received related to the company's consolidated income tax return.

Q. That was a response to Department of

Defense data request No. 1871?

A. I believe that's correct.

Q. When was that request first made of the company?

A. I don't recall.

Q. Would you accept subject to check January 26, 1993?

A. Yes, I will.

Q. And do you know when the company responded to that data request?

A. I think they responded in part before the testimony was due, but there was something wrong with the response. It didn't have enough detail for us to make the calculation.

Q. Would you accept subject to check that that response was given on February 9, 1993?

A. The original response?

Q. Yes.

A. Yes.

Q. What was done after the original response was given to follow up on what was deemed by the Navy to be insufficient?

A. I think we probably asked supplemental requests.

Q. When was that done?

A.   I don't recall offhand.

Q.   When did you receive the information that you felt was necessary in order for you to prepare your testimony?

A.   I think it was received late but before we filed the original testimony but there wasn't time to analyze it and put it together.

Q.   Would you accept subject to check that it was received by you via telefax transmission at 5:14 p.m. on April 23?

A.   Could be correct.

Q.   Is that not ten days before your testimony was due?

A.   Could be, but there were other things we had to work on at that time and didn't have the time to concentrate on.

Q.   Do you know whether the Navy entered into a confidentiality agreement in order to obtain access to the information the company had provided in response to that --

A.   I believe that's correct.

Q.   Do you know what date that agreement was entered into by Mr. Furuta, your counsel?

A.   No, I don't.

Q.   Will you accept subject to check April 20, 1993?

A. I will accept that.

MR. VAN NOSTRAND: Your Honor, the company objects to the admission of Exhibits T-794 and 795. The due date for filing opposing testimony in this proceeding was May 3. Navy made no arrangements with either the Commission or the company to submit supplemental testimony. The claim the Navy believes it can submit this testimony was based on its failure to receive certain information which it failed to pursue with the company for nearly two months, and when the necessary arrangements were made so that this information could be provided to the Navy that was done on April 20, the information was promptly related to the Navy, fully ten days before Mr. Larkin's supplemental testimony was due. We would submit it's extremely prejudicial to the company to be asked to accept -- although Mr. Furuta indicates the testimony was distributed on May 7 it was not in fact received by the company until May 12 -- we believe it's extremely prejudicial for the company to be asked to respond to the testimony which failed to observe the filing deadlines and was received by the company with an inadequate amount of time for us to do adequate discovery on.

JUDGE HAENLE: When was the supplemental

request received by you, Mr. Van Nostrand?

MR. VAN NOSTRAND: We don't indicate there was any supplemental request received in writing. The original response to 1871 indicated that confidentiality arrangements would have to be made before that information could be made available and the signed confidentiality agreement was not returned by the Navy until April 20 and I have copies of these documents. Once we received that we promptly faxed the information to Mr. Larkin at his office on the 23rd. I would also submit that the complexity of this adjustment is not such that it requires a lot of time to calculate, the ten days was sufficient.

JUDGE HAENLE: The objection is that it was not prefiled by the due date. Do you want to respond?

MS. GIANULIAS: I would have to check on that, your Honor. My understanding is that it was timely filed but I would have to check on that.

JUDGE HAENLE: It did come in after the prefiling date. I don't know at what point it came in. It was not filed within the time it was specified to be prefiled, I'm positive of that.

MS. GIANULIAS: I would have to go back and check.

JUDGE HAENLE: Do you want to report back

on that after lunch then?

MS. GIANULIAS: I would have to check with Mr. Furuta. If I get ahold of him I will be able to report back on it.

JUDGE HAENLE: We've had no objection to the entry of T-792 and 793 so far. Have you an objection to any of the documents, Ms. Brown?

MS. BROWN: No objection.

JUDGE HAENLE: Mr. Adams.

MR. ADAMS: No, I have none, your Honor. Could I ask a clarification question, though? Is company's objection to the whole document or just a piece of it because some of this, as I understand it, is correcting some errors versus new information so I just wanted to find out what we're -- are we addressing the whole document because I think the witness in any case is entitled to correct errors.

MR. VAN NOSTRAND: It goes to the entire document. I think we would all like to have another nine days to correct errors in previous testimony. We have filing deadlines and they need to be observed. It goes to the whole document.

JUDGE HAENLE: Mr. Richardson?

MR. RICHARDSON: No objection, your Honor.

JUDGE HAENLE: All right. I am going to

enter T-792 and 793. We will deal with the admissibility of the other document after lunch and you can begin your cross-examination then. It does seem to me that the company has made corrections to its testimony at the time of cross-examination, has it not, in the past?

(Admitted Exhibits T-792 and 793.)

MR. VAN NOSTRAND: It has not filed updated documents in a similar manner. The correction part of it relates to the fact that Mr. Larkin's revenue requirement calculations did not correspond with Mr. Legler's rate of return calculations, rather a fundamental correction. The rest of it is responding to updates by the company. And no one else had an opportunity to take additional time to analyze and incorporate into their testimony this information.

JUDGE HAENLE: My question was from time to time does not the company make updates to its prefiled testimony?

MR. VAN NOSTRAND: Updates, yes.

JUDGE HAENLE: We will deal with the admissibility then after lunch. Why don't you begin with your examination.

CROSS-EXAMINATION

BY MR. VAN NOSTRAND:

Q. Start on page 4, Mr. Larkin, your discussion of plant held for future use. Your testimony proposes a number of adjustments to the properties included by Puget as plant held for future use, is that a fair statement?

A. It proposes three different types of adjustments.

Q. And your first adjustment shown on schedule 4 removes 16 properties which the companies agree should properly be removed from plant held for future use?

A. That is correct.

Q. And your second adjustment is to remove those items of property which the company does not expect will be used within ten years; is that correct?

A. That is correct.

Q. And essentially by your adjustment you're asking the Commission to adopt and enforce in this proceeding a policy that properties must be used within ten years in order to be included in this category?

A. Yes.

Q. You would admit that the Commission has not previously enunciated a previous benchmark ten

years for this property?

A. No, they have not, but the purpose of my testimony is to urge the Commission to do so.

Q. And the effect of your adjustment is to have the Commission adopt this policy now and enforce it retroactively with respect to the property included in the account 105; is that right?

A. It would, yes. It would implement that policy now, but the company has had that property in plant held for future use and it has earned a rate of return on it for a number of years so it's not like it's a --

Q. But you would agree, wouldn't you, that the company would not have had an opportunity to modify its practices in light of a policy which the Commission adopts in this proceeding?

A. That is correct.

Q. Are you familiar with Exhibit 760 in this proceeding which is just the excerpt from the Uniform System of Accounts that describes account 105?

A. I am familiar with the Uniform System of Accounts.

Q. Would you accept subject to check that Exhibit 760 is just the excerpt from the Uniform

System of Accounts that describes 105, plant held for

future use?

A. I will accept that.

Q. Is there anything in the description of account 105 which requires the property be used within 10 years before it can be included in that account?

A. I don't believe so, but there might be somewhere else in the Uniform System, some description. But I don't recall any offhand.

Q. Would you accept subject to check that account 105 requires that the electric plant must be, "owned and held for future use in the electric service under a definite plan for such service"?

A. Yes, that's what I was thinking of.

Q. And the third piece of your adjustment for plant held for future use is to exclude all remaining balance of plant held for future use basically; is that right?

A. It would exclude it and allow the company to record a carrying charge on that property until such time as the property was placed in service and was used and useful in providing service to ratepayers, that would negate the problem that currently exists that ratepayers would pay indefinitely on property that may or may not provide them service.

Q. These carrying charges you're talking about, they're just accounting entries, aren't they?

A. Yes.

Q. There's no cash?

A. There's no cash, but the accounting entries are included on a regular basis, such as AFUDC on plant construction and there's depreciation is an noncash adjustment. FASB 106 right now is a noncash requirement. So there are lots and lots of adjustments that are included in cost of service that are noncash adjustments.

Q. In the case of your proposal for plant held for future use, in the event the property is ultimately determined not to be necessary and doesn't get placed into service the company would never recover the carrying charges; is that right?

A. They would recover them if they were able to sell the property for the original cost plus the carrying charge. They would eat anything less than original cost plus the carrying charge and they would gain anything above the original cost plus the carrying charge. So, it's an even policy that places upon the company the burden of determining and taking the risk associated with placing or taking this property and making sure that it is eventually put

into service for ratepayers.

Q. If we could try to illustrate your proposal by a simple example. Let's assume the Navy announces that within the next decade it will expand its facilities in Bremerton and the company, anticipating that upgrades in its facilities will be necessary to serve the Navy expansion, acquires land to build a new substation within the vicinity of the facilities. At the time the land is acquired there is a definite land and it is tied to the anticipated needs of the Navy. Five years later, however, the Navy announces that it has changed its plans and the expansion will not occur. The company has no other need for the property and decides to dispose of it. Under your proposal this property would never be included in rate base; is that right?

A. That is correct.

Q. And the company would never recover its carrying costs, would it?

A. No, it would not -- well, they would recover it if they were able to sell it for what they originally paid plus the carrying charge.

Q. Well, assume that given the change in the Navy's plans for expansion that real estate prices dropped dramatically in Bremerton and the company

sells it at a loss, it would not recover this loss, would it?

A. That is correct.

Q. Under your proposal, wouldn't the company in all cases be better off by not anticipating future needs but simply waiting until the last minute to acquire properties so that it can be sure that the property is absolutely necessary?

A. No. They would be taking the risk that the property that they acquire would either be used in providing utility service or in the alternative that they could sell it for a price that exceeded the original cost plus carrying charge. So it would have a motivation to insure that whatever they purchased was property that would not depreciate and would not be available in the future.

Q. Why does the company buy property for electric utility purposes? What's the reason for the decision?

A. Well, there's an assumption that property may be necessary in the future to provide electric utility service.

Q. And do you believe it's easier to acquire properties in advance of development in an area or simply to wait until the development has occurred

before buying property on which to located necessary electric facilities?

A. It depends. Sometimes if the area develops it is not possible to buy it without condemnation, but that places upon the company the burden of deciding whether that particular area is going to develop such that the prices will escalate that they can't buy that property at some future point at a lesser cost.

Q. In the example I gave you it would have taken the risk in loss; is that right?

A. In your example that's an example that you take all the time or the risk that you take all the time. If you went ahead and you expanded power facilities in addition to serve the Navy there's no way you would recover those costs if it was excess capacity. You have to determine and take steps to insure that what people tell you really is going to come to pass. You are the best party to do that.

Q. Wouldn't you agree that notwithstanding what people tell the company the company has an obligation to meet the electric service needs of the customer?

A. Any reasonable projection or any reasonable increase the company should anticipate but I don't think that you're required to buy facilities every

time somebody says we might do something. For instance, if there's a customer that's a thousand feet off the distribution line, you're not required to run that out there free or uneconomically. The Navy does make -- if you were building a facility specifically for the Navy, the Navy does make contributions in aid of construction. So, you could ask the Navy that if you are really making these plans and you expect us to serve, we expect you to make a contribution to this line that is going to go specifically for you. That would be reasonable and that would avoid your possible loss.

Q. Dividends declared, page 11?

A. Yes.

Q. How do you define working capital for purposes of this adjustment?

A. Working capital is the -- for this particular adjustment it's cost free capital that's provided -- working capital is the additional investment that stockholders and bondholders make over and above facilities in order to operate the company. As it relates to this particular adjustment these are cost-free funds that ought to be deducted from working capital.

Q. What's the accounting transaction that

occurs when dividends are declared?

A. The accounting transaction is to debit retained earnings and to credit accounts payable and it's that accounting transaction that changes the nature of this dividend. It no longer is part of the company's equity. And the stockholders are now unsecured creditors just like any other accounts payable. So if the company were to go bankrupt at that particular time that particular dividend, preferred and common, would stand just like the accounts payable, person who had sold something to the company, they would be an unsecured creditor. And that's why this is a cost resource of funds that should be deducted from working capital.

Q. Does the bookkeeping entry itself have any impact on the availability of the funds to the company?

A. Well, the bookkeeping entry doesn't affect funds or cash in and of itself. The amount of cash to pay them is there or isn't there. The bookkeeping entry changes the nature of the dividend from a source of capital that the company is entitled to return a rate of return on to a cost-free source that they're not entitled to earn a rate of return.

Q. Once the dividend is declared do the investors immediately receive the funds from the company?

A. No.

Q. So they're still available to the company?

A. That is correct. But they are in the nature of an accounts payable.

Q. So it becomes zero cost merely because you say they don't need to earn a return on them?

A. It's zero cost because of the adjustment and that is the way return on equity is calculated. You don't calculate a return on equity by adding in dividends declared. Company doesn't earn on that. When analysts analyze what a company actually earns, they take an average of what's actually in common equity and divide that into net income. That doesn't include dividends declared. So they're not entitled to earn a rate of return.

MR. VAN NOSTRAND: No further questions, your Honor.

JUDGE HAENLE: I assume you mean lunch break, although it sounded real good.

Let's take our lunch break now and be back at 1:30, please.

(Luncheon recess at 12:00 noon.)

AFTERNOON SESSION

1:30 p.m.

JUDGE HAENLE: Let's be back on the record after our lunch recess. Go ahead, Mr. Van Nostrand.

MR. VAN NOSTRAND: Thank you, your Honor.

Q. If we could look at the other accumulated deferred income taxes. Your schedule 12, line 1 you also make an adjustment which removes $61,000 related to interest income related to Colstrip?

A. Yes.

Q. Your testimony notes that this item arises as a result of the settlement agreement between the owners of the Colstrip project this was realized as taxable income in 1989?

A. That is correct.

Q. When you made this adjustment, did you make the corresponding adjustments to take the deferred interest income out which created the deferred taxes?

A. Out of the test year?

Q. At the same time that you made this adjustment, wouldn't there also be a corresponding entry for deferred income tax?

A. If it's in the test year you would take that out, but the reason that I am taking it out of the rate base is because it's not a going forward

adjustment. After this is amortized this is gone and it's going to be gone January 1, 1993, I believe. So if you put it in the rate base now ratepayers would be paying a return on a deferred income tax which will not be there on a going forward basis. That's the reason for adjusting this out of the rate base, and if it is in the test year and it's not a continuing income it would be appropriate to take that out of the test year expense -- income but I wasn't aware that it was in there.

Q. If you could turn to Bad Debt Expense on page 23 of your testimony. You would agree that the company's proposal is to base the level of bad debts on the most recent five years of experience?

A. Yes, that's correct.

Q. And this is a practice that has been followed by the company in recent rate cases?

A. By the company and the Commission, but as my testimony points out steps have been taken to improve that and ratepayers are paying for those improvements and therefore the ratepayers should get the benefit of --

Q. And these improvements you're referring to are the items from Mr. Knutsen's testimony which you cite on page 23?

A. Yes.

Q. And apart from changes in the company's credit practices, would you agree that weather conditions also affect the level of bad debt expense?

A. Sure.

Q. And in fact Mr. Knutsen's testimony there at the bottom of page 24 indicates that if the weather is much colder and the bills are much higher, the bad debt expense could be higher?

A. That's true, but then the company's income is higher because the revenue they're collecting is above the level on which rates were based. So if the bad debt expense is higher, they're still earning more than they would on a normalized basis so it would be appropriate for them to pay a higher bad debt expense in that condition.

Q. Is the company's income higher if weather is colder under the PRAM decoupling mechanisms, as you understand it?

A. That may have an effect.

Q. Do you know what weather conditions were like during the test period?

A. They were warmer than normal.

Q. And doesn't it therefore follow that if the test period had warmer than normal expenditures, given

what you've previously stated, that the bad debt expense during the test period might be unusually low?

A. That was normalized and Mr. Knutsen said on cross that he didn't expect on a going forward basis that their bad debt experience would -- or that you would have more bad debts so I think the company's historical experience in recent years and Mr. Knutsen's conclusion that that looks like a reasonable level is an appropriate basis on which to set the bad debt expense.

Q. Would you agree that economic conditions in the company's service territory might also affect the levels of bad debt expense?

A. Sure.

Q. And that the levels of lay-offs might be higher in a stagnant or recessionary economy and lower in a robust or growing economy?

A. Yes, but when you establish rates we try to factor out all of that.

Q. Wouldn't you agree that using a five-year average tends to even out the impact of economic conditions on bad debt expense?

A. That would be true absent or if all of the improvements that the company has made were in place during that entire five-year period. They were not.

Therefore, in order for the ratepayer to benefit from the additional cost that he's incurring then the Commission has to look at the cause and effect, you pay more, you improve your collection process, the bad debt to revenue ratio goes down. That ought to be reflected in current rates.

Q. And using the five-year average will ultimately result that being reflected in rates, won't it?

A. Five years from now.

Q. Isn't the impact of the test period in the five-year average right now?

A. Yes, the past.

Q. If we could look to your testimony on the FAS 106 adjustment beginning on page 33?

A. Yes.

Q. And this item concerns changing from pay as you go for expenses associated with post retirement benefits to an accrual amount calculated in accordance with FAS 106. Is that a fair statement?

A. Yes.

Q. Could you give us some background on FAS 106 and what it relates to?

A. Well, FAS 106 is a pronouncement by the financial accounting standards board that in effect

stated that there is an undisclosed future liability that companies have to their employees. It is in FASB 106 characterized as deferred compensation, and 106 says that that ought to be disclosed and reflected in the financial statements of the company.

Q. And is it fair to state that FAS 106 prescribes the way that this liability would be accounted for and that companies are required to state this liability on their financial statements?

A. It does for nonregulated companies. For regulated companies FASB 71 affects that. And how it's stated for accounting purposes does not necessarily affect what should be reflected in rates.

Q. But what was -- the goal of FAS 106 was for comparability of financial reports that people would be able to compare this liability for deferred compensation from one company to the other, is that the goal?

A. That's part of it that it would be disclosed in the financial statements what that liability was.

Q. And you would agree that for financial reporting purposes Puget is required to record this liability calculated in accordance with FAS 106?

A. Yes, but I also point out how the emerging

issues task force pronouncement could affect how that is recorded on the utility's books. In other words, a regulatory asset and liability could be recorded which would not affect the company's income statement.

Q. Your testimony does not challenge the prudence or the level of Puget's post retirement benefit amounts, does it?

A. No, but I would hasten to say that we didn't do an extensive comprehensive analysis of that, and I think perhaps the Commission should rely on its own staff. All we're doing is -- first of all we state pay as you go is probably a better method, but based on the Commission's order and the staff's work paper it appears to us that the Commission would be inclined to give the company some amount of FASB 106 accrual. We're just saying here is a way to mitigate that effect on ratepayers by phasing it in.

Q. And you would agree that Puget's expense on pay as you go basis is $11.838 million? I believe that's on page 39 of your testimony?

A. Its expense is what?

Q. If it's calculated on a pay as you go basis its expense for post retirement benefits other than pension?

A. Is how much?

Q. About $1.838 million, line 3 on page 39.

A. Yes. That looks like the -- yes, pay as you go amount.

Q. I am trying to get a basis for comparison for pay as you go versus FAS 106. And the FAS number is as you stated $3.6 million?

A. Yes. But I hasten to point out that an accrual is not cash, pay as you go is cash, and accrual, $3.6 million is not something the company would actually have to expend.

Q. Is your primary recommendation that Puget continue to follow pay as you go or are you recommending the phase-in that you described later in your testimony?

A. Well, we would like to see the Commission go steady with pay as you go. We don't think that that's a recommendation they would follow. Therefore, our secondary recommendation is the phase-in.

Q. Have you presented a recommendation for a phase-in in other rate proceedings?

A. I don't think I have personally but perhaps somebody else in our firm has.

Q. Have you testified generally on the transition from pay as you go to FAS 106 accounting?

A.   Yes.

Q.   In other rate proceedings?

A.   Yes, and New Mexico and I believe Connecticut and perhaps Hawaii.

Q.   Did the companies in those proceedings, were the amounts comparable in terms of the difference between the pay as you go amount and the FAS 106 amount?

A.   I would say that I don't recall and there's liable to be substantial differences because of the age of the employees and the type of benefits that provided they could be all over the place.

Q.   Wouldn't you say that would be relevant to deciding whether a phase-in is appropriate, the difference between the FAS 106 amount and the pay as you go amount?

A.   It could be something that could be considered.

Q.   Your testimony at pages 41 to 45 discusses a tax advantages of certain funding mechanisms. You would agree that the funding mechanisms chosen by the company take advantage of the provisions you identified in your testimony?

A.   As far as I know they do.

Q.   Look for a moment at your adjustment for directors and officers liability insurance, page 52.

You're proposing to disallow 50 percent of the premiums paid by the company for directors and officers liability insurance; is that right?

A. I'm proposing that stockholders should pay for half of it. If you want to characterize that as a disallowance, yes.

Q. Do you believe insurance premiums paid by the company are a legitimate operating expense?

A. If they are for the benefit of the ratepayer, I do.

Q. Do you believe the company's carrying an excessive level of the directors and officers liability insurance coverage?

A. I didn't analyze that. My analysis was based on a conclusion that this primarily benefited the stockholders in that the board of directors worked for the stockholders and if anybody is going to sue anybody it's going to be the stockholders suing the board of directors. So I don't see why ratepayers should protect the board of directors from their own stockholders. I think that that's a cost that at least should be borne 50/50 by both groups.

Q. Have you done any sort of analysis of what sorts of lawsuits that shareholders initiate against their directors?

A. Not in detail but we've been involved for a number of years in utility cases and most suits by stockholders against utility executives have been for management decisions that went awry and that the stockholders lost money.

Q. Like participating in building generating plants that ultimately are abandoned?

A. Yes, and the sale of assets that stockholders conclude were not for the benefit of the stockholders.

Q. And you believe that when a company initiates construction of a generating plant it is doing so for the benefit of its shareholders?

A. Generally, because a plant doesn't become used and useful to ratepayers until it's finished and completed and put on-line and accepted by a Commission. So up until that time the plant belongs to the stockholders, doesn't belong to the ratepayers and it's not the ratepayers' responsibility.

Q. What sorts of other suits are filed against directors apart from decision of utilities to build generating plants?

A. I don't recall any offhand -- come to mind. Those are the ones that I primarily recall. There was a suit that stockholders filed against Tucson Electric

Power when they sold off a generating station to a company that was eventually owned by the president of that company. So I think that that was a similar stockholder suit but it wasn't abandonment of a plant.

Q. Isn't another reason for your directors and officers liability insurance adjustment is that this insurance also covers the company's subsidiaries?

A. Yes.

Q. Have you reviewed the testimony of staff witness Nguyen in this proceeding?

A. Briefly, yes.

Q. He proposes to allocate about 3.3 percent of the insurance premiums to the subsidiaries based on the net assets of the subsidiaries?

A. Yes.

Q. Would you agree that that figure represents the allocation that would be made if it were done on the basis of net assets of the subsidiaries?

A. I will accept subject to check that his calculations are correct. It wouldn't surprise me if that number were the right number.

Q. Did your adjustment consider whether or not the level of directors and officers liability coverage may affect the company's ability to attract and retain qualified directors on its board?

A. I am not saying that the company should change its coverage. All I am saying is that the stockholders ought to pay for half of it. So my recommendation doesn't change the coverage on these directors. It only allocates to the stockholders part of the payment for those premiums.

Q. So if the company increases the coverage it pays a greater penalty?

A. If the Commission accepts my recommendation that stockholders ought to pay for some part of it.

Q. Are you saying that customers do not benefit from having qualified directors serve on Puget's board?

A. No, I didn't say that. My testimony says that there is a benefit to stockholders for having this insurance and at least some part of that premium ought to be paid by the stockholders.

Q. If you could look at environmental remediation which begins on the next page, page 53?

A. Yes.

Q. I take it from your testimony you're recommending that the company not begin with covering its remediation costs and that these costs not be recovered until the next rate proceeding; is that right?

A. Well, or until there is a final determination of what the insurance coverage is in recovery and who is ultimately responsible.

Q. And your testimony recognizes the Commission's accounting order issued with respect to the company's environmental remediation program?

A. I recognize that there is one.

Q. And as part of that accounting order isn't the company required to flow through to customers any insurance proceeds which it receives in connection with environmental remediation costs?

A. Yes, but the final determination of what those insurance companies will pay has not been determined, and it seems to me if I were an insurance company being sued by the company, my first defense would be that you've already recovered these monies from the ratepayer and you don't belong in court. So if I were the Commission I would be cautious about passing it through to ratepayers. Even if there is a final settlement on insurance, you're not going to get that insurance money back to the exact people that you allocated the current costs to. So in my mind it's better to wait until you settled all the litigation, gotten all the money and then amortized it over a period of time into rates.

Q. Would that be a valid defense in the insurance litigation proceeding that the company could already recover these amounts in rates from customers?

A. I testified in a case in Illinois, and I understand that that's one of the issues that the lawyers in there raised with the Illinois companies is that if they recovered through remediation costs now that would be a defense that possibly the companies could -- insurance companies could.

Q. As long as the accounting order remains in effect there's no risk that whenever these insurance recoveries are paid that they ultimately be flowed through to the company's customers?

A. No. In answering your question -- there is no risk that it will be flowed through except that there will be a discrimination against certain groups of ratepayers who will have paid amortization and other groups of ratepayers who will see the insurance proceeds. So there's some inequity, intergenerational inequity there.

Q. If the company doesn't begin recovering some of these environmental remediation costs, will the company still be able to book this regulatory asset under accounting principles?

A. I would think so, as long as the Commission

agrees that it will get full recovery of the asset and the carrying cost.

Q. Doesn't it become a lot less probable if recovery doesn't commence in this proceeding?

A. I guess I don't think so. Under what theory?

Q. Can any deferred costs be put off indefinitely?

A. No, not indefinitely, but I think if the Commission says we think you ought to wait until the next rate case and see how this litigation ends up, I think that that is enough pronouncement by this Commission that those costs can be deferred under FASB 71.

Q. Look at storm damage for a minute.

JUDGE HAENLE: Before you go on, if you're changing subjects may we, now that we have all of the Commissioners, deal with the objection to the entry of the supplemental testimony and exhibit.

What did you find out?

MS. GIANULIAS: Your Honor, if anything, the Navy has been prejudiced. The Navy made a request for the data March 5, the last day for the request was March 6. That request was faxed to the company on

March 5. They had 10 working days to respond which

would have been somewhere around March 21 or 22. There was no response. My understanding is the Navy made two additional requests or maybe three. The company responded by April 21. The company has to recognize that the Navy needs a reasonable period to review the data, to draft the testimony and for mailing and distribution. The company has had the information three and a half weeks and I think it's untimely for them today to come in and say that they're prejudiced.

JUDGE HAENLE: Mr. Van Nostrand indicated that the supplemental information was sent on April 20. Is that not correct?

MS. GIANULIAS: I was told around April 21st.

JUDGE HAENLE: Mr. Van Nostrand.

MR. VAN NOSTRAND: Once we received the signed confidentiality agreement back from the Navy on April 20th, the information was sent out by fax on the 23rd.

JUDGE HAENLE: Why was this information not put into the supplemental testimony?

MS. GIANULIAS: My understanding is that the --

JUDGE HAENLE: I'm sorry -- into the

original testimony.

MS. GIANULIAS: It was not provided by the company.

JUDGE HAENLE: Well, there's been the representation of counsel is that it was provided on April 23rd. The prefiled testimony was due, I believe, May 3.

MS. GIANULIAS: Because it had to be reviewed, your Honor.

JUDGE HAENLE: Did you contact the parties and let them know that it was going to be late?

MS. GIANULIAS: The parties were aware that it would not be timely filed, is my understanding.

MR. TROTTER: There was a cover letter on the transmittal letter.

MR. VAN NOSTRAND: When the testimony was filed on May 3 there was the indication then for the first time that additional testimony was going to be filed later.

THE WITNESS: I think it's in my testimony, too.

JUDGE HAENLE: In your testimony you say you reserve the right to file supplemental testimony. I don't believe there was any right granted to file supplemental testimony. You can't reserve something you don't have. What we're trying to determine here is

whether information was requested timely and provided timely and whether there was good cause for any kind of late filing.

MR. VAN NOSTRAND: I do have some documents that if you want to see them I have a signed confidentiality agreement signed by Mr. Furuta on April 20th and the faxed transmission sheet dated April 23rd whereby this information was provided to the Navy.

JUDGE HAENLE: Well, if the information was provided on the 23rd, the information after the signed document on the 20th that seems to me to be relatively quick.

MS. GIANULIAS: I think there needed to be a review process, your Honor, which our consultant is in Michigan, we're located in California. By the time that review process was completed you need more than three days to review it.

JUDGE HAENLE: I think you had more than three days from April 23rd until May 3rd. I think that's the period of time we're talking about. My concern is that the purpose of prefiling and a prefiling deadline is to let all of the parties know what's in all at the same time so that they can conduct discovery on it and so that we don't have material trickling in from some period of time.

MS. GIANULIAS: Again, I think I want to reiterate that the company was late in responding to our requests. We made several requests. They had 10 days to respond. They did not respond within that 10-day time frame.

JUDGE HAENLE: Are you indicating that Mr. Van Nostrand is not correct when he indicated there was some response by February 9?

MS. GIANULIAS: I am just stating what I was told in a telephone conversation with Mr. Furuta. He informed me that he made three requests for the data. The company was late in responding to the data request, the company was aware that our filing would be late. The company did not object prior to this date that it was going to object and I think that is unfair that they are objecting today. They should have given us information that they would be objecting earlier than today.

JUDGE HAENLE: Mr. Van Nostrand.

MR. VAN NOSTRAND: I would think if the Navy proposes to file supplemental testimony perhaps they could secure some approval from the Commission or from the other parties that they intend to file testimony a week or nine days later after everyone has to file their testimony. I think if there's any

approval or any communication that has to occur among the parties it should have occurred then.

JUDGE HAENLE: Mr. Furuta has in the past requested approval from the parties to file testimony a day late. I don't know of him doing it on any other time without requesting approval from the parties or the Commission.

I am going to make a distinction between the new calculation, which I believe should not be included into the record on the basis that it was not provided in a timely manner, and updates to those calculations which had already been provided. We routinely see people bring in some updates to their numbers as those become available. We do not routinely see new calculations, and I do not feel that is appropriate.

Looking at the document, it seems to me, then, that the information regarding consolidated tax savings calculation should be excluded as not having been prefiled in a timely manner as per the Commission's instructions. The remainder of the testimony seems to me is in the nature of updates which are generally done either as a revision to direct testimony or done on cross-examination in order to save time and be efficient. I would leave the rest

of those in there, so that the testimony T-794 would be entered except for pages 2, 3 and 4 and 795 would be entered other than schedule 36 which is the new schedule. Now, I understand that there is a number from that schedule in the results of operations. I guess rather than trying to go through and bust that out in some manner, the Commission would have that number, it would not have any way of telling how the calculation was made and so it's not going to be able to use that calculation. But that's -- so the 795 will be entered only schedules 1, 2 and 35, not schedule 36.

(Admitted Exhibits T-794 and 795, with exceptions.)

MR. VAN NOSTRAND: Your Honor, could that also extend to the first four lines on page 5?

JUDGE HAENLE: Of what?

MR. VAN NOSTRAND: Of Exhibit T-794. That's where the recommendation, the number is brought in from the consolidated tax adjustment.

JUDGE HAENLE: Well, that is a part of it. Because I've left it in that other exhibit I figured that would help the Commission to have what the number is that they don't have the calculation to get to. So the Commission does not have any manner of testing this

witness' calculation but I thought leaving that in would help them identify the number.

Q. Resume with storm damage, Mr. Larkin, on page 58. Your testimony notes that Puget's recorded storm costs in this proceeding are substantially higher than in prior cases. Is that a fair statement?

COMMISSIONER CASAD: Can't hear you.

Q. Your testimony notes that Puget's recorded storm costs in this proceeding are substantially higher than in prior cases. Is that a fair statement?

A. The accounting is higher, yes.

Q. Are you suggesting that the reason for this higher storm damage reserve does not relate to particular storms but is due strictly to the manner in which Puget accounts for storm damage expense?

A. In part it's due to how you account for storm damage expense by allocating overheads and nonincremental costs of the storm damage.

Q. As I understand your adjustment you're proposing to reduce the storm damage expense by two separate adjustments, one is to reduce work order costs which do not appear to be incremental to or indirectly caused by storms, and the other is to exclude nonwork order costs; is that right?

A. Yes.

Q. As far as the first portion of your adjustment, is it correct you identified about $4.8 million of the expense associated with the Arctic Express storm of December 1990 and January 1991 as relating to overheads based on payments by Puget's insurer?

A. I will accept that number subject to check.

Q. And how did you determine that the basis for the insurance company's refusal to reimburse $4.8 million in costs related to the Arctic Express event related to a contention that certain overheads constituted fixed costs?

A. By looking at the total cost less the deductible, less the reimbursement, that's how we segregated those costs.

Q. Are you aware that the insurer took a position that more than one deductible would apply to the Arctic Express event and that that was a reason that affected the magnitude of the recovery?

A. That there was more than one deductible -- I assume there was one applied in December and one in January.

Q. That was the issue.

A. I would have to look at the calculation. I am not sure that was taken into consideration.

Q. Couldn't it be that the magnitude of the recovery was affected by how many deductibles the insurer applied rather than whether the expense items constituted fixed costs?

A. It could be there were fixed costs in there that I assume wouldn't be reimbursed.

Q. But your adjustment assumes that the reason they weren't reimbursed is because the insurer found they were fixed costs?

A. Yes.

Q. With respect to your treatment of nonwork order costs, I take it from your adjustment that you assume that if it's not a work order cost it's not storm related?

A. If they're fixed costs, if they would have been incurred by the company anyway and that those are in rates.

Q. Is it necessary to have a work order in order to have storm damage expense?

A. Generally so, that you want to segregate those costs.

Q. If your proposal on storm damage is adopted by the Commission, will the company be required to write off amounts previously recorded in the storm damage reserve and treated as a regulatory asset on

its financial statement?

A. You would be required to write it off. I don't know about treating it as a regulatory asset.

Q. Isn't that how it's treated on the financial statement, that's essentially a promise that these amounts will be recovered in rates in the future?

A. Maybe I misunderstood your question. Did you say write it off and treat it as --

Q. No, write off the amount which is now recorded in the storm damage reserve --

A. Yes.

Q. It will be required to write off?

A. Yes.

Q. Have you calculated how much that write-off would be?

A. No, but I think you could calculate it from my exhibits. It would be the difference between my adjustment and what the company -- so it would be over $10 million.

Q. Over $10 million?

A. Yes.

MR. VAN NOSTRAND: No further questions.

JUDGE HAENLE: Have you questions,

Mr. Richardson?

MR. RICHARDSON: No questions, your Honor.

JUDGE HAENLE: Questions, Mr. Trotter or Ms. Brown?

MS. BROWN: No.

JUDGE HAENLE: Questions, Mr. Adams?

CROSS-EXAMINATION

BY MR. ADAMS:

Q. I had just a couple of questions. Mr. Larkin, first directing you to your discussion concerning the property held for future use?

A. Yes.

Q. Discussion starting around page 8 of your testimony. You make reference or suggest a ten-year limitation and cite, I think, that other jurisdictions use a ten-year or something similar to that. Could you indicate where the other jurisdictions are that use ten or fewer years?

A. Well, the discovery the company asked that question. We didn't make a thorough comprehensive but we did provide public utility reports which indicate for instance that Texas PUC, and I will quote in part, "The Commission's policy allows utility to include plant held for future use in rate base as long as the utility can show specific plans for the facility and

show that the investment will become fully used and useful within ten years." That's the Texas Commission.

The California Commission has a similar rule: "Newly adopted guidelines for electric plant held for future use provides that right-of-way associated with transmission lines and substations could remain in plant held for future use ten years if associated with new power plants and in plant held for future use for five years if not associated with power plants."

State of Illinois in one of their decisions says, "The Commission acknowledges the ten-year rule for plant held for future use but explain that each case must be reviewed separately."

The Hawaii Commission, "however, the ten-year criterion is meant to balance the risk of future higher acquisition costs and nonavailability of property against the burden the ratepayer will need to bear for the inclusion of the property in plant held for future use for an extended period of time."

So those are the ones that I am aware of.

Q. Under your recommendation if the company has specific plans for a particular piece of property, for instance, can it go beyond ten years or must it be

put into service within the ten years under your recommendation?

A. Well, I had three recommendations if you accept all three. Nothing would be in plant held for future use and the company would record a carrying charge and that when that became used and useful then they would recover that carrying charge in rate base and earn a rate of return on it.

Q. But if the Commission is to address, let's say specifically your ten-year proposal, are you suggesting that even if there is a plan for a given asset it must be used and useful in service within that ten years?

A. Yes.

Q. I gather, then, you take issue with staff's suggestion of a 20-year time frame?

A. I would think that that's a might long.

Q. Quick clarification. You may have answered this relating to the directors and officers liability insurance. As I understand it, you are not taking issue with the limits that the company may have for that insurance policy but you are simply splitting, if you will, the costs of that coverage?

A. Yes.

Q. In the area of storm damage, just a

question, I think staff is suggesting a six-year normalization process. You are going with the four years, I think as you've said, it's been used previously?

A. Yes.

Q. Do you have any opposition to the six-year normalization?

A. No, but I will. I would still suggest that the overheads be taken out.

JUDGE HAENLE: Commissioners, have you questions?

CHAIRMAN NELSON: No questions.

COMMISSIONER CASAD: No questions.

EXAMINATION

BY COMMISSIONER HEMSTAD:

Q. With respect to your testimony with regard to working capital and dividends declared, is there any normal accepted practice with regard to that throughout the country?

A. No, because most Commissions don't do it the right way. This Commission happens to do it the right way and calculates working capital using a balance sheet approach, so many Commissions use a lead/lag study which may or may not consider the

dividends. So I would say that there probably isn't a national policy or one that you could point out and say everybody does it this way.

Q. Is there anything analogous to that issue to nonregulated private corporations?

A. Well, I think I quoted the accounting theory that once you reclassify these that they are no longer under the control of the company that the stockholders then become unsecured creditors and that the company couldn't just reverse that entry and give that money back. That money belongs to the stockholders and would have to be paid. So, the accounting test books say that this is unsecured liability of the company and not equity of the company. So under that basis it is correctly deducted from working capital.

Q. With regard to the directors and officers liability matter, again, my question is a similar one. Is there a national policy with regard to 50/50 split of that kind of insurance?

A. I would say not.

Q. Is there no policy or that the pattern is the other way?

A. The pattern is that it's generally not raised in rate cases and --

Q. Is that because in the past the amount has not been particularly significant?

A. Yes, and it usually doesn't come to the attention of -- if it came to the attention because there was an adjustment here in this case.

Q. The staff adjustment -- is it your understanding the staff made an adjustment because they felt it was too high, too much money?

A. No. I think, and I am not sure I remember everything that's in Mr. Nguyen's testimony, but he at least came to the conclusion that at least part of it should be allocated to the subsidiaries because they received --

Q. But that's almost diminimus, 3.3 percent?

A. Yes. He did talk about one other policy but I can't remember what his conclusion was, one additional policy that's just been added.

Q. But so you have no opinion as to the appropriate amount of liability insurance to be covered?

A. That is correct.

Q. Only that it ought to be -- whatever the level is ought to be shared?

A. Yes.

COMMISSIONER HEMSTAD: No further

questions.

JUDGE HAENLE: Have you any redirect?

MS. GIANULIAS: No, your Honor.

JUDGE HAENLE: Anything more of the witness?

Thank you, sir, you may step down. Let's go off the record to change witnesses.

(Recess.)

JUDGE HAENLE: Let's be back on the record. During the time we were off the record we changed witnesses. This is one of public counsel's witnesses now.

During the time we were off the record I marked for identification two documents. Marked as T-796 for identification is a multi-page document entitled direct testimony of Steven G. Hill. And 797 for identification in the upper right-hand corner has SGH-1 and is composed of schedules 1 through 17. We would appreciate your witness in the future using -- putting the number on his testimony, the initials and the number on his testimony as well for whatever the initials are in the testimony. Thank you.

(Marked Exhibits T-796 and 797.)

Whereupon,

STEVEN HILL,

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

DIRECT EXAMINATION

BY MR. ADAMS:

Q. Mr. Hill, state your full name and spell your last name.

A. My name is Steven G. Hill, H I L L.

Q. Could you give us your business address?

A. My business address is P.O. Box 587, Hurricane West, Virginia 25526.

Q. I thought I better make it clear in advance you're not sponsoring a weather normalization.

Were you asked by public counsel to review the company's filing in this case and analyze in particular the rate of return implications?

A. That is correct.

Q. And is what has been marked Exhibit T-796 your prepared testimony in this case?

A. Yes, it is.

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

A. It was prepared by me.

Q. Are there any changes that need to be made?

A. There's a couple of typographical changes

that need to be made.

Q. Refer us to those, please.

A. Page 16, line 29, fourth word, "since" should be struck.

And page 18, last line, 29, the first percentage in that line, 44 percent, should be 54 percent. Those are all the changes I have.

Q. With those changes is your testimony true and correct to the best of your knowledge?

A. Yes, it is.

Q. And turning now to what has been marked Exhibit 797, were these -- was this exhibit or the contents of this exhibit prepared by you or under your supervision?

A. It was prepared by me.

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

A. Yes, it is.

Q. There are no changes that need to be made to this?

A. No.

MR. ADAMS: Your Honor, I would move the admission of what has been marked as Exhibit T-796 and 797.

JUDGE HAENLE: Any objection, Mr. Marshall?

MR. MARSHALL: No objection.

MR. TROTTER: No objection.

MR. RICHARDSON: No objection.

JUDGE HAENLE: Exhibits T-796 and 797 will be entered into the record.

(Admitted Exhibits T-796 and 797.)

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

JUDGE HAENLE: Mr. Marshall?

CROSS-EXAMINATION

BY MR. MARSHALL:

Q. Good afternoon, Mr. Hill.

A. Mr. Marshall.

Q. Just have a few questions today. Shouldn't take more than 20 minutes or so. At the end of your testimony T-796 you have a brief outline of your employment and education history?

A. Yes.

Q. In 1971 you received a degree in chemical engineering; is that correct?

A. Yes.

Q. And then after that degree in chemical engineering you were in a two-year MBA program at

Tulane University?

A. That is correct.

Q. At Tulane in the MBA program, did you take courses that were taught in the economic department there at Tulane?

A. Yes, I did.

Q. Do you have any kind of upper level work toward a PhD in economics?

A. I do not.

Q. When you went to West Virginia after your MBA program you were hired as a pollution control engineer; is that correct?

A. That is correct.

Q. And then you basically worked on chemical company compliance with the Clean Air Act?

A. Correct.

Q. Now, let's turn to your testimony in terms of what you've testified to in substance. At page 13 in your testimony you refer to the FERC generic return on common equity. Do you see that at page 13?

A. Yes.

Q. Now, the FERC no longer of course establishes a generic return on common equity?

A. That is correct. I explained that in my testimony also.

Q. So, if we turn to Exhibit 797, schedule

2, page 2, the number at the bottom of that, that 10.786 number, that's your number, not the FERC's number, correct?

A. It's a number that was generated by the FERC methodology and if the FERC, in fact, were continuing their FERC generic return today that's the number it would produce.

Q. Well, that's just my point is that the FERC is not continuing that so this is your number and not the FERC's number, correct?

A. I think I agreed with you. It's my number produced by the FERC methodology.

Q. On that same calculation, page 2 in Exhibit 787, the application of the way you've applied this approach you've come up with a growth rate of 4.32 percent. Do you see that?

A. Yes. If you turn over one more page you will see that the FERC generic return used the 4.33 or 4.32 percent for about four years in a row there so I applied that number.

Q. That shows that in the past the FERC used that -- came up with those figures when it was doing a generic rate of return?

A. Correct.

Q. But they stopped doing that as of 1991-92?

A. In January 1992.

Q. So they were using that 4.3 percent growth rate throughout the late 80's and early 90's; is that right?

A. Well, it was 4.3 something from the beginning of 1988 all the way through the time that they quit publishing the generic return, and it's unreasonable to believe that it would change very much over the years in time this elapsed since they stopped publishing it.

Q. Do you know whether the FERC derived their 4.3 percent growth rate from data that was generated in the early 1980's through the late 1980's and into the early 1990's?

A. No. The way they derived their growth rate in and generic methodology was in similar fashion to the methodology that I used. They used a sustainable or quote B times R unquote growth rate analysis. And they look at recent history, as I do, except I believe they look at three years rather than five and they looked at projected information as I do. And they look at three years projected information rather than five, but the methodology is similar.

Q. When they derived the 4.3 percent growth rate the last time they used it what data did they

use?

A. They don't publish that data.

Q. How far back did they go?

A. For the benchmark that was published in January of 1992 -- and this will take a little bit of explaining of the FERC methodology -- each year the benchmark would be updated in January and for that update process they would look at the previous year data, stock price data. As for growth rate data they would look at the three year past, three year projected data, look at B times R sustainable growth rate primarily. But they would also look at historical growth in earnings and dividends and projected earnings in dividends and that kind of thing, but in the beginning of the year they look at a one year time frame, take the stock price from the past year. When they updated it quarterly they looked at six months updated. So I hope I've answered your question about the time frame.

Q. In capsule form, how far back do they go and how far forward?

A. For growth rate data?

Q. Right?

A. Three years.

Q. Back three years and how far forward do

they look?

A. Look forward three years or they use the Value Line projection three to five year period as I do.

Q. So last data they had if it concluded in '92 they would have looked back three years before January of 1992?

A. Yes, to '87-88 period.

Q. Okay. Now, turn, please, to page 15, lines 2 to 5 of your testimony. At that page you have the average market-to-book ratio for the electric utility industry?

A. Yes.

Q. As of March?

A. Yes.

Q. And that was 1.64; is that correct?

A. Correct.

Q. And using Puget's 1992 yearend book value Puget's market-to-book ratio was already somewhat below the average for the electric utility industry. Is that true?

A. Somewhat. I have a May 1993 CA Turner's utility reports. It's the same publication as quoted in my testimony. It's updated three months. And it says here Puget Power market-to-book 162 percent. So

it's virtually the same.

Q. So just about at or slightly below, a little below the average?

A. Right.

Q. Turning back to page 13 of your testimony you state there, I believe at line 23, that Puget has "An equivalent to the investor-owned electric utility average"?

A. Yes.

Q. Now, how many of the electric utilities you list in your schedule 2 of Exhibit 797 -- the one we just looked at, have common equity ratios as low as the ratio that you recommend in this case?

A. I haven't looked at the individual common equity ratios but I know that the average electric industry equity ratio is in the 41 percent range, if you use the short-term debt.

Q. But for A-minus rated companies, do you know what that would be?

A. Well, the average of the industry is around A-minus and the average FA ratio for the industry is around 41 percent, so I think that's a pretty good indication.

Q. In order to determine that for each of the companies that you list here you would go to the

CA Turner book that you just brought forward here?

A. No. They don't have that kind of detail in this monthly publication. They publish a yearly report that you could find that kind of information or you could go to the quarterly stock reports of each company or possibly get the information off of a computer service.

Q. You could, then, update this schedule to reflect what the common equity ratios are for the various companies listed in your schedule 2; is that right?

A. Sure. Certainly could be done. It wouldn't be comparable to the capital structure we're discussing in this case unless short-term debt were included.

Q. As a data request we would like the witness to provide that data using the material he referred to, the CA Turner, and you also used Value Line; is that correct?

A. Yes, sir, but I don't have the CA Turner annual report book that I referenced. I thought you were asking me how you could do it. I mean, I don't have that kind of information in the monthly reports and I could get that information from Value Line, but I am sure that's not a difficult task. You folks have

the Value Line too, probably.

Q. When the rating agencies consider the appropriate bond rating to give an electric utility they do consider the common equity ratio, don't they?

A. Yes.

Q. They consider that to be one of the important things they look at?

A. It's one of the things. Bond rating process, as we discussed last week in the Washington Natural Gas case is a two-step process. And the rating agencies look first at more subjective measures, qualitative risk factors if you will, like the service territory, and that sort of thing, the customer mix. Then once they look at the qualitative factors called the determined business risk, because that's really what determines credit risk over the long term is business risk, and once that analysis is done then they turn to the the quantitative factors. One of those quantitative factors, and there are many, one of those is they don't usually look at the equity ratio as closely as they look at the debt to total capital ratio, but it's a capital structure parameter.

Q. So, again, it is fair to say that the common equity ratio is an important factor, one of the quantitative factors that the rating agencies examine?

A. Yes, it is a factor that they examine. It is a quantitative factor and I guess I would have to say second-tier part of the analysis of credit risk. Certainly not the factor, the only factor that's considered.

Q. And you could do common equity ratio for each of these utilities that you've listed in your schedule 2 of Exhibit 797. It's just that you haven't performed that calculation?

A. Yeah. It's doable.

Q. Did you review Dr. Legler's testimony?

A. Yes, I did.

Q. Did you see his schedule 7 by any chance?

A. I don't recall what that was. I mean, I saw it and I am sure I read his testimony.

Q. Do you know where he goes through and compares the common equity ratios based on companies that have an A-minus bond rating?

A. I have his testimony and I can get it one second here.

MR. ADAMS: Counsel, can you cite us to the exhibit?

MR. MARSHALL: I believe -- I'm not sure exactly of the exhibit number. It's schedule 7 of

Dr. Legler's exhibit Exhibit 6 '78.

A. I have it.

Q. Now, you have reviewed that?

A. Yes.

Q. Of those companies how many of them listed in Dr. Legler's exhibit have automatic fuel adjustment clauses or equations?

A. I don't know.

Q. I take it that -- have you made a determination on your Exhibit 797 schedule 2 how many of the companies you've listed here have automatic fuel adjustment clauses or equations?

A. I haven't made that determination. I know from my experience that after the oil embargo in the 1970's, fuel clauses became pretty commonplace in the electric utility industry, and I would say that today, although they are being phased out in places, that probably more utilities have them than don't have them. While we're talking about Dr. Legler's schedule 7, page 1 of 2, I would just note that those equity ratios you see there from Value Line do not include short-term debt. And they should if they're going to be comparable to what we're talking about in this case.

Q. In order to make your determination of risks comparable when you compare one company to another, isn't whether a company has an ECAC relative

to that determination of risk, comparative risk?

A. It is a factor that should be considered, but it's my understanding that although the ECAC, as you call it here, was discontinued the company still has some protection from fluctuations and weather through the PRAM, and matter of fact in the first page of the company's 1992 10K it discusses that in the third paragraph, it says the company, "the company is affected by various seasonal weather patterns throughout the year and therefore operating revenues and associated expenses are not generated even during the year." It goes on to discuss how that affects their earnings. Then it says, "With the implementation of the periodic rate adjustment mechanism, PRAM, in October 1991 earnings are no longer significantly influenced up or down by sales of plus electricity to other utilities or by variations in normal seasonal weather or hydro conditions."

So, even though the company doesn't have an automatic fuel adjustment clause it's clear they're telling investors that they are protected from those kind of fluctuations.

Q. Is that a fair and accurate statement for the company to make informing investors of their view of the PRAM decoupling mechanism?

A. Well, I hope so. It's what they published in their 10 K. They could be in trouble if they're not making fair statements.

Q. We have heard some criticism that investors haven't been properly educated in that area. Do you believe that that 10 K statement is a fair representation of what PRAM decoupling is intended to do?

A. Yes.

Q. Have you also reviewed any of the exhibits relating to the Standard & Poor's questionnaire sent to the company? There's an Exhibit 582 in this case?

A. I've looked at it, reviewed it, yes.

Q. There was a cover letter to that Exhibit 582, Standard & Poor's rating group to a Mr. Chris Moulton. Were you familiar with that as well?

A. I can't bring that to mind.

Q. Was there anything in that Standard & Poor's questionnaire that -- responses by Puget or in the cover letter that led you to believe that Puget was communicating inaccurately to investors about the PRAM decoupling mechanism?

MR. ADAMS: Your Honor, I think we're getting well beyond what -- the responsibilities of Mr.

Hill were in this case was to develop rate of return

analysis, not to determine whether the company was properly communicating with its investors. Mr. Elgin looked into the issue of whether or not he felt that investors were not being informed of all the benefits but that certainly was not Mr. Hill's charge.

JUDGE HAENLE: Mr. Marshall.

MR. MARSHALL: Whether investors have taken these risk reduction measures into account or not does bear on the testimony and conclusions of this witness.

JUDGE HAENLE: This witness does testify about risk of purchased power and a number of other things besides the cost of capital, Mr. Adams.

MR. ADAMS: I don't dispute that, your Honor. Just seemed to me this set of questions was going well afield from that. I certainly have no problem with the inquiries of that issue.

JUDGE HAENLE: Well, I am going to overrule the objection. If the witness has any information on that, if he doesn't that's fine, too.

A. I think I recall the question. I read the document, I am not very familiar with the document, and I don't think I can respond to your question of whether or not the company has told Standard & Poor's everything it can tell them about the PRAM. First of all, Standard & Poor's is not an investing

organization. They disseminate their -- they're a news company basically, they disseminate financial news about the companies to the investment community and information does flow through them, but I believe your question was couched in the term of whether or not what the company was telling Standard & Poor's as if Standard & Poor was an investor and they're not.

Q. You indicated that utilities that have an automatic fuel adjustment clause or an ECAC-type mechanism would have, in your view, a lesser need for a higher common equity ratio. Is that a fair general statement?

A. Did I make that statement in my testimony, is that what you're saying?

Q. Is that a fair general statement?

A. I think that is a risk factor and any time a company is able to pass through its costs an automatic sort of basis it lowers the risk, and a lower risk would call for a lower common equity ratio.

Q. So when you're comparing Puget Power to the other companies in your schedule, isn't it relevant to try to determine whether those companies have an ECAC or automatic fuel adjustment mechanisms?

A. I think the risks that exist with those companies that I am looking at in my sample group

which are different than the ones you keep referring to -- when you say companies, you point to the FERC analysis that I did which is open on your desk there. My more specific look at cost of capital analysis is with the same companies that your witness picked, and with those companies, as well as these others, the investors determine through the stock price they're willing to pay the risks that they see in these companies and the risks they're willing to bear. So I think that we're taking investor's opinions into account when we look at the market to determine the cost of capital.

Q. The market has already discounted these automatic fuel adjustment clauses?

A. As they are a part of the overall risk of a company, I would say that is correct, and remember, that although Puget doesn't have an automatic fuel adjustment clause per se, they say themselves to investors that they are protected from those kind of fluctuations. So I think that the risks are similar in that kind of regard to a company that does have that protection.

Q. So you're comparing apples to apples, you're saying investors have made the same determination with respect to that portion of Puget's

PRAM decoupling mechanism as they have for companies that have automatic fuel adjustment clauses or equations?

A. I think that they are generally similar and the impact in and of itself on an overall investment risk for a utility would be very difficult to determine just that one issue. I think it's a small issue just by itself, and I think that these two mechanisms, one, the PRAM rate making mechanism, and the other, the ECAC, are similar enough in construction that they would be seen as imparting similar risk with regard to weather or a fuel-specific issues. Of course, the PRAM for Puget is much broader than that and goes to overall revenues stabilization which is another risk reduction step beyond an ECAC.

Q. The ECAC would include fuel-type things such as the cost of coal or gas or fuel for hydro and you're talking about decoupling having also an impact or an effect on weather related or economic related issues?

A. Right, and those weather and economics, as we say in my analysis in this case, are the much, much bigger factors which affect risk.

Q. Now, have you calculated the part of this mechanism relating to decoupling, that is the weather

and the economic conditions separately from the fuel type adjustments, the ECAC type adjustments?

A. No. I have looked at the three variables that I described in my testimony. I looked at flow rates on the Columbia River and I looked at economic variables that specifically was employed in the Puget service area, and the other variable I looked at was heating degree days and I looked at the correlation between those variables and the company's quarterly revenues and quarterly net income and found that the river flow rates indicative of the hydro conditions were not significantly correlated with the company's revenues or net income over the past decade, and that is due most probably, I believe, to the existence of the ECAC during that period of time. In other words, what my analysis showed here is the ECAC worked, essentially.

Q. So a fuel adjustment mechanism would be appropriate for a hydro-based system where the water is the fuel?

A. Well, I think that's a determination the Commission makes. I can tell you whether or not a fuel adjustment clause would reduce risk, and I believe it would, but again, the company makes it quite clear to investors that those kind of risks are

taken care of, quote-unquote, in the PRAM mechanism.

Q. And your analysis was that for quite a period in the 80's -- what period did you say was covered by?

A. '82 to '91.

Q. '82 to '91 that hydro fuel risk was already being taken care of. Was that your analysis?

A. That's what my analysis showed. It showed that the variability in the company's revenues and net income were not well correlated with hydro conditions. In other words, they did not have a significant impact on the variability of the company's revenues and net income during that period.

Q. Would there be any way for you to take the work that you have done and separate out just the weather and the economic portion of decoupling from those things that were like ECAC fuel adjustment mechanisms?

A. I think it would be possible if there had been no fuel clause over that time. Then if you were able to determine an impact of the flow rates, if that indeed is a good measure of the availability of hydro power, then you might be able to make that determination, but since there was an ECAC in place over that period of time I don't believe it's possible

looking at the data that I've looked at in this proceeding to do that.

Q. Now, if the utility's revenue fluctuates due to changes in weather and economic conditions and if decoupling affected those you have done a calculation that shows what that's been in the last 18 months?

A. No.

Q. Have you done any analysis on what the revenue fluctuation due to weather and the economy has been for Puget over the last 18 months?

A. Over the last decade. I don't know where you get the 18 month figure.

Q. Since the PRAM decoupling mechanism was established by --

A. No, my numerical analysis of the company's revenue and net income volatility went up through the year end 1991.

Q. So you haven't done a calculation on the revenue fluctuation for the past 18 months isolated to the decoupling portion of the mechanism?

A. No. I don't think that you're going to get sample size big enough in that 18 month period to get any kind of reliable results. You need a larger sample size than that. You might. I haven't done

that analysis. I don't believe that that would be the case. I don't think you would get good results for looking at 18 months.

Q. Do you have any approximation on what the revenues would be in that period of time, that 18 month period of time that would have been affected by just a decoupling portion of the mechanism? Do you have any estimate at all?

A. I am not sure what you mean by affected, but I know that the company has made a filing of requests of $42 million in 1992 having to do with PRAM recoveries.

Q. Do you know how Puget's -- do you have any idea how Puget might compare to utilities that might have equations in terms of the effect on volatility that you discuss in your testimony for that 18-month period?

A. No, I haven't done an analysis on that past 18 months. I have looked at the market response with the stock price, comparing Puget's stock price movements to other companies in the similar sample group. But I haven't looked at volatility of revenues and net income since the implementation of PRAM.

Q. I believe on page 57 you did indicate that you looked at the stock market reaction to

implementation of PRAM. I think on line 18 you meant September 1992 instead of September 1991; is that right?

A. That is correct.

Q. So that's another correction that you would make to your testimony?

A. Yes. On page 57, thank you for pointing that out, page 57, line 18 --

JUDGE HAENLE: I will make that correction on the official copy.

A. Page 57, line 18 September 1991 should read '92.

Q. You indicated there that the market is tending to discount the advantage of PRAM decoupling?

A. That's my opinion, yes.

Q. Have you talked to any rating agency people or investor groups to come to that conclusion?

A. No, I haven't. I presented a graph in my schedules Exhibit 16 that shows that there was a difference in market index price between Puget Power and the sample group that began to be established in like the early second quarter of 1991 and remained pretty expanded until the fourth quarter 1992 and then began to diminish.

MR. ADAMS: Mr. Hill, just for the record

you're referring to Exhibit 797 schedule 16, I believe.

Q. Turning to another topic. On page 36 you state that your recommended capital structure would produce an interest coverage of 2.83 times; is that correct, line 67?

A. Yes. That is also shown in my schedule 12.

Q. Now, is interest coverage also another important quantitative factor to the rating agencies in setting bond rating for electric utilities?

A. Yes, it is. It is a factor that is considered. It is not the factor. It is one of the factors that is considered.

Q. Don't the rating agencies look at interest coverage on a cash or XAFUDC basis?

A. Yes, they often do. Look at it both ways.

Q. What level of interest coverage would be produced by your recommended return on equity and capital structure on a cash basis?

A. I haven't done that analysis.

Q. Is it a good policy to recommend a return on capital and capital structure without knowing what a cash coverage it will produce?

A. Well, I know that the ex-AFUDC level of Puget is relatively low and I wouldn't expect that the cash coverage would be very different than what

appears in my schedule 12 or my testimony. I do check coverages when I make a recommendation. I think that if a regulatory body pays too much attention to coverages then we will create what I call a tail wagging dog effect of regulation, in other words, all you need to know is the coverage and you can back into a revenue requirement and I don't think that's what cost-based rates are all about. The cost of capital the company is allowed to recover in rates should equal the cost of that capital in the marketplace.

Q. Could you do that calculation if requested?

A. The cash --

Q. Coverage?

A. -- coverage calculation? I don't have the accounting data to do that calculation. My schedule 12 is based on a capital structure recommendation and uses the capital structure to derive a pre-tax coverage. It's an approximation and it's not an exact accounting.

Q. What information would you need to do that calculation?

A. Well, I suppose I would need someone to develop a proforma income statement based on this recommendation.

Q. At page -- turning now to page 48 of your

testimony, line 7 of 14. You have a quote there from Merrill Lynch regarding PRAM; is that correct?

A. That is correct.

Q. And would you say from that that Merrill Lynch understands PRAM and its advantages, as far as you're concerned?

A. Yes. Generally, I think that the salutory effects of PRAM are widely understood in the investment community.

Q. How do you define "decoupling"?

A. Decoupling is the separation of revenues from sales.

Q. And you, in fact, have presented a paper in September of 1992 on the impact of decoupling on electric utility operating risk?

A. Yes, to NARUC.

Q. Did you define decoupling as being intended to promote energy conservation by separating utility revenues from aggregate unit sales?

A. I would say that's my definition.

Q. So the idea of decoupling is to promote energy efficiency, energy conservation?

A. That's the concept, yes.

Q. Now, weather volatility, in fact, economic volatility is often a product of the way in which

rates are designed in the first instance; is that right? The actual way in which customers pay on a fixed charge basis whether they have a declining block or inverted block rate structure or do you know?

A. No. It's due primarily to changes in the weather.

Q. If you had an old style way of making rates where you had a high demand charge and a declining cost of power as you purchase more power, would that tend to diminish the effect of weather or increase the effect of weather?

A. Well, I am not a rate design expert but I think just considering it that it would tend to decrease the impact of, for example, if you had a very cold winter it would tend to decrease the impact.

Q. Sure. If you had declining rates instead of increasing rates at the tail, at the outer edge, they would tend to magnify the effects of weather or the economy. Isn't that fair to say?

A. I think you misspoke.

Q. If you had -- what I am trying to get at is the way in which rates are designed now so that as you buy more energy your rates go up that tends to magnify the fluctuations in weather or in the economy.

Is that fair to say?

A. I think that's probably a fair statement. The degree to which that changes the overall variability of a company's revenues I am not prepared to say.

Q. Were you finished with your answer?

A. I wasn't answering. I was just extemporaneously talking.

Q. The rates, the rate design now is designed in large part in order to help promote conservation by increasing the amount of costs per kilowatt hour used out beyond a certain point?

A. That is correct.

MR. ADAMS: Your Honor, I guess I won't object. He's answered but he's not an expert on Puget's rate design and we don't hold him out to be such.

MR. MARSHALL: I was asking that as a general principle.

Q. Now, the state of Washington, are you familiar with the state of Washington's bond rating?

A. No.

Q. Have you consulted with any state on its bond ratings?

A. No.

Q. Have you been responsible for any bond

placements or advised any utility on placing bonds?

A. No.

Q. In your calculations on risk, did you attempt to build into your model a lag structure?

A. With regard to what?

Q. With regard to rendering bills, degree days, employment, those types of factors.

A. As I was doing the analysis of revenue volatility I investigated different lags to see what kind of correlation coexisted, and the only parameter for which that was beneficial was flow rates and that turned out to be an insignificant parameter so lags didn't affect the analysis in any way. I examined that issue in the process of doing the analysis.

Q. I do have a record requisition for you. I would like to take your schedule 13 in Exhibit 797 and the three regressions that you run in that schedule I would like you to add one more variable and the variable is the number of common shares outstanding at the beginning of each quarter, and if you need data on the shares we would be happy to supply that for you.

JUDGE HAENLE: That would be record requisition 583.

(Record Requisition 583.)

A. So let me ask a question about that. First

of all, I will need that data. You're talking about page 1 of 3? You want me to add to revenues and heating -- the regression of heating degree days and employment data on revenues you want me to add common shares outstanding?

Q. Right, to your three regressions that you have in schedule 13 to add that one additional variable?

A. I see, to each one.

Q. Correct.

A. So that in the first one there will be three variables and the other two there will be four.

Q. Correct.

A. Okay. I suppose you want me to supply you with the results of that.

Q. Yes. One last area. You testified about the various capital and debt structure quarter by quarter. I believe it was at page 17 of your testimony. That you indicated that you derived your quarter by quarter line 2?

A. Yes.

Q. Average capital structure for the year. And were you aware of the unusual timing of various debt and stock issuances throughout 1992 that might have an impact on your use of the end of quarter data?

A. I was aware that the company was issuing quite a bit of medium term debt and retiring other debt and they issued lots of securities in 1992. I didn't pay attention to exactly when in the quarter that happened. I just took the company's report at quarter end.

Q. Wasn't there, for example, a $75 million preferred stock issue in July that reduced the June short term debt balance of $110 million?

A. I know there was a preferred stock issuance. I don't know the impact specifically on what was done with those funds. If they were used to recall the debt or refund the debt then I suppose that's correct.

Q. Even if it didn't refund the debt might it have had an impact on the ratios that you examined?

A. Well, the capital structure ratios in point of fact change every day. You have collections in your bank account and if you did a capital structure every day it would be different to some degree.

Q. I am just looking at the quarter by quarter analysis that you made. Were you aware that there was a $60 million common stock offering in October that reduced the September short-term debt balance of $110 million?

A. Yes.

Q. So that also would have had an impact on --

A. Yes, that's true, but the company does make these reports quarterly and the investors are aware of these reports and they know that generally over time the company has been capitalized with a level of equity in the capital structure that approximates 40 percent for a very long time.

Q. And also then in December of 1992 were you aware that there was $125 million of short term notes issued in anticipation of the redemption of $114 million of PEI bonds?

A. Yes.

Q. So that had the effect of doubling up some extra debt at the end of 1992?

A. Yes.

Q. Did you make any adjustment in your calculations of 1992's capital structure for the timing of those things that we've just discussed?

A. No. As I discussed, I believe that investors who evaluate the same kind of information I've looked at would come to virtually the same conclusion I had that the company is effectively capitalized with 40 to 41 percent equity. Has been for many years.

MR. VAN NOSTRAND: No further questions.

JUDGE HAENLE: Take our afternoon recess at this time. Let's take 15 minutes.

(Recess.)

JUDGE HAENLE: Let's be back on the record after our afternoon recess. Do you have questions, Mr. Trotter?

MR. TROTTER: Yes, I do.

CROSS-EXAMINATION

BY MR. TROTTER:

Q. Mr. Hill, beginning with the FERC generic analysis, would you agree that because that is a generic analysis it is rather mechanical?

A. Yes, yes. It was designed to be mechanical and, in fact, it is.

Q. And on page 14 of your testimony you conclude that the FERC generic return will necessarily overstate the current cost of equity capital from Puget; is that correct?

A. Yes, that's correct. That's because the way it's constructed the stock price goes back into the past too far, I believe, to represent the current costs of capital.

Q. And you have estimated a growth rate less

than the growth rate FERC estimates; is that correct?
A. If you're referring to the growth rate for Puget Power, yes, that's correct.
Q. And do you recommend that the Commission use your growth rate or the generic growth rate?
A. I would recommend they use my growth rate for Puget and the similar sample companies. The generic analysis is meant to be looked at in toto. In other words, the individual analyses that appear are not usable as, for example, you couldn't take the 4.32 percent growth rate and add it to Puget's dividend yield and come up with a meaningful number. It's meant to represent an industry average growth rate and that's really the only way it should be used.
Q. You were asked a number of questions about companies with fuel adjustment clauses and you stated that PRAM is broader than a clause that just tracks fuel. Do you recall that?
A. Yes. That's correct.
Q. And then you were asked about the other aspect of PRAM, that is, decoupling. Do you recall that?
A. Yes.
Q. Would yet a third aspect of PRAM be

recovery of purchased power costs?

A. Yes. Purchased power would not necessarily be included in a fuel -- quote-unquote fuel recovery clause. Sometimes they are, sometimes they're not, but it is not necessarily so. So, a PRAM adjustment mechanism is a much broader risk-reducing rate mechanism than is a fuel clause. And therefore would require a specific adjustment to the allowed return.

Q. You were asked some questions about a statement from Merrill Lynch. Would you turn to page 7 of your testimony. And on line 16 am I correct that Merrill Lynch is predicting a dividend growth over the 1991 to '96 period of approximately 2.2 percent?

A. That is correct.

Q. And you indicate on line 20 and 21 that Merrill Lynch is telling investors to expect a return of 9.1 from their investment?

A. Yes.

Q. And I take it that's the equity investment?

A. Yes, they're telling equity investors that they should expect a return of around 9 percent for Puget Power, and although I believe that's a little bit low it certainly is in the ballpark and all of the analysts in this case except for the company's analysts have come up with DCF results in the 10 percent range for this company.

Q. On pages 15 and 16 of your testimony you discuss market-to-book ratios; is that correct?

A. Correct.

Q. And you spoke earlier with Mr. Marshall about Puget's market-to-book being in the range of 1.6 or thereabouts?

A. Yes.

Q. And on lines 14 through 17 on page 16 you state that if market prices are greater than book value as they now are in the electric utility industry, the market price to book value ratios substantially exceeds unity and the expected book equity returns, the 11 to 12 and a half percent range of return noted above exceed the cost of equity capital. Do you see that?

A. Yes.

Q. And then you quote from Mr. Olson's deposition on lines 8 through 13; is that right?

A. That is correct.

Q. Is his testimony consistent with your belief?

A. Yes, essentially that if the market price exceeds the book value that means that investors expect the company to earn a return on book that exceeds the market costs of capital.

Q. Now, you selected a group of six utilities for your analysis of Puget's cost of equity; is that right?

A. That is correct.

Q. And those are the same utilities that were used by Dr. Lurito and Dr. Olson; is that correct?

A. Yes. I believe Dr. Lurito testified he did his own analysis and came up with the same companies. I reviewed Dr. Olson's analysis and thought his selection process was reasonable and used those companies.

Q. On page 46 of your testimony you're referring to a risk and volatility analysis, and I believe you assumed that Puget's cost of equity was 50 basis points or that the PRAM was worth 50 basis points on Puget's cost of equity capital. Am I correct?

A. That is correct. Did a couple of different analyses to determine that a reduction in the company's volatility would be equivalent to investors being indifferent to a 50 basis point reduction in the allowed return on equity. And I implemented that change in the allowed return on equity through a change in the recommended capital structure on which rates will be based.

Q. Now, turn to page 57 of your testimony. And again, you were asked by Mr. Marshall, apparently after PRAM the stock market placed evaluation premium on Puget stock but after the Commission's order last fall the premium began to diminish. Is that your testimony?

A. That is my testimony, yes.

Q. And the PRAM 2 order last fall created some doubt about the future of the PRAM; is that correct?

A. Yes. It is my understanding that the Commission was questioning the length of the time that the company would be able to recover their accruals and there was a FASB emerging issues task force report about whether or not those earnings would have to be written off if they were recovered over too long a period and the Commission changed its order. But it created uncertainty in the minds of investors, as did the consideration of PRAM issues in this proceeding, and I think that currently investors are not imputing a market price increment, positive increment, to Puget because they have concerns about the continuance of PRAM as they know it and uncertainty has been injected into the PRAM issue, and therefore based on the analysis that I've done with recent market prices, if

PRAM is to be accounted for then the 50 basis point

reduction should be applied to the allowed costs of equity.

Q. As shown on line 11 and 12 of page 57 the actual computation was 57 and a half basis points and you rounded that down to 50?

A. Yes. I did a lot of rounding down in this analysis. Regression analysis showed that revenues were -- virtually 90 percent of the volatility of revenues was accounted for by weather changes and changes in the economic conditions and virtually 80 percent of the changes in net income by quarter were accounted for by weather and economic condition changes. And I rounded that estimate down to 50 percent to get my two estimates for the impact on revenues and net income. So that's not the only rounding down I did to make this a conservative, I believe, adjustment.

Q. Turn to page 65 of your testimony. On line 6 you indicate that Moody's reported in 1992 that since 1982 O and M expenses for the electric industry industry have averaged 55 and a half percent of revenues?

A. Yes.

Q. And for Puget since 1982 its O and M

including purchased power has averaged 55 percent of

revenues; is that right?

A. That is correct. And I show that where I derived that average on my schedule 17 of Exhibit T-797.

Q. And in both of those averages is purchased power included not just for Puget but for the average utility?

A. Yes.

JUDGE HAENLE: Please be sure that counsel has finished his question before you begin to answer it so that you know the full question.

MR. ADAMS: One other thing, Mr. Hill. The T is only in front of your testimony so 797 does not have a T in front of it.

Q. Turn to page 67 of your testimony and on the prior page and here you are talking about the analysis that Mr. Abrams and Mr. Miller sponsored by the company give and you indicate the generic assumption of the rating agency analysis that the cost of the imputed debt is 10 percent. Do you see that?

A. Are you talking about at the top of page 67?

Q. Yes.

A. Yes.

Q. That is the cost of the imputed debt that

both Mr. Miller and Mr. Abrams used?

A. Yes, they say for ease of calculation they generally use 10 percent.

Q. Is that a reasonable cost rate of debt given today's circumstances?

A. No, it isn't. I think it points out the generic nature of these kinds of rating agency adjustments. The cost rate for single A debt is in the high 7 percent range, 7.8, 7.9 percent. More than 200 basis points below the 10 percent they use.

Q. Turn to page 72 of your testimony, and on line 6 you address the company's proposed capital structure increasing the equity ratio of 40 to 45 percent reducing the short-term debt ratio from 4 to 2 percent. Do you see that?

A. Yes.

Q. Based on your analysis the 45 percent equity ratio is too expensive; is that right?

A. That is correct.

Q. Is there any justification in your mind for a company reducing its short-term debt from 4 to 2 percent given today's market and the market you would expect to occur on average over the time rates during the time that we are in this proceeding?

A. No. I think that the company's position in

this case to reduce the short-term debt vis-a-vis the financings that it's undertaken in the past year which are using medium term debt but the shorter end of the medium term debt are sort of in direct opposition to each other. In other words, the company is saying one thing and doing another. They are very definitely using the shorter end of the spectrum because the old curve is very steep which is right now expected to continue to be that way which means that short term rates are very far below in cost long term rates. It's 350, 400 basis rates between T-bills and T-bonds right now. So it makes sense with inflation continuing to remain low for the company to avail itself of those short-term rates. And instead the company suggests in this case that they change their historical average level of short-term debt from about 4 percent, cut that in half to 2 percent. I don't think that would be wise at this point in time.

Q. Have you reviewed the testimony of all of the cost of equity witnesses in this case?

A. Yes, I have.

Q. There was a question asked from a Commissioner last week regarding how far apart the witnesses are with respect to cost of equity capital.

Do you have an opinion on that?

A. I think the witnesses are all remarkably close together. My recommendation is 10 percent in this case. Dr. Lurito's recommendation is 10.25 percent without his flotation cost adjustment with which I disagree. Mr. Legler's testimony, his DCF analysis is in the high 19 and every other analysis he does except his cap M analysis is in the 10 percent, 10 and a half range. Dr. Peseau is also in the 10 and a half percent range, and one thing I disagree with him on is he used Dr. Olson's long term average stock price dividend yield which I think kind of overstates his numbers. So in my way of thinking -- and even if you update the Charlie Olson's results to current time period his number falls down into the range also. So in my way of thinking, the Commission is presented in this case with a very narrow range of cost of equity estimates and they fall in the 10 to 10 and a half percent range, all of them.

Q. With respect to Dr. Legler's -- I will represent to you that he testified that had he just used DCF his recommendation would be lower, and if you would just assume that, is there any justification in your mind to increase your DCF analysis based on beta or a method utilizing beta?

A. Well, it's been my practice for some time

to use the DCF in combination with three other techniques that I've done for a number of years and the cap M is one of those techniques. It is a supportive technique that I would not use to change, substantially change a DCF analysis, but for example. If I had DCF analysis that gave me a result of 10 percent, say. And I did my other three analyses and they all had results of 10 and a half to 11 percent, then I would be inclined to recommend something higher than 10 percent, although it would be relatively close, say 10 and a quarter. So I think there is some justification for looking at other results. However, I think that the cap M especially has sort of been in the limelight over the past couple of years with regard to the beta particularly and there have been some academic articles published specifically by Eugene Fama, a long time supporter and one of the initial supporters of the cap M. He has come out in 1992 with a very indepth analysis of beta saying that beta is not correlated to anything in particular. So it is not a good measure of risk and return. So the cap M analysis per se, which I believe produces Dr. Legler's highest result, is certainly not an analysis that I would base a cost of capital recommendation on.

Q. Was it your view that that method is highly volatile?

A. That method is highly volatile. It's -- it depends to a great deal on the selection of the inputs that are used with the model. One of the foremost users, if you will, of the cap M these days is a fellow named Roger Ibbotson and I am involved in a case in Illinois with him and at one time he used three month T-bills and now he decides that 30 year T-bonds are better, and as we were saying a moment ago, the difference in that choice can mean the difference of 4 percent in the allowed cost of capital. So that's a very volatile methodology.

THE WITNESS: I B B O T S O N.

Q. You mentioned the pressure and flotation cost adjustment. Isn't it true that Dr. Lurito in making his flotation or pressure cost adjustment does so on the basis of a 1.07 market-to-book ratio?

A. Yes, he does, and while I have no problem with the idea that a goal of regulation should be to allow rates that are equal to costs and with regard to cost of equity if that happens there will be a tendency for the market price to tend toward back value, I believe that one of the problems I see with

Dr. Lurito's flotation cost analysis is he believes

that there is a very hard and strict correlation between the allowed equity return and the resulting market price so much so that he carries out -- he believes he can carry out a flotation cost adjustment that will give him a precise market price 1.07 times booked value as a result of a particular allowed rate of return. To be quite frank, costs of capital analysis is just not that accurate, and while you can virtually say there are tendencies for the market price to respond to allowed returns and tendencies for market price to approach book value over time, those things are not going to happen in sort of a landslide format, and I have a difficult time with his reliance on that very strict adherence to the mathematical relationship between allowed return and market price. It just doesn't happen that quickly that way in the marketplace.

Q. We set rates over time, don't we?

A. We set rates over time, that's right.

Q. Now, with respect to -- I noticed in your qualifications you've indicated that you've testified in Maine?

A. That is correct.

Q. And we've had some testimony on the Central

Maine Power experiment. There seems to be a

divergence of views of whether decoupling is dead there or whether it still has some breath left. Do you have any personal knowledge of that?

A. Well, decoupling, the initial decoupling experiment was ended by the Maine Commission in January, in a January order. I was involved in that proceeding. The decoupling experiment was supposed to end in March, I believe, of 1994. The Commission ended it at the end of the year or in October or November of 1993, roughly six months early. Immediately upon the order the Commission ordered the company to file a new rate case. In the new rate case filing there is another permutation of what they call the ERAM, Electric Rate Adjustment Mechanism, included in the company's filing. So it is confusing. The Commission has ruled that the initial decoupling mechanism be discontinued, the company has refiled another idea and the Commission is considering it.

MR. TROTTER: That's all I have, thank you.

JUDGE HAENLE: Do you have questions, Mr. Richardson?

MR. RICHARDSON: I do, your Honor, thank you.

CROSS-EXAMINATION

(HILL - CROSS BY RICHARDSON)

Q. As a housekeeping item, on page 66 of your prefiled testimony at line 15 you used the word "buying" in that line. Do you mean building?

A. Yes.

Q. So that should read rather then "building actually puts"?

A. Yes, this is another change in my testimony.

MR. RICHARDSON: Page 66, Commissioners, at line 15.

JUDGE HAENLE: I will make that correction on the official copy.

Q. If you would turn to page 40 of your prepared testimony. You state at line 3 on that page that "One of the primary reasons Puget's witness Olson overstates his estimated cost of capital is the proxy he used to estimate investor expected growth." What was the proxy that Dr. Olson used to estimate investor expected growth?

A. Well, the only growth rate that he produces in his analysis which is close to that which he recommends is his growth rate for market price. So, the only conclusion that we could come to is that he relied heavily on market price to determine his DCF growth rate.

(HILL - CROSS BY RICHARDSON)

the case.

Q. I guess you would conclude that using the market price to estimate growth is not a generally accepted method for estimating growth, is it?

A. That is correct, it is not widely used.

Q. Turn to page 66 of your prefiled testimony, please. Never mind, that was the housekeeping item. Page 16 of your prefiled testimony. I would like to follow up a little bit on the questions you were asked by Mr. Trotter dealing with market-to-book ratios. You informed Mr. Trotter that when market-to-book ratios exceed one investors expect the company to earn above its cost of capital. Is that a fair characterization?

A. Yes.

Q. And in your testimony on page 16, line 16 as well, you refer to the word unity. Does that mean one?

A. Yes.

Q. If this Commission sets Puget's cost of capital -- sets a revised cost of capital that is unexpected, market-to-book ratio wouldn't actually go to unity precisely, would it?

A. Well, that was sort of the discussion I had with Mr. Trotter about the assumption, Dr. Lurito's

assumption that -- which is flotation costs based on that there's a hard mechanical relationship there. I think we can safely say that there would be a tendency for the market price to tend towards book value when the allowed return on equity is equal to the cost of that equity capital. That could happen through the market price remaining constant and book value increasing or the market price growing at a lower rate than book value over time. There are different ways that it can happen. Doesn't necessarily mean that there would be a precipitous fall tomorrow in the market price if the Commission allowed the company to earn its cost of capital today.

Q. You would be surprised, wouldn't you, if there would be a precipitous fall in the market price of Puget stock?

A. I would be surprised but I would also caveat that if I knew what the market was going to do, I wouldn't have to work for a living.

Q. We will be watching your trades with interest.

MR. RICHARDSON: That's all I have, your Honor.

JUDGE HAENLE: Questions, Commissioners?

EXAMINATION

BY CHAIRMAN NELSON:

Q. Mr. Hill, has there been a change in personnel at the Maine Commission?

A. Yes, Commissioner Gordon is no longer there, I don't believe.

Q. Do you know who has replaced him?

A. I think Liz Paine may have. I don't know if they went inside the Commission or outside.

Q. Your discussion about purchased power and investor -- the analyst's concern about purchased power prompts this question. Are you aware of any other Commission in the country which has attempted to adjust specifically for purchased power in the utility's cost of capital?

A. It's been presented in several cases that I've been in in the past two years, utilities have requested it. I've never seen it granted. It was not granted in California. I was involved in a West Penn Power case in Pennsylvania. It was not granted. Maryland it was not granted. And so, to my knowledge, it has not been.

Q. I asked this of a previous witness. I had heard through the grapevine but been too lazy to track it down that the Georgia Commission may have

done an explicit adjustment but you have no knowledge of that either?

A. I have no knowledge of that either.

Q. Thank you.

EXAMINATION

BY COMMISSIONER CASAD:

Q. Afternoon.

A. Afternoon.

Q. I am a Commissioner who asked a question of Dr. Lurito along the lines of there are some very eminent cost of capital witnesses in this case, all highly educated, highly trained, broadly recognized in their profession, and they seem to arrive at different conclusions and the conclusions seem somewhat related to the parties they represent. That brought a gasp from Dr. Lurito so I didn't pursue that. But then Dr. Lurito advised me that really there wasn't very much difference and if Dr. Olson had updated his testimony there would hardly be any difference amongst all of you and I have heard you essentially repeat that today so I guess it wouldn't cause you any heartburn, whichever cost of capital witness' testimony we chose. Would that be correct?

A. With the exception -- of course the

recommendation of Drs. Olson and Legler are higher but Dr. Olson's numbers are quite old by this point in time, and if they were updated they would be in the 10 percent range. Dr. Legler's numbers -- recommendation is different than his numbers. He makes quite clear in there that his recommendation, in my reading it's more of a policy statement. He believes that it's not proper to go all the way to the cost of capital because I think he feels like the cost of capital may change in the future, may go back up, but that's not what I see my role as in this proceeding. I see my role as a reporter of sorts reporting to you, the Commission, what the costs of the company's money is. This is the profit level they should be allowed to earn. This is what the market is telling us they require, and all of us, all the analysts are coming up with something in the neighborhood of 10 to 10-and-a-half percent, and if your recommendation is in that range, no one will have any problem with that, but that's our recommendation to you and the Commission can take that, and if you have other policy considerations or whatever your other considerations are, you certainly will do what you will with that, but I think the reporters in this proceeding on the issue of cost of capital when you look at their

results are all in the same ballpark. We're all in the 10 to 10-and-a-half ballpark.

Q. I think you indicated, did you not, that cost of capital analysis is -- there's a bit of art interspersed with the science?

A. Someone would say a lot more art than science. I wouldn't say that but some would.

Q. I think you said cost of capital analysis is just not that reliable?

A. It's not reliable when you're talking about 1.07 and talking about a particular allowed of rate of return. I have -- I give it about 25 basis points one way or the another is my version of how accurate it is.

Q. Also I might have been confused but I wanted to clarify, I thought you indicated that Dr. Lurito had depended inordinately on market pricing in his analysis. And did you really mean Dr. Olson or did you mean Dr. Lurito? That was in response to question --

A. I am not sure what you mean by market pricing. I said that Dr. Olson's market prices were out-of-date and therefore his dividend yield was probably too high to be representative. The concern I had with Dr. Lurito's testimony was that he thought there was a hard and fast mathematical relationship

between allowed return and cost of capital. I think there is definitely a tendency for that correlation to exist, but as far as breaking it down to the second decimal place, I don't think that's possible and I am not sure if that's what you're talking about.

Q. Not exactly. I suspected that there was an intermixing of names and Dr. Lurito was being used instead of Dr. Olson and I just wanted to clarify in fact that it was Dr. Olson because I hadn't recalled anybody stressing that about Dr. Lurito's testimony?

A. Right.

Q. Thank you.

JUDGE HAENLE: Commissioner?

COMMISSIONER HEMSTAD: I don't have any questions.

MR. TROTTER: If I could just ask a clarifying question for Commissioner Casad. Market price growth rate issue was a Dr. Olson issue on page 40 of your testimony that you were asked questions from Richardson?

THE WITNESS: Yes. That's probably what you were referring to.

COMMISSIONER CASAD: Yes.

THE WITNESS: I understand now. I was

asked about his reliance for the growth factor and the

DCF. He relied on the growth in market price and my comment was that it's rarely done because it's not a very reliable situation especially in Puget's case over that period the market-to-book ratio has changed so drastically.

COMMISSIONER CASAD: I got your answer. I just didn't know whom to attribute it to.

MR. RICHARDSON: You're attributing it to Dr. Olson?

THE WITNESS: Right.

JUDGE HAENLE: Any redirect, Mr. Adams?

MR. ADAMS: Yes.

REDIRECT EXAMINATION

BY MR. ADAMS:

Q. Mr. Hill, just following up on this last point about the change from 1982 to 1992, I gather, between the relationship of market price to book, is a good piece of that change correlated with the substantial change in interest rates over that same period of time? And your Exhibit 797, the schedule 1 rather dramatically shows what's occurred since 1988?

A. Right. Well, schedule 1 page 1 of 2 shows what's occurred since 1984, and page 2 of 2 of schedule

1 shows what's happened to utility debt costs since

1988, and very clearly the direction of capital costs is downward. There's no question about that. The change in Puget's market-to-book ratio that we're discussing on page 41 of my testimony where it moved from .82 or below one in 1982 to 1.5 today or thereabouts, 1992 is attributable certainly in part to the drop of capital costs over that period of time. It's also attributable to Puget's general improvement, their financial position, their construction problems they had in the early 1980's and those were resolved. So it's a combination of those two things, but underlying -- if you look at the entire electric utility industry you will see a similar kind of change in market-to-book ratio from below one in the early 80's to 1.4, 1.6 in the early 90's, and that is attributable to primarily the lower -- the fall in capital costs over that period of time.

Q. I might gather that's why not only for Puget but for the industry in general you're saying you can use that as the indication of similar growth in the future?

A. Right, unless you expect utility debt to be free, you know, within ten years. I mean, essentially you're talking about that magnitude of a change of the you're talking about 5- or 600 basis point drops since

1984 and 5- or 600 basis points more drop would be a utility debt cost of 2 percent. If that's your expectation then you might use stock price growth but I don't think that's anybody's expectation.

Q. You referred to, I think, Dr. Legler's analysis and then sort of his conclusion which was not the same as at least what the DCF and some of those other methods showed. I think he used a term of trying to protect shareholder shock due to these drops. Do you believe that that's appropriate to take into consideration?

A. No. I think once again our function here is not a policy function but sort of a reporting function. And I think clearly Dr. Legler has made a policy decision to recommend a return on equity which is much higher than his numbers will support. I think it also important to remember that this ratepayer shock that apparently he wants to attempt to alleviate by awarding a too high cost on return on equity capital is just one side of the scale of utility earnings. Utility market prices are significantly above book value now because they are over earning their cost of capital. In other words, the other side of the scale that the ratepayers have been suffering the shock of their own over the past, since the mid

1980's by paying out too much in rates for utility profits. The portion of the rates they pay that go to equity returns have been too high for a number of years, and so it wouldn't really be ratepayer shock if market prices would tend toward book value, it would simply be a balancing of the regulatory equation.

Q. I think you may have misspoke. I think you meant shareholder shock?

A. Yes. It wouldn't be shareholder shock, it would simply be a balancing of the regulatory equation.

Q. You indicated earlier you had some discussion with Mr. Marshall concerning companies with fuel adjustment clauses and also the issue of the PRAM. I wanted to find out, in your opinion are the two synonymous in terms of the risk implications?

A. No, they're not. Only with regard to the actual protection of volatility in fuel prices are dissimilar. The PRAM also includes purchased power and it also -- and it causes a reduction in volatility of revenue and earnings due to weather and economic conditions. And so it's a much more broad-based wide ranging risk reducing regulatory construct than is a fuel clause.

Q. Two spots in your testimony that I recall.

Page 7 and then 48. You quote from Merrill Lynch and

on page 7 there was a reference that Mr. Trotter asked about where they're projecting a 9.1 percent return for investors. Do you see that?

A. Yes.

Q. And then later on you quote again. Now, these quotes from Merrill Lynch come from what I will call the stock side of the house?

A. The equity side.

Q. It's not the debt side?

A. Right.

Q. You had a brief discussion with Mr. Trotter concerning flotation pressure and Dr. Lurito used a 1.07 percent factor. Again, you were not here but he indicated on my questioning that that calculated out to approximately $7 million a year, that is the .07 factor. Do you believe that that is a reasonable number for Puget?

A. No, I don't believe it's a reasonable number for several reasons. I've laid out in my testimony pages 37 through 38, and I won't reiterate all of those right now but I think if we just -- if we agree that there was a need for flotation costs, which I don't think there is because market prices are so far above book value, if market prices were closer to book value then I would be inclined to say that

there would be a need for flotation adjustment, but first of all it wouldn't be on all of the equity capital. It would be on the new capital that's raised. Dr. Legler's judgment is for the whole equity base and that's not logical because all the equity wasn't raised in the market place. Some of it is retained earnings and there's no flotation costs involved with retained earnings. When stock is issued when the market price is 50 percent above book value then there is an overall increase in the book value of the stock and all of the investors of the company are made essentially wealthier essentially by the issuance of stock and so there's no need to compensate them for some sort of hypothetical dilution that just doesn't occur. I feel very strong it's not a proper adjustment and $7 million, which is what he's talking about, is a lot of money for ratepayers to invest to make stockholders whole for something for which they don't need to be made whole.

Q. It is your understanding that that would remain in effect until the next rate of return adjustment so the $7 million would continue on for at least perhaps the next three years?

A. Right, included in rates would be $7

million every year that those rates are in effect

until the rates are changed, and if you believe that a flotation cost is necessary and if the flotation costs were 5 percent, whatever 7 divided by .05 is, the company would have to issue $140 million of equity every year that rates -- these rates are in effect in order to actually incur flotation costs of that magnitude.

Q. At the beginning of this response you referred to Dr. Legler. I think you were referring to Dr. Lurito, weren't you?

A. Sorry, Dr. Lurito.

Q. It's Monday.

A. There's a lot of rate of return witnesses in this case.

Q. One last issue in reference to volatility of earnings I had asked Dr. Lurito what the impact in '92 earnings would have been without the PRAM mechanism and he calculated that without PRAM the company would have earned approximately 1.66 a share which was below even the dividend payout. Would you concur in that or do you have any different numbers that you would believe would be the impact if PRAM did not exist?

A. The company in the notes to the financial statements in its annual report -- have to sort of dig

back in there, it's in there -- they note that the $43 million of their earnings in 1992 was due to the PRAM adjustment. And so I assume he took that out and calculated the per share earnings based on that, and if that's what he did then I would agree with that figure.

Q. So this is sort of part of the volatility that the PRAM evens out for investors?

A. Right. The company discusses that in a general sort of a way in its annual report.

JUDGE HAENLE: Any recross, Mr. Marshall?

MR. MARSHALL: One brief area.

RECROSS-EXAMINATION

BY MR. MARSHALL:

Q. You mentioned that there was a purchased power adjustment to common equity ratio presented in the California case last summer that you were involved in?

A. There was a request by several of the utilities that their equity ratios be increased because of their purchased power requirements.

Q. And those California companies included Pacific Gas and Electric, San Diego Gas and Electric and Southern California Edison?

A. And Pacific Gas and Electric, did you say that?

Q. I may not have, but you testified in that on what you believe the common equity ratios ought to be for those three companies?

A. No. I testified only on cost of capital issues.

Q. Do you know what the common equity ratios are for those three?

A. No. Generally that those companies generally -- one of them is AA-rated and the others are A-plus rated and I would expect that the common equity ratios are probably in the mid 40 range if you include short-term debt.

Q. Above 45 percent?

A. I would guess that's the case but I am not certain.

Q. Of the companies that were asking to have a purchased power adjustment to common equity ratio of the 45 percent or so, what percentage of their power purchases were purchased power?

A. I don't recall exactly. I think the heaviest reliance on purchased power was, I believe, San Diego Gas and Electric, but I don't recall what that number was.

Q. And what was the rate of return on equity that was allowed at the end of that proceeding for those three utilities? I believe that came out in November or December of 1992.

A. Yes, it was based on data from early 1992 and the allowance was 11.7 to 11.8 and the California Commission in its order recognized that the cost of capital was lower than their allowance and made the decision to allow something higher. But they did recognize that the cost of capital was lower.

MR. MARSHALL: Nothing further.

JUDGE HAENLE: Anything more of the witness?

MR. TROTTER: Just one. None of those California utilities are in your list of comparables or Dr. Olson's list of comparables?

THE WITNESS: No, they're not. And the cost of capital has fallen quite a bit since that case.

COMMISSIONER CASAD: One quick question. Regarding stock pricing and market-to-book ratio, how much of that fluctuation or that increase would you attribute to the fact that because of declining interest rates and the relative stability of utility stocks and relatively stable regulation, how much do

you believe that has contributed to pricing, market pricing of stock?

THE WITNESS: I think a great deal. I think that the drop in capital costs is a primary contributor to the level of market price in relationship to book value. I think that allowed rates of return have fallen over the past three or four years but they have fallen slowly. Utilities have been reluctant to come in for rate cases and costs of capital -- allowed returns have not come down as quickly as capital costs have come down.

COMMISSIONER CASAD: Thank you.

MR. ADAMS: Just a followup on the California experience. Was Mr. Abrams also a witness in that proceeding?

A. Yes, he was and the California Commission did not consider him an impartial witness. They considered him a witness on behalf of the companies.

MR. ADAMS: Was this on the issue of imputation of -- imputation of debt for purchased power?

THE WITNESS: Yes, that was the issue. Same testimony he gave here.

MR. ADAMS: And the Commission did not adopt that testimony?

THE WITNESS: Correct.

JUDGE HAENLE: Anything more of the witness?

MR. MARSHALL: No, your Honor.

JUDGE HAENLE: Thank you, sir, you may step down. I believe that's everyone that we had here today. We've estimated that the open meeting on Wednesday will be done at 10:30. It may not be done by then but please be here and ready to go at 10:30. I will call Mr. Paine and Mr. Meyer and let them know. We'll begin as soon on Wednesday as we can after the open meeting. Be in recess until then.

(Hearing adjourned at 4:20 p.m.)