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August 13, 1993

Mr. Paul Curl, Secretary
Washington Utilities and
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P. O. Box 47250
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Olympia, Washington 98504-7250

Re: Docket No. UE-921262, UE-920433 and UE-920499
Puget Sound Power & Light

Dear Mr. Curl:

Enclosed for filing are the original and nineteen copies of the Brief of Commission Staff and Certificate of Service in the above-referenced matter. Also enclosed is a disk in Lotus format, containing the tables in Appendix A to the brief.

Very truly yours,

DONALD T. TROTTER
Assistant Attorney General

DTT:ss

Enclosures

cc: all parties

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STATE OF WASH.
UTIL. AND TRANSP.
COMMISSION

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

PETITION OF PUGET SOUND POWER & LIGHT COMPANY FOR AN ORDER REGARDING THE ACCOUNTING OF RESIDENTIAL EXCHANGE BENEFITS

GENERAL RATE FILING
DOCKET NO. UE-920433

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

DOCKET NO. UE-920499

Complainant,

vs.

PUGET SOUND POWER & LIGHT COMPANY,

Respondent.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

DOCKET NO. UE-921262

Complainant,

vs.

PUGET SOUND POWER & LIGHT COMPANY,

Respondent.

STATE OF WASH.
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August 13, 1993

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APPENDIX A

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I. OVERVIEW.

On October 30, 1992, Puget filed the largest rate increase in its history: \$218 million over the rates authorized in the last rate case. This increase does not include the additional \$76 million PRAM 3 increase, half of which is proposed to be implemented October 1, 1993. The aggressiveness of Puget's request is clear:

- Puget requests a 45% equity ratio, the highest it has ever recommended, yet it has never used this ratio in any of its IRPs to analyze new and existing purchased power costs;
- Puget requests a 12-12.5% equity return, only .3-.8% lower than it received in 1990, despite a veritable freefall in interest rates since that time; and
- In addition to a 45% equity ratio and a premium rate of return, Puget desires to maintain the PRAM as well, which insulates it against substantial risks. It would not have paid its dividend out of earnings but for PRAM.¹

Puget's request is plainly excessive. While this rate filing may constitute Puget's "wish list," it is an entirely unbalanced proposal. As Puget's Dr. Olson put it: "You can go too far with cost recovery, too." (Tr. 763). Puget's proposal goes too far.

II. BURDEN OF PROOF.

RCW 80.04.130 places on Puget the burden of proving the rate increases are fair, just and reasonable. This is not just the burden of producing evidence, but the burden of persuasion as well. Neither the Staff, Intervenors, nor the Commission itself, bears any such burden. There are instances in this case where Puget has failed to either produce evidence (e.g., prudence of new resources; PRAM review criteria) or to persuade. The Commission is required to rule against Puget on such issues.

¹ Of Puget's \$2.16 1992 earnings, PRAM deferrals were worth \$.50/share (Sonstelie, Tr. 4021). Puget could not pay its dividend with earnings of \$1.66/share. (Elgin, Tr. 2230; Lurito, Tr. 2351).

III. PRAM EVALUATION.

In its order in Docket UE-920630, the Commission required Puget to file a rate case in order to evaluate the PRAM.² The case Puget filed had very little to do with PRAM evaluation and almost everything to do with bond ratings, purchased power risk, and the largest rate increase it ever filed. Indeed, in an unprecedented action, Puget was required to supplement its direct case to address issues it failed to address. (Ex. 726).

PRAM evaluation, the anticipated "main event" of this case, was relegated to "minor side show" status by Puget. This is abundantly clear in Puget's rebuttal case, in which Puget's principal witness on PRAM evaluation was not even aware of the details of Staff's PRAM proposal! (Sonstelie, Tr. 4013-14). Despite these infirmities, we proceed to evaluate PRAM, and conclude PRAM should continue with these minor changes:

- The base/resource cost split should be principled. If Puget needs a multiplier to produce a desired financial result, it should prove the need for one.
- The SDM should be modified to eliminate the assumption that secondary sales are priced the same as secondary purchases. "Price spread factors" should be developed for projected secondary transactions. For the true-up, actual secondary prices should be used.
- Development of a revenue per customer per class should not be implemented because, while theoretically correct, it would create a perverse economic incentive for Puget to move customers from one schedule to another.

A. Analysis of the PRAM Experiment.

In order to properly evaluate the PRAM, it must first be understood what PRAM is. We begin with that analysis, and then analyze the propriety of maintaining PRAM.

² First Supp. Order in Docket UE-920630 (hereafter "PRAM 2 Order") (Sept. 24, 1992), p. 17-18.

1. PRAM Is A Broad Mechanism Which Insulates Puget from Traditional Business Risks.

As Mr. Elgin testified, PRAM "protects Puget from short-term earnings impacts due to efficiency investments, [and] protects Puget from short-term earnings fluctuations from virtually any cause."³ Puget apparently agrees that PRAM protects against downside losses from changes in economic activity and customer initiated DSM, and "anything else that would cause sales to decline." (C. Olson, Tr. 4446). PRAM also provides prompt and timely recovery of purchased power expense,⁴ significantly reducing regulatory lag. (Elgin, Tr. 2229).

2. PRAM is Not Traditional Ratemaking.

While many states may implement fuel clauses of one variety or another (See Ex. 681), that does not make PRAM "traditional." First, Puget did no analysis indicating the degree to which other "fuel clauses" are as broad as PRAM.⁵ Second, the WUTC's "tradition" is that if the reduction in cost to ratepayers cannot be demonstrated, an energy clause will not be continued.⁶ Third, no other electric utility in this state has an energy clause.⁷

3. PRAM is Not "Cost Based" Ratemaking.

What started out as a small point, seemed to turn into a big one. It should be obvious that PRAM is not truly "cost-based ratemaking"; the rate of return is not updated, so rates do not reflect current capital costs,⁸ and the base cost "escalator" may or may not reflect Puget's actual costs. (See Martin, Ex. T-749, p. 43). This does not mean that PRAM violates FASB Statement 71's proscription regarding "Cost of Service" regulation. (See Ex. 682, and Martin, Tr. 2693-94). What this issue does demonstrate is that Puget can overearn under the PRAM, as capital costs decline, or

³ Ex. T-670, p. 8; Tr. 2500, 2501, 2214.

⁴ Puget noted that the SDM does not true-up to actual coal prices, causing a \$3 million "under recovery." (Lauckhart, Tr. 4735-36). However, this amount is only .5% of the resource related costs flowed through the PRAM, and does not take into account any number of other items that work in Puget's financial favor.

⁵ C. Olson, Tr. 4442; Weaver, Tr. 4588.

⁶ WUTC v. Puget, Docket U-89-2688-T/U-89-2955-T, (hereafter "1989 Rate Case" Third Supp. Order, p. 14, and WUTC v. Puget, Cause U-81-41, Sixth Supp. Order, p. 19, 20.

⁷ Sonsteli, Tr. 4014-15.

⁸ Sonsteli, Ex. 574, p. 54.

if base costs do not escalate in proportion to allowed revenue growth provided by the decoupling mechanism. (Elgin, Ex. T-670, p. 14).

4. Puget Has Not Shown Rates Would Be Higher Without PRAM.

Puget attempted to claim rates would be higher without PRAM.⁹ Not only did Puget confuse rates with revenues, its analysis was obviously self-proving, since it assumed an energy cost tracker!¹⁰ Absent PRAM, Puget would be subject to the vagaries of weather as are Washington Water Power and Puget Power & Light; its earnings would likely have suffered greatly.¹¹

5. PRAM Evaluation Criteria.

The criteria established by the Commission in evaluating an experiment in regulatory reform are that the mechanism must be measurable, it must be simple to administer, it must be understandable, and it must be an improvement on traditional ratemaking. (PRAM 2 Order, p. 3). Only Staff evaluated PRAM under these criteria.

6. The PRAM May Not Satisfy the WUTC's Evaluation Criteria, But It Does Provide Benefits Which Merit Its Continuance, If Risk Reduction Is Properly Accounted For.

As Mr. Elgin testified, the PRAM is measurable, but it is neither "simple" nor "understandable", nor an "improvement over traditional ratemaking." (Ex. T-670, p. 8-12). Puget has acknowledged that the "large hydro deferrals" generated by PRAM have been a problem in PRAM's evaluation.¹² One need only add that rates for PRAM 3 will include amounts deferred from 5 months of PRAM 1, from 7 months of PRAM 2, plus true-ups from these prior PRAMs, plus a general rate increase, plus the potential for further deferrals if rate moderation is accepted.¹³ And one must also agree that PRAM's accounting has become very complex, bringing in dollars attributable to several prior periods.

⁹ Lauckhart, Ex. T-533, p. 4-5.

¹⁰ Elgin, Ex. T-670, p. 18-19,

¹¹ Id. Even if Puget came in for rates, the "tradition" is to base rates on normal weather.

¹² Sonstelie, Ex. T-878, p. 4.

¹³ Elgin, Ex. T-670, p. 11; Tr. 2218.

This does not mean PRAM should be discontinued. In Staff's view, if the risk reducing features of PRAM are properly reflected in return and capital structure, and if the SDM is changed in certain respects, PRAM should continue.¹⁴ PRAM permits Puget to pursue DSM, implement rational rate design,¹⁵ and to have reduced variability in earnings, hence lower risk.¹⁶ However, only if the Commission recognizes and reflects the risk-reducing features of PRAM in capital costs and capital ratios should PRAM be retained.

7. Puget Did Not Evaluate PRAM Pursuant to the Evaluation Criteria. Even Under An Analysis of the NOI Policy Objectives, PRAM is an Extremely Broad Incentive Mechanism.

Instead of using the Commission's evaluation criteria, Puget focused on the general objectives enunciated in the NOI:¹⁷

- Adjustment for changes in costs beyond the utility's control
- Purchased Power Cost Recovery
- Conservation Cost Recovery
- Incentives for acquiring least cost resources.

We take no particular exception to Puget's evaluation of the first three of these objectives, other than to point out that many mechanisms may meet the NOI objectives - that does not mean such mechanisms are acceptable. In any event, the fourth goal, incentives, has not been adequately evaluated by Puget. Indeed, rather than evaluate the issue of how broad a mechanism PRAM is, and how it significantly insulates Puget from traditional utility business risks, the Commission is told that PRAM is just a typical "fuel clause."¹⁸ Puget ignores the clear policy directives in the 1989 Rate Case in which the Commission rejected ECAC because of Puget's failure to demonstrate a positive impact of return. (Third Supp. Order, p. 16).

¹⁴ Elgin, Ex. T-670, p. 26-27.

¹⁵ It is Staff's position that rate design can be accomplished without PRAM, but PRAM does reduce uncertainties.

¹⁶ Elgin, Ex. T-670, 26-27; Parcell, Ex. T-810, p. 4, Tr. 3223, 3250.

¹⁷ See Sonsteli, Ex. T-501, p. 12-14.

¹⁸ C. Olson, Ex. T-924, p. 6-7; Dell, Ex. T-923, p. 12. Curiously, neither witness produced any analysis comparing the breadth of PRAM to other fuel clauses. (Tr. 4406).

PRAM should be maintained, but only if the financial benefits to Puget and its ratepayers (cost of capital, capital structure) are recognized. If such benefits are not recognized, the PRAM has doubtful viability. (Lurito, Tr. 2310).

8. Base and Resource Costs Should Be Classified in a Principled Manner; If Puget Needs a "Multiplier", It Should Prove It.

The current base/resource classification is unprincipled¹⁹ and is highly favorable to Puget since there has never been a showing that base costs grow in relation to customer growth.²⁰ What results is an unproven attrition adjustment.²¹ Base and resource costs should be classified in a principled manner; resource costs should be composed of power supply and power production related costs, and the abandoned project write-offs.²² If a multiplier is needed to meet Puget's financial goals, Puget should prove it.²³

Puget's response was first to deny Staff's multiplier proposal: neither Mr. Sonstelié nor Ms. Rittenhouse was even aware of it!²⁴ Puget merely suggests that since Staff's position was rejected when PRAM was established, it should be rejected again.²⁵ This is not the reasoned analysis one would expect and which the Commission commanded. Puget will point to its earned returns under the PRAM, suggesting it has not overearned or earned a windfall.²⁶ But this ignores the fact that Puget's authorized return on equity, 12.8%, is plainly too high, given market conditions since the last rate case. PRAM does not track capital costs, which is even more reason for a principled classification of base and resource costs.

¹⁹ Or, in Ms. Lynch's view, "negotiated." Ex. T-1011, p. 2.

²⁰ Elgin, Ex. T-670, p. 14.

²¹ Id.

²² Martin, Ex. T-749, p. 40.

²³ Id., p. 42; Elgin, Tr. 1975-77, 1983-84.

²⁴ Sonstelié, Tr. 4013-14; Rittenhouse, Tr. 4524-26.

²⁵ Ex. T-878, p. 4. In fact, the Commission asked the parties to specifically re-evaluate previous proposals on the base/resource split issue. PRAM 2 Order, p. 18.

²⁶ Weaver, Ex. T-935, p. 22.

9. The SDM Should Be Changed to More Accurately Reflect Prices for Secondary Sales and Purchases.

PRAM currently prices secondary sales and purchases at the same rate. (Moast, Ex. T-778, p. 20). As Ex. 782, p. 4 shows, Puget consistently purchases secondary power at a price lower than it sells. The difference can amount to as much as \$15 million. (Ex. 782, p. 4, 1/93 col.). The current method of valuing these transactions understates the value of surplus secondary purchases.²⁷ Staff proposed that "price spread factors" be used to project prices for secondary purchases/sales; for the true-up, actual prices should be used.²⁸ Incredibly, while stating "I don't even understand it" (Lauckhart, Tr. 4682) Puget accepted Staff's proposal!²⁹ Puget then misapplied what it did not understand by applying the price spread factor to the inputs, not outputs.³⁰ The Commission should simply reject Puget's misapplication of Staff's proposal. Staff's proposal is clear; it can be applied under the current scheme; and it more fairly reflects the historical relationships between secondary sales and purchase. It should be accepted.

10. Use of Class-Specific RPC Is Theoretically An Improvement, But it Creates Perverse Incentives and Should Not Be Adopted.

Staff showed that failure to compute a revenue per customer (RPC) on a class basis works a windfall when customer classes grow at different rates.³¹ Puget did not dispute that customer classes have grown at different rates. Instead, it quarrels with the RPC as not being reflective of cost of service.³² (All the more reason to adopt a principled base/resource cost division). We can agree that a class-specific RPC would provide a perverse economic incentive for Puget to switch customers between schedules (Hoff, Tr. 4918), so Staff will not pursue its proposal further.

²⁷ Moast, Ex. T-778, p. 22.

²⁸ Moast, Ex. T-778, p. 24-27. (Example calculation).

²⁹ Lauckhart, Ex. T-938, p. 3.

³⁰ Lauckhart, Tr. 4681.

³¹ Elgin, Ex. T-670, p.15-16.

³² Lynch, Ex. T-1011, p. 7-9; Hoff, Ex. T-1016, p. 8-10.

11. Puget's Critique of Staff's PRAM Analysis Is Slanted and Unfair.

The Staff cannot be all things to all people. Unlike Puget, Staff did not have \$700,000 to spend on this case, nor did it have a similar amount to spend reviewing the efficiency of Puget's operations.³³ For reasons known only to Puget, it was deemed necessary to lower the level of debate, and through several witnesses, Puget criticized Staff for failing to attend certain "collaboratives,"³⁴ and solicited a witness to single out Mr. Elgin for allegedly failing to conduct "balanced" analysis, and to criticize Staff as "not wanting PRAM to succeed."³⁵

a. Collaboratives. Puget complains that Staff did not attend collaboratives on the PRAM and the subject of water years. A "balanced view" of this matter shows the following:

- The Commission ordered the parties to address PRAM issues in this case. If it wished to initiate a collaborative it would have done so, and provided the necessary guidance;
- The PRAM "collaborative" was instituted unilaterally by Puget;
- In its direct case, Puget itself did not address all issues required by the PRAM 2 Order; supplemental testimony was required; Even then, certain issues were not addressed;³⁶
- Puget unfairly singles out Staff for criticism, but not other parties, although other parties elected not to attend all sessions;³⁷
- Puget set all meetings during Staff's preparation time, not when Puget was preparing its direct case or rebuttal. Id. Even Puget called the timing "difficult;" (Knutsen, Tr. 4116).
- Puget set the water year collaborative 3 years after the Commission suggested it, but failed to produce any new evidence on the subject compared to prior cases. (Winterfeld, Ex. T-858, p. 15).

³³ In the face of the largest Puget rate case in history, Staff allocated its resources accordingly. (Elgin, Tr. 1986-87).

³⁴ Sonstelie, Ex. T-878, p. 5; Rittenhouse, Ex. T-929, p. 24.

³⁵ Rittenhouse, Ex. T-929, p. 27.

³⁶ See e.g., Ex. T-533, p. 7, in which Puget addressed prudence of new resources in only procedural terms.

³⁷ Knutsen, Ex. T-882, p. 15. Indeed, Rittenhouse stated Staff "didn't have time" to attend, apparently without even reviewing Ex. 725, which contains several practical reasons why Staff was unable to participate. (Tr. 4554). Her bias is obvious.

Puget conceded it wouldn't be fair to suggest a different result would have obtained. (Knutsen, Tr. 4116-17). Its criticisms therefore have a highly questionable motive, serving only to distract.

b. Criticisms of Staff's PRAM Evaluation. Puget sponsored Ms. Rittenhouse to attack Mr. Elgin in particular, and Staff in general. She claimed Mr. Elgin's proposal to make changes to the PRAM "inconsistent" and "unbalanced" for failure to provide analysis of financial impacts,³⁸ yet:

- Puget and other parties offered changes to PRAM without such analysis, and drew no criticism from her;³⁹
- She was unaware that Staff's proposal was to have a principled base/resource split, and if a multiplier was needed to produce acceptable financial results, Puget should demonstrate that need. (Tr. 4524-26);
- She gave a highly unbalanced review of the PRAM 2 order, finding "disallowances" in adjustments intended merely to true up to actuals. (Tr. 4536-40);
- Her "dividend yield" discussion defies any rational financial analysis. (Tr. 4547).

She claimed "Staff doesn't want PRAM to succeed,"⁴⁰ yet:

- Staff joined Puget in opposing the deferral recovery in PRAM 2 that led to the principal concerns she raised;
- Staff supported Puget on the Pebble Springs issue and supports continuation of PRAM in this case.

The lack of preparedness of Puget's witness was apparent: she referred to a "new standard" of prudence (Ex. T-929, p. 15), but did not even know the "old standard," and believed the IRP established prudence (Tr. 4527); a view not even shared by Puget! (Sonsteli, Ex. T-878, p. 9). She characterized Mr. Elgin's presentation at the Boston conference as highly critical of Puget (Ex. T-

³⁸ Ex. T-929, p. 22-27.

³⁹ She did not even review the testimony of Intervenors; she gave only cursory review to other Staff testimony. Tr. 4522.

⁴⁰ Ex. T-929, p. 27.

929, p. 3), yet agreed he did a good job of presenting his topics. (Tr. 4556). Her self-professed bias for Puget (Ex. T-929, p. 6) is evident.

The only use this regrettable episode can have is to distract the Commission from meaningful review of this case. It has succeeded in distracting us, as the foregoing pages attest. Puget's tactics do not lend credibility to the process.

B. Intervenor PRAM Evaluations

WICFUR recommends that PRAM be discontinued and that a more narrowly focused "pure" decoupling proposal be developed. It also recommends a resource tracking proposal to provide recovery of incremental new resource costs and eliminate the deferred accounting that makes Puget whole for the variations in hydro and temperature. (Schoenbeck, Ex. T-798, p. 19-23). WICFUR recommends that any mechanism adopted include a rate moderation proposal that limits increases that result from the mechanism.

In the alternative, WICFUR offers changes to the PRAM. First, a principled division of base/resource costs must occur. Next, only 90% of the variations in hydro and temperature should be deferred for later recovery. Rate moderation would be an element of the modified PRAM. (Id., p. 28-29).

Public Counsel recommends that the classification between base and resource cost categories be changed, and supports the Staff proposal in this regard. (Blackmon, Ex. T-832, p. 55). To relieve the potential for significant swings in rates, power costs would be treated on the basis of normalized weather and hydro conditions. Finally, Public Counsel recommends that the SDM be adjusted to account for the differences in secondary sales and purchases. Id., p. 67-69.

NCAC recommends that the Commission develop a "pure" decoupling proposal. It reasons that the only significant issue for the Commission in evaluating regulatory reform is the perverse incentive of lost revenue occasioned by investments in DSM. (Power, Ex. T-823).

Although Staff believes the theoretical basis for these proposals may have validity, particularly on the point that decoupling does not require a full resource recovery mechanism, we are unable to fully evaluate WICFUR's and NCAC's "pure" decoupling proposals, since they require future proceedings to develop them. The record is not clear exactly how such mechanisms would work nor how the Commission should unwind the PRAM and transition to the new mechanism. Staff believes there is merit to the view that deferred accounting be eliminated and that the utility be responsible for managing the variations in hydro and temperature.⁴¹ However, the Commission's policy directions are inconsistent with that view.⁴² Finally, it appears that if a mechanism such as PRAM is to continue, most parties recommend a principled split between base and resource cost categories. As we argued above, Staff's case should be accepted since it reflects such a split.

C. Conclusion on PRAM Evaluation

Although PRAM may not fully satisfy the Commission's evaluation criteria, it should be maintained, with Staff's suggested modifications, and on condition that PRAM's risk reducing characteristics are fully reflected. This latter subject we address in more detail below.

IV. RATE OF RETURN, CAPITAL STRUCTURE AND "PSEUDO-DEBT" ISSUE.

THE FAIR RATE OF RETURN IS NO MORE THAN 8.91%. (See Appendix A, Table 1).

A. The Cost of Equity is No More Than 10.8%.

1. Staff's Recommendation.

Dr. Lurito recommended that Puget be allowed to earn a 10.8% return on equity based on his application of the DCF method to Puget and to a group of six electric utilities he considered to be appropriate for comparative analysis.⁴³ (Ex. T-700, p. 16). For Puget and each of these six

⁴¹ Indeed, if the Commission were to adopt any proposal that decoupled, yet determined power supply costs on the basis of normalized temperature and hydro, Staff would recommend the Commission simply return to traditional rate base regulation. Decoupling in and of itself is not necessary, since a prudent utility in the long run should pursue all cost effective resources including conservation. (Elgin, Ex. T-670, p. 25).

⁴² See e.g., Notice of Inquiry in Docket UE-900385 (May 9, 1990); Decoupling Case, Docket UE-901183-T/901184-P (Third Supp. Order, April 1, 1991).

⁴³ Note that Dr. Lurito's comparables are the same as Dr. Olson's. Nonetheless, these companies are only roughly comparable, since none of them have PRAM-like mechanisms. (See C. Olson, Ex. 585, p. 28-29).

electrics, he presented a detailed study of dividend yields and growth rates. (Ex. 703, p. 9). This produced a 6.76% dividend yield for Puget and 6.32% for the group of six electrics. Id. An equally detailed study was conducted of dividend growth rates. (Ex. T-700, p. 17-22). The result was a growth rate of 3.50% for Puget and 3.71% for the group of six comparable electrics. (Ex 703, p. 9). Hence, Dr. Lurito found that the bare cost of equity for Puget is 10.26%, while it is 10.03% for his comparable group. Based on this analysis, Dr. Lurito concluded that the bare cost of equity for Puget is 10.25%. (Ex. T-700, p. 25). After accounting for market pressure, and to permit stockholders to earn a return on the historical costs they have borne to float common stock issues, he recommended that Puget be allowed to earn a 10.8% return on equity. (Id., p. 26-29). To see how reasonable Dr. Lurito's 10.8% return on equity is, the Commission should note that the average return on equity recommended by the other Intervenor witnesses averages 10.6%,⁴⁴ some 20 basis points below Dr. Lurito's 10.8% recommendation.

2. Puget's Recommendation.

Dr. Olson, in his prefiled testimony, recommended that Puget be allowed to earn a 12.5% to 13.0% return on equity. (Tr. 735). On cross-examination, he indicated Puget's cost of equity was probably 50 basis points lower. (Tr. 742). Hence, he opined that Puget's cost of equity was in the 12 - 12.5% range. By rebuttal, without the benefit of a study, he stated Puget should be allowed to earn 12.0% to 12.5% on equity. (Tr. 4432).

To arrive at his initial 12.5% to 13.0% return on equity, in his prefiled testimony Dr. Olson performed what he called a DCF analysis on Puget and on the same group of six electrics Dr. Lurito used in his study. Dr. Olson checked his DCF result with an interest premium approach. (Ex. T-516, p. 37-38). To compute his dividend yield, he relied on a 6-month period ended September 30,

⁴⁴ Space limitations prevent a detailed analysis of Intervenor cases on cost of capital. We summarize the recommendations of all parties in Table 1 of Appendix A. We do note that Puget has criticized other parties for engaging in "friendly cross-examination" of other Intervenor witnesses on this subject. (C. Olson, Ex. T-924, p. 15). We believe Puget's characterization is inappropriate. Even if true, Puget should not be the first to cast stones in this regard. See e.g., Tr. 3255-66.

1992 which he then marked-up by expected dividend growth. This produced a 6.87% dividend yield for Puget (Id., p. 32), and a 6.52% average yield for his group of six electric utilities. (Id., p. 37).

For dividend growth, Dr. Olson believes that investors in Puget are expecting a 4.5% to 5.0% dividend growth and a 5.0% to 5.5% dividend growth for his comparable-risk electric group. (Id., p. 32, 37). Based on all this, Dr. Olson concluded that the bare cost of equity for Puget is 11.52% to 12.04%. A similar analysis produced an 11.68% to 12.20% bare cost of equity range for his comparable group. Id. Dr. Olson concluded that Puget's bare cost of equity is 11.75% to 12.25%. This 11.75% to 12.25% bare cost of equity was then marked-up by 8% to account for historical financing costs and market pressure. (Ex. T-516, p. 40). This produced a 12.69% to 13.23% return on equity. Accordingly, Dr. Olson concluded that Puget should be allowed to earn a 12.5% to 13.0% return on equity. (Id., p. 42).

3. Puget's Estimate of Cost of Equity is Substantially Overstated. Its Most Recent Recommendations Are Not Even Based On a Formal Study.

Both Dr. Olson's original 12.5%-13.0% return on equity recommendation and his revised recommendation of 12.0% to 12.5% are overstatements of Puget's current and prospective cost of equity capital. The Commission need only recognize that Dr. Olson's revised recommended equity return is not supported by a formal study reflecting more current data. It is not surprising Puget did not ask Dr. Olson to do a formal study as to the current cost of equity (Tr. 4431), lest that study show the obvious: the cost had fallen well below the 12.25% return on equity Puget now recommends be used to set rates in this case.⁴⁵ Dr. Olson prepared his prefiled testimony in the October-November 1992 time-frame, when the yield on "A" rated public utility bonds was 8.6%. (Ex. 678, Sch. 15); he admitted this yield is about 7.5% currently. (Tr. 4432). Hence, bond yields have fallen 110 basis points since Dr. Olson prepared his prefiled testimony. That would put the lower end of Dr. Olson's return on equity range at 11.4% (12.5% - 1.1%), even if one were to

⁴⁵ Dr. Olson testified that in past cases, he typically has provided an updated study. (Tr. 4432).

accept, arguendo, the reasonableness of his original 12.5% cost of equity estimate. The fact is, however, that his original 12.5% to 13.0% return on equity range is vastly overstated, as his evidence shows.

4. Puget's Invitation to See "What Other Commissions Are Doing" Shows That Dr. Olson's Estimate is Too High.

Dr. Olson testified on rebuttal that a recent issue of Public Utilities Fortnightly shows the reasonableness of Puget's return on equity recommendation. (Ex. T-924, p. 3). Even assuming the Commission should adopt his "what are other commissions doing" test,⁴⁶ he admitted that the only "A" rated electric shown in that publication was Potomac Edison, and Potomac Edison was allowed to earn only an 11.9% return on equity in an order issued in February, 1993. (Tr. 4439-40). This is already lower than Dr. Olson's estimate. Moreover, the yield on "A" rated utility bonds was 8.04% in February, 1993. (Ex. 678, Sch. 15). It is only 7.5% now. A .54% difference implies an 11.36% current cost of equity. Putting it somewhat differently, Puget is now recommending that its rates be based on a 12.25% return on equity, a return 35 basis points above what was allowed to Potomac Edison in February, 1993 when bond yields were 54 basis points higher than currently. Puget fails its own test!

Puget asked Dr. Lurito to accept that in December, 1992 the California PUC allowed its "largest utilities" to earn in the 11.7% to 11.8% area. (Tr. 2274). Apparently, Puget was not aware that in December, 1992 the yield on "A" rated utility bonds was 8.43% (Ex. 678, Sch. 15), while that yield is only 7.5% currently: 93 basis points less. Were 93 basis points deducted from the 11.7% to 11.8% equity return the California PUC allowed at the end of 1992, a 10.82% return on equity results. This is precisely what Dr. Lurito is recommending.

⁴⁶ None of the utilities referred to were in his group of comparables.

5. Dr. Olson's Markup to Dividend Yield Is A Flawed Procedure And His Growth Rate Is Without Analytical or Market Support.

Dr. Olson's original 12.5% to 13.0% return on equity recommendation is overstated for many other reasons. First, Dr. Olson's mark-up to the dividend yield for one-half year's dividend growth expectation produces overstated results, as Dr. Lurito testified and proved in uncontroverted evidence. (Ex. T-700, p. 58; Ex. 702). Second, Dr. Olson did not provide a shred of evidence to support the dividend growth rates he used for Puget and his comparables, other than to tell us what he did not rely on:

- The IBES growth rate for Puget is 2.4%, but he didn't rely on it (Tr. 747, 750). He has relied on IBES in the past. (Ex. 585, p. 17).
- He didn't rely on Puget's 5-year and 10-year growth rate in earnings per share, dividends per share and book value per share. (Tr. 748-49).
- He testified he also didn't rely on a retention growth analysis for Puget. (Ex. T-516, p. 30 and Tr. 750).

Dr. Olson simply testified that in his opinion, investors are expecting a 4.5% to 5.0% dividend growth rate for Puget. (Ex. T-516, p. 32). No analysis; just an opinion. Dr. Olson also ignored his study in estimating dividend growth for his comparables. Ex. 517, Sch. 10-12 and 14 show:

- The average 10-year and 5-year earnings per share growth rate for the group is a -.6% and 3.6%;
- The average 10-year and 5-year dividend growth rate was .9% and 3.3%;
- The average 10-year and 5-year book value per share growth rate for the group was .9% and 1.9%; and
- The average IBES growth rate of the comparable group was 3.8%.

HE RELIED ON NONE OF THESE GROWTH RATES!!! (Ex. T-516, p. 34-36). While these data indicate a lower growth rate, he simply stated that in his opinion investors are expecting a 5.0% to 5.5% dividend growth for the group. (Id., p. 36). Again: No analysis; just an opinion.⁴⁷

In Docket U-89-2688-T, Dr. Olson opined that Puget's dividend growth expectation was only 3.25% to 3.75% (Tr. 745), yet more than three years later, after a decline in interest rates of more than 200 basis points and a correspondingly large decline in the cost of equity capital, Dr. Olson would have us believe that Puget's growth expectation has risen by 30% to 40%. Such an opinion is as illogical as it is insupportable.

Dr. Olson testified that investors in Puget are not expecting Puget to earn in excess of 12.5% on common equity; indeed, he indicated that investors are only expecting Puget to earn 11.5% to 12% on equity. (Tr. 745). If that is true, then the only way they could expect a 4.5% to 5.0% dividend growth to prevail is if Puget retained 60% of its earnings. Last year, it only retained 19% of its earnings. What this means is that rational investors can't possibly be expecting a 4.5% to 5.0% dividend growth for Puget as Dr. Olson believes. (Ex. T-700, p. 59). The inescapable conclusion is that Dr. Olson's dividend growth expectation estimates for Puget and for his group of six electrics are simply unsupported and insupportable on their face.

In 1990, this Commission determined the cost of equity to be 12.8%. Today, Dr. Olson is recommending that Puget be allowed to earn 12% to 12.25%. The 12.8% return on equity is in the middle of the 12.5% to 13.0% range Dr. Olson initially recommended, and is only slightly higher than what he now recommends, without a formal study! This, at a time when "A" rated public utility debt is yielding 200 basis points less. Dr. Olson's recommendation is vastly overstated and makes no sense.

⁴⁷ Dr. Olson testified Puget has stuck with him and DCF. Tr. 4502-03. The problem is he didn't really apply DCF in any accepted form. What results is an excessive return without basis.

6. Puget's "Investors Aren't Rational" Defense Is Wholly Without Merit.

Dr. Olson sought to buttress his recommendation that Puget be allowed to earn in the 12.0% to 12.5% range by noting that evidence indicates that investors are not rational. Were they rational, Dr. Olson stated, then earned equity returns of 12% would not be producing a 1.5 market-to-book ratio for Puget. (Ex. T-924, p. 35-36). Chairman Nelson found Dr. Olson's testimony in this regard "astonishing" (Tr. 4496), and indeed it is. However, Dr. Olson had no other choice but to suggest that investors are not rational because were they rational, his 12.0% to 12.25% return on equity recommendation could not be supported, as Dr. Lurito proved. (Ex. T-700, p. 60).

7. Dr. Olson's "Criticisms" of Staff's Analysis Are Either Unfounded in Fact, Contradicted by Other Puget Witnesses, or Wholly Support Staff's Case.

Dr. Olson alleged that Dr. Lurito's 10.8% return on equity recommendation is too low because long-term interest rates have fallen by less than 150 basis points, but he later was forced to admit that long-term interest rates have fallen over 200 basis points since Dr. Lurito prepared his testimony in Puget's last case. (Tr. 4445). Dr. Olson went on to suggest that Puget had an ECAC at the time Puget's last base rate case was in hearings and since, in his opinion, ECAC was less risky than PRAM, Puget's cost of equity could not have fallen by 200 basis points as Dr. Lurito claims. (Ex. T-924, p. 16-17). First, it should be noted that Dr. Olson admitted that he made no study to show that ECAC was less risky than PRAM. (Tr. 4443). Second, Puget witness Rittenhouse totally contradicted Dr. Olson in this regard, testifying "how favorably it [PRAM] has been viewed by investors." (Tr. 4531). She testified that PRAM provides "greater stability for Puget's earnings" (Tr. 4533) and that investors view PRAM more favorably than ECAC. (Tr. 4545-46). Indeed, in Ex. T-700, p. 36, Dr. Lurito noted that PRAM has had a salutary effect on cost of equity:

[There is] convincing evidence that the institution of PRAM since Puget's last base rate case has resulted in about a 50 basis point reduction in its cost of equity over and above the decline that could have been expected for other reasons.

Hence, it is clear that Dr. Olson's criticism is without merit.⁴⁸

Dr. Olson also claimed Dr. Lurito's analysis was faulty because Dr. Lurito found Idaho Power (one of his comparables) to have a cost of equity lower than Puget, yet Idaho Power does not have an automatic resource recovery mechanism. (Ex. T- 924, p. 23). However, Dr. Lurito explained that Puget's cost of equity had declined more rapidly than the comparables since the last rate case, since Puget started from a higher level. (Tr. 2307-10). Puget's criticism misses the mark.

Dr. Olson attempted to attack the reasonableness of Dr. Lurito's 3.5% dividend growth rate for Puget on the ground that rational investors could not be expecting Puget to earn a 13% return on equity at this time which, Dr. Olson claimed was Dr. Lurito's position. (Ex. T-924, p. 17). Dr. Olson apparently didn't read Dr. Lurito's testimony. Dr. Lurito indicated that over the period of time encompassed by his dividend yield, i.e., the 12 months ended 3/31/93, investors were not anticipating an earned return in excess of 13%. (Ex. T-700, p. 19). This is a perfectly rational statement given that Puget in fact earned 13.22% on equity in 1990, 13.15% in 1991 and 12.45% last year. (Ex. 703, p. 7). Moreover, Dr. Olson admitted that had Dr. Lurito used an expected return of less than 13%, his 3.50% growth expectation for Puget would have been lower and, therefore, his cost of equity finding would have been lower than 10.8%. (Tr. 4448).

8. Ratemaking Is Not a One-Way Street; Market Price Should Align With Regulatory Reality. Ratepayers Deserve No Less.

Puget's cross-examination of Dr. Lurito focused on Dr. Lurito's recommendation that Puget's return on equity be set at 10.8%, a return that would likely produce a market-to-book ratio of 1.05 to 1.10. Dr. Lurito testified that if Puget's market-to-book ratio were to fall to about 1.07, the price of its common stock would fall from about \$28 per share to about \$19. (Tr. 2256-58).

Puget apparently was not aware that Dr. Olson himself testified that if Puget earned the 12.5% to 13.0% he had recommended, Puget's market-to-book ratio would fall into the 1.05 - 1.10

⁴⁸ The Commission explicitly rejected Dr. Olson's position in the 1989 Rate Case, 3rd Supp. Order, p. 16. (C. Olson, Tr. 4447).

range. (Ex. 585, p. 14; Tr. 741). This is also precisely what Dr. Olson indicated in his prefiled testimony. (Ex. T-516, p. 38-40). That is why Dr. Lurito testified that Dr. Olson agrees with him that Puget's market price should be brought down by regulatory action. Dr. Lurito testified further in this regard:

[R]ates of return on equity that are being allowed are falling all over the country as interest rates have fallen. So that it would not be surprising if we see now in the next three or four years, assuming capital markets stay reasonably constant, that market-to-book ratios of the great majority of utilities will be [falling] into the area that I am indicating. [Tr. 2269].

Nor can such a market price decline be considered a "loss." As Dr. Lurito stated at Tr. 2315:

What I'm asking is that ratepayers get back what they have been giving. It's not taking away something from someone who deserves it. It's righting what in fact is an inappropriate situation. And it's really important, I think, to understand that and both Dr. Olson and I see eye to eye in that regard.

The record evidence on the issue of the appropriateness of reducing Puget's market-to-book ratio is clear and unanimous:

- Dr. Olson was the first witness to recommend that Puget's market-to-book ratio be brought down to 1.08 so that it lies within the bounds of what is appropriate for a regulated utility. Dr. Lurito simply agreed.
- No return on equity witness in this case is recommending that Puget be granted a return on equity sufficient to maintain its current 1.43 market-to-book ratio.

The point is clear: Regardless of what return on equity the Commission allows in this case, it can do so with the knowledge that Puget's inappropriately high market-to-book ratio will decline. It should allow Staff's recommendation of 10.8% because that is Puget's cost of equity; anything higher would be unfair.

B. The Cost of Long-Term Debt, Short-Term Debt and Preferred Stock.

Staff recommends that a 7.89% cost of long-term debt be used to set rates while Puget recommends that a 7.91% cost rate be used. These recommendations are so similar that either can

be used. The same is true for the cost of preferred stock.⁴⁹ The only issues to resolve are the cost rate and level of short-term debt.

Puget recommends a 4.42% cost of short-term debt while Dr. Lurito proposes a 4.00% cost rate. In uncontroverted testimony, Dr. Lurito stated that the current cost of Puget's short-term debt is 3.825%, which he rounded to 4.00%. (Ex. T-700, p. 11). Mr. R. E. Olson's 4.42% is based on a DRI-forecast. (Ex. 919, p. 9, 12). There is no evidence that short-term rates are rising and since the current cost of Puget's short-term debt is known, the Commission should use a 4.00% cost of short-term debt to set rates in this case as fair and reasonable.

C. Staff's Capital Structure Should Be Used To Set Rates.

1. Staff's Recommendation.

The essential difference between Dr. Lurito's recommended capital structure and Puget's lies in the different short-term debt and common equity ratio recommendations that were made. Dr. Lurito recommends more short-term debt and less common equity than Puget proposes.

In support of his recommended 5% short-term debt ratio, Dr. Lurito testified that over the last five years, on average, Puget has had a 4.4% year-end short-term debt ratio. (Ex. T-700, p. 10). In Docket U-89-2688-T, the Commission set rates based on a 4.4% short-term debt ratio.⁵⁰ Dr. Lurito further testified that in light "of the current and likely future low cost of short-term debt, it would be less than prudent to use less than a 5% short-term debt ratio to finance rate base." (Ex. T-700, p. 10).

Dr. Lurito's recommended common equity ratio of 41.0% is very much in line with the 41.5% equity ratio in Puget's last base rate case and is 170 basis points higher than the 39.3% common equity ratio the Commission used in its Decoupling Case. (Tr. 4337).

⁴⁹ Dr. Lurito recommends an 8.09% net cost rate while Puget recommends 8.10%.

⁵⁰ Docket U-89-2688-T, Third Supp. Order, p. 68.

It is crucial to note that Dr. Lurito tested the safety of his recommended capital structure. (Ex. T-700, p. 30-34). This test went unchallenged on the record, and showed if Puget experienced an earnings decline that had only a 1 in 160 chance of occurring, his recommended capital structure could withstand such a decline and still be of sufficient strength to produce a 2.15 times after-tax coverage of Puget's total interest obligation. (Id., p. 33). The pre-tax interest coverage consistent with Staff's capital structure and overall rate of return would produce a 3.03 times pre-tax interest coverage. (Id., p. 33).⁵¹ S & P guidelines for an "A" rating require that a 2.5 times to 4.0 times pre-tax coverage and a 44% to 54% total debt to total capital ratio be achieved by an electric. (Ex. 519, p. 4-b). Both Dr. Lurito's capital structure recommendation for Puget and the resulting pre-tax interest coverage are well within the S & P guidelines for "A" rated electric utilities.

2. Puget's Recommendation.

Mr. R. E. Olson recommends that Puget be regulated based on a capital structure containing 47% total debt, including 2% short-term debt, 8% preferred stock and 45.0% common equity capital. Mr. Olson testified that the principal reason why Puget has requested a 45% common equity ratio in this case is because rating agencies have represented to him that a lower equity ratio would prompt downgrading of Puget's debt due to the alleged risk associated with its purchased power program. (Tr. 816). Mr. Weaver concurs. (Ex. T-935, p. 7).

Puget's 47.0% recommended total debt to total capital ratio is at the strong end of the S & P guideline of 44% to 54%, which means that it could well produce an "A+" rating; two grades higher than Puget's current rating. Puget's recommended capital structure and cost rates of capital are consistent with a 3.55 times pre-tax interest coverage.⁵² This is at the strong end of the 2.5 times to 4.0 times S & P guideline for an "A" rating.

⁵¹ This analysis uses a time series that includes periods prior to PRAM. Even including such data from periods of less stable returns, Staff's capital structure is safe. No Puget witness questioned this analysis or did a similar analysis.

⁵² $(.65 + 5.51)/(1 - .34) + 3.56 + .10/(3.56 + 1.0) = 3.55$

As mentioned, the principal reason why Puget is requesting that rates in this case be set based on a 45% common equity ratio, is because of the risk associated with its purchased power program. Rating agencies have advanced the proposition that the capacity portion of a utility's purchased power expense should be viewed as constituting "per books" debt financing and, because of this, the utility's "per books" capital structure ratios and other financial health parameters, particularly pre-tax interest coverage, should be adjusted to reflect this point of view. According to Puget, rating agencies are suggesting that a utility's debt ratio and pre-tax interest coverage be adjusted to reflect purchased power expense and that after these adjustments are made the utility's adjusted debt ratio and adjusted pre-tax interest coverage must be within the agencies' guidelines for a particular bond rating or a downgrade will occur.

Mr. Olson followed the S & P methodology to adjust Puget's financial ratios for purchased power expense; he found that after adjustment, Puget's recommended debt ratio would rise from 47% to 54% and its pre-tax interest coverage would fall from 3.55 times to 2.82 times. (Ex. 918, p. 4). Mr. Olson pointed out that these adjusted financial ratios are just within the S & P guidelines for an "A" rating.

The S & P methodology also calls for imputing over \$30 million in "pseudo-debt" to Puget's capital structure. Mr. Olson agreed that before imputation, all parties' recommendations meet the S & P guidelines. (Tr. 4340). After imputation, most produce total debt ratios and pre-tax interest coverages below what the S & P guidelines suggest is needed to maintain an "A" rating. (Ex. 918, p. 3). Hence, he concluded that unless Puget's proposed capital structure and cost rates are accepted by this Commission, Puget could well suffer a downgrading of its debt. (Ex. T-917, p. 10-12).

3. The PRAM Provides Significant Protection Against Earnings Variability and Justifies a Lower Equity Ratio.

Puget sold 3.45 million shares of common stock in June, 1993. (Tr. 4337-38). This sale increased its common equity ratio to 45%, the equity ratio the company requests its rates be based on. This sale has caused the common equity ratio recommendation of every rate of return witness

in this case (except Mr. Olson, of course) to become hypothetical. (Tr. 4584-87). As Mr. Weaver stated:

Adopting [Staff's] hypothetical equity component would cause [Puget] to under-recover its costs of capital by a substantial amount, since [Puget] will actually have a 45% equity component.... To agree with the Staff, the Commission would have to find that the existence of a 45% equity component in [Puget's] actual capital structure is imprudent. (Ex. T-935, p. 6).

While we have found no order where the Commission used a hypothetical capital structure and made a "finding of imprudence,"⁵³ Puget's 45% common equity ratio is excessive. Rates should be based on Staff's recommended capital structure. Indeed, the Commission used a hypothetical 39.3% equity ratio in the Decoupling Case, as Puget was forced to recall, (R. Olson, Tr. 4337), yet there was no "finding of imprudence" in that case. The Commission should continue that practice in this case.⁵⁴ This is particularly true since Puget has been allowed, is currently allowed, and is recommended to continue to be allowed, to recover its prudently-incurred purchased power expense through the PRAM mechanism and, hence, in rates. Interest is at risk when earnings fluctuate. (Lurito, Tr. 2301-02). As recent history proves conclusively, Puget's earnings do not fluctuate under PRAM; Puget gets timely recovery of its prudent purchased power expense. (Ex. T-700, p. 42, 51). Mr. Olson and Mr. Weaver agreed that this is the case. (Tr. 572, 812). The significance of this fact was explicated by Dr. Lurito in Ex. T-700, p. 51:

The relationship between Puget's purchased power expense and its risk turns critically on how its purchased power expense is recovered under the specific regulatory treatment applied by this Commission. The reason why debt and equity investors build in a risk component into their cost of capital is because a company's earnings can fluctuate. It can fluctuate because regulation typically does not guarantee that a specific return on capital will be achieved.

The same is true regarding purchased power expense. If the recovery of purchased power expense were not guaranteed, then earnings would be subject to more volatility

⁵³ Mr. Weaver relied on no such order, either. (Tr. 4586).

⁵⁴ Puget quoted Dr. Legler's testimony, to suggest that the Commission should maintain a "hands off" policy on a utility's capital structure, and that Puget's 45% equity ratio should be used. (R. Olson, Ex. T-917, p. 9). Conspicuously absent from Puget's discussion is Dr. Legler's testimony that an equity ratio above 40% would be appropriate. (Tr. 2006). As to the "hands off" policy, this would be contrary to the long-standing policy of this Commission. This is not the time to accept Puget's invitation to abandon that policy.

than if it were. This volatility would produce risk and this risk would have to be dealt with not only in the cost of equity capital but also in the capital structure that would be needed to achieve a desired level of interest coverage and a desired bond rating. In Puget's case the PRAM guarantees dollar for dollar recovery of its purchased power expense.... Under these circumstances, there is no earnings volatility created by Puget's purchased power program and, hence, there is little risk created by it. Indeed, it is precisely because of the PRAM that investors can expect Puget's earnings to be quite stable. Because its earnings can be expected to be quite stable, less interest coverage is needed, all else the same, to satisfy bondholders that Puget's interest obligations will be met.

There can also be no doubt as to the uniqueness of the regulatory treatment accorded to Puget's purchased power expense by this Commission. Dr. Olson tried to imply that PRAM is not unique by stating that more "than 40 states have fuel clauses, and they include the larger states with big electric utilities." (Ex. T-924, p. 7). Yet he admitted that PRAM is more than a fuel clause and that he has made no study of what proportion of purchased power expense is recovered in those 40 states' fuel clauses. (Tr. 4442). Mr. Weaver had no idea of the proportion of purchased power expense that is allowed to be recovered in rates for the 17 electrics he listed as being "downgraded" due to purchased power. (Tr. 4588-89). Mr. Dell admitted that he has made no study as to the purchased power cost recovery mechanism used by various commissions (Tr. 4406); he further admitted that Duff & Phelps doesn't differentiate between PRAM and the way other utilities recover their purchased power expense. Id.

Puget notes that the mid-Columbia licenses and contracts will begin to expire in 2005. (Dell, Ex. T-923, p. 13). This ignores the fact that these projects are up for relicensing, not retirement. (Dell, Tr. 4411). Puget has not explained why we should have a 45% equity ratio now because of events that may occur in 12 years. Similarly, Puget's view that there is no "long-term guarantee" that power costs will be recovered (C. Olson, Ex. T-924, p. 21; Tr. 4443) ignores the fact that the Commission can guarantee recovery, and has under the PRAM.

It is also obvious that if Puget's bondholders were concerned about Puget's purchased power program they would have responded long ago by requiring that imputed interest and imputed debt related to purchased power be reflected in the first mortgage bond indenture agreements they have

made with the company. Bondholders have not requested any such amendments to the indentures. (R. Olson, Tr. 4343-44). Mr. Olson then offered the startling revelation that bondholders look to rating agencies to protect them! (Tr. 4344). Bondholders can and do protect themselves.

Dr. Lurito succinctly stated why there is no need for this Commission to adopt Puget's higher equity ratio request due to purchased power, since PRAM's effect is to ensure timely recovery of this item of expense. In Puget's case, the rating agencies have created a hypothetical risk which simply does not exist under PRAM. (Tr. 2300-02).⁵⁵ The point is clear: there is little or no risk related to Puget's purchased power expense because it is recovered on a timely basis. PRAM permits Puget to have a lower equity ratio and lower rates.⁵⁶

4. Rating Agencies and Equity Ratios - "Does Analysis Matter?" or "Are We 'Stuck' With the 'Unassailable Statements of Fact'?"

Puget has expressed surprise that Staff had the audacity to question Mr. Abrams, Mr. Dell and others on their imputed debt theory. In Puget's view, it is "astonishing" that Staff and others would question the untested pronouncements of the rating agencies.⁵⁷ According to Puget, the rating agencies have "reasoned through and rejected" our arguments.⁵⁸ This is entirely consistent with Puget's view that "whether we dispute [the rating agencies methods] or not makes no difference. WE'RE STUCK..."⁵⁹

Obviously, under Puget's view of regulation, we have all wasted a lot of time and energy in this case doing analysis, since it is the rating agencies that dictate the outcome. We believe the equity ratio issue deserves reasoned analysis, generic formula notwithstanding.

⁵⁵ This hypothetical risk is supported by a mistaken analogy, which shows how greatly Puget overstates its case. Puget likens purchased power contracts to a house owner who seeks a personal loan, but the bank, like Wall Street, will consider the homeowner's mortgage debt. (Dell, Ex. T-923, p. 14). This is highly misleading. The correct analogy is to a homeowner whose mortgage is largely supported by a payment stream that is highly secured (by ratepayers, in the case of Puget).

⁵⁶ This specific viewpoint was shared by other economic witnesses. See Elgin, Tr. 2501; Hill, Tr. 2999; Parcell, Tr. 3223.

⁵⁷ C. Olson, Ex. T-924, p. 3.

⁵⁸ Weaver, Ex. T-935, p. 11.

⁵⁹ Weaver, Tr. 592 (emphasis added).

5. The Rating Agencies Have Provided Only a Generic Analysis. They Have Not "Leveled the Playing Field" In Puget's Case. It is Pure Conjecture to Presume a Downgrade Will Occur if "45%" Does Not Appear in the Order.

We agree with Mr. Olson that the rating agencies are making a generic analysis. (Tr. 4348-49; Abrams, Tr. 1032). One need only recognize that under the generic formulae, the largest debt imputation comes from the mid-Columbia contracts! (Hill, Ex. T-796, p. 66-67). As a result, the analyses offered by S & P and Duff and Phelps do not "level the playing field" as Puget puts it. (Tr. 4341). Puget asserts that "the rating agencies have considered and rejected" all contrary arguments (Weaver, Ex. T-935, p. 11), but on the other hand, it cautions that the rating agencies will consider all factors in making decisions. (Id., p. 9). What we do not have is the rating agencies' analysis of "all factors." Not even Duff & Phelps has provided such an analysis. Staff requested that Duff & Phelps produce analysis of Puget in light of the factors listed in Ex. 510, p. 3. No written analysis was done or provided. (Abrams, Ex. 602, p. 49). To adopt the rating agencies' purported views would truly be delegation absent legal or factual basis.

6. Puget's Case on the Financial Impact of Purchased Power is Blistered with Inconsistencies and Contradictions.

The inconsistencies and contradictions in Puget's case are as varied as they are manifold.

Consider the following:

- Mr. R. E. Olson states he "doesn't disagree" with the analysis, and although he "could argue with the risk factor," he's "just reporting."⁶⁰

BUT

Mr. Weaver indicates the rating agency analysis is "accurate and appropriate." (Ex. 579, p.11).

- Puget claims the rating agencies are fully informed on Puget's purchased power contracts, and know them "in detail."⁶¹

BUT

Mr. Abrams did not compare Puget's contracts with those of other utilities (Ex. 602, p. 17); he was unaware of the specifics of the PRAM (Id., p. 45); he made no written, analytical analysis of Puget

⁶⁰ Tr. 809-10; Ex. T-917, p. 6.

⁶¹ R. E. Olson, Ex. 587, p. 21.

vis a vis the factors he identifies in Ex. 510, p. 3. (Id., p. 49) He was not knowledgeable about the displaceability provisions in the newer contracts. (Tr. 1004). Mr. Dell did not know how the PRAM accounts for secondary sales. (Tr. 4414).

- Even the rating agencies are not consistent. S & P places a "risk factor" for Puget's take or pay contracts 1.7 times that of its take and pay contracts. Yet Duff & Phelps considers the difference between those contracts "not a big issue" and "the financial effect is the same." (Abrams, Tr. 989-90).
- Ms. Rittenhouse testified investors are "definitely not indifferent" to PRAM 1. (Tr. 4533).

BUT

Dr. Olson testified they are indifferent to PRAM.⁶²

It is difficult to evaluate a case so riddled with inconsistencies between Puget's own witnesses.

7. The Information Provided to the Investment Community By Puget Is Incomplete.

In addition to the inaccuracies and contradictions, there was a concern on this record about the adequacy of Puget's communications of the workings of PRAM and Puget's unique characteristics to the investment community. Although Ms. Rittenhouse and Mr. Dell claim that adequate information was provided,⁶³ and while there was some dispute over interpretations of statements in financial publications, we list the following "unassailed statements of fact":

- Duff & Phelps was unfamiliar with how secondary sales are handled under PRAM, the displaceability provisions in the new power contracts, and the specifics of how PRAM works. (Tr. 4414; Tr. 1004; Ex. 602, p. 45).
- Puget did not decouple for financial reporting purposes (Rittenhouse, Tr. 4554; Ex. 699), and its annual reports did not inform investors that under PRAM, booked revenues are based on normal weather. (Ex. 573 and 573A are silent on this matter).

⁶² Tr. 4437.

⁶³ Rittenhouse, Ex. T-929, p. 12; Dell, Ex. T-923, p. 8. Mr. Dell also suggested that Mr. Elgin and Dr. Lurito gave inconsistent testimony on this subject (Ex. T-923, p. 9), although Mr. Dell was unaware that Dr. Lurito explained the testimony. (Tr. 4410-11). Dr. Lurito testified that he and Mr. Elgin were consistent, noting the analysis of risk by Puget's rating agency witnesses was inadequate, given the PRAM. (Tr. 2328). Dr. Olson's comments in Ex. T-924, p. 13 regarding Staff concerns about Puget's communications with the investment community as "inconsistent with the concept of efficient markets" are therefore without merit.

- Puget's Annual Reports continue to refer to growth in demand as indicative of earnings growth (Ex. 573, p. 12, 1st Q&A), while Puget admits on the record that PRAM removes the benefit of growth in sales. (Sonstelie, Ex. T-878, p. 7).

Perhaps the most revealing fact comes from Dr. Parcell. Though he examined the financial reviews of Puget and offered them as exhibits to his testimony (Ex. 812-15), he could not tell us how PRAM works even at a basic level! (Parcell, Tr. 3230-31).

8. Puget's "Don't Ask" Policy is a Disservice to Ratepayers.

Puget opines that it gave adequate information to rating agencies, but it has nothing to say about what they do with that information.⁶⁴ This gives a very jaded and simplistic view of reality.

The reality is that Puget did correct an error by S & P. (Weaver, Tr. 568-69). The reality is also:

- Puget never asked the basis for, or why S & P assigned a risk factor to Mid-Columbia power 1.7 times that of the new power contracts (Weaver, Tr. 654), or what the 25% factor even means;⁶⁵
- Puget does not know how S & P defines capacity payment in the formula (R. Olson, Tr. 4345);
- Puget testified it doesn't know what percentage of its purchased power is capacity related (R. Olson, Tr. 4345) although it provided Moody's an estimate;⁶⁶
- Puget's capacity analysis in Ex. 582 was provided to Moody's BUT NOT S & P EVEN THOUGH S & P ANALYZES CAPACITY! (Ex. 582, second page; Weaver, Tr. 655);
- One of Puget's senior financial officers did not know what percentage of Puget's purchased power is tracked through PRAM.⁶⁷ He also gave inconsistent testimony. He said PRAM risk reduction was "very, very slight" and then "It's not been slight;"⁶⁸

⁶⁴ Rittenhouse, Ex. T-929, p. 12.

⁶⁵ R. Olson, Tr. 812, 4347. It is a mystery how Puget can claim its new contracts are more harmful to its credit than the hydro contracts (Weaver, Ex. T-935, p. 8) when S & P shows the opposite, by giving the hydro contracts a higher risk factor.

⁶⁶ Ex. 582.

⁶⁷ R. Olson, Tr. 4352.

⁶⁸ Tr. 1392, 1396; Ex. 587, p. 43-45.

- Puget complains it is "Number 1" in purchased power, but it requires cross-examination to reveal it is also "Number 1" in low cost hydro power. (See e.g., Dell, Ex. T-923, p. 12; Tr. 991, 1098).⁶⁹

Puget apparently believes that a departure from its "don't ask" policy shows it is not committed to credit quality.⁷⁰ The ratepayers pay the penalty.⁷¹

9. Puget's "Proof" and "Quantification" of a Potential Downgrade are Overblown.

Puget posits that it will be downgraded absent a 45% equity ratio, but we find little to support its claim. Mr. Weaver provides a list of companies which were "downgraded,"⁷² but he failed to even analyze each companies' cost recovery mechanisms, saying "I have no idea what form of cost recovery they have." (Tr. 4588). Likewise, Mr. Dell refers to other states' recovery mechanisms, but did no survey to see if they were as broad as PRAM. (Tr. 4406). Puget points to Moody's comments about Staff's case. (Ex. T-917, p. 3-4). This report, issued shortly after Moody's met with Puget, contains no indication that Moody's reviewed the transcript or the data requests, or any details supporting Staff's case.

Nor does Mr. Olson's "cost of downgrade" of \$2.25 million per year withstand scrutiny. (Tr. 4385). His .60% spread between "A" and "BBB+" is completely out of touch with current conditions, which show a .1% spread. (Tr. 4400, as corrected). Worse, he ignores the fact that debt interest is tax deductible.⁷³ Also ignored is the fact that a higher equity ratio requires more revenues and income taxes in support.⁷⁴

10. The Generic Approach Does Not Reflect Puget's Situation.

⁶⁹ The facts also show that Puget's O&M including purchased power has averaged 55% for years, in line with other electrics. (Hill, Ex. T-796, p. 65; Tr. 3022-23). Puget never mentions this.

⁷⁰ Weaver, Tr. 569.

⁷¹ Puget requested Staff input to the rating agencies. (Ex. 676). However, Puget gave no advance notice, no follow-up (Tr. 2516-17) and apparently believes Staff could provide such input without Commission approval, which would likely constitute an ex parte communication.

⁷² Ex. T-935, p. 9-10. "Downgraded" does not mean bond downgrading in each case. Tr. 4587-88.

⁷³ At a tax rate of 34%, the \$2,250,000 becomes \$1,500,000, even assuming Puget's figure is correct.

⁷⁴ Assuming a \$2 billion rate base, a 4% higher equity ratio at a 12.25% cost of equity = \$9,800,000 added return. With tax effects, this is almost \$15,000,000. Puget ignores this impact.

The across-the-board, generic and mechanical approach to adjusting financial parameters for the effects of purchased power cannot be applied to Puget. The S & P methodology of adjusting a utility's debt ratio and pre-tax interest coverage for purchased power has four steps to it (Ex. 918, p. 10):

- The present value of the utility's take or pay and take and pay purchased power contract payments is determined;
- It is assumed that 50% of the present value of total payments are capacity-related;
- A risk factor is applied to the take or pay and the take and pay capacity-related present value totals to get an imputed debt equivalent; this debt equivalent is then added to the "per books" total debt to arrive at an adjusted debt ratio; and
- The imputed debt equivalent derived from step (3) above is then multiplied by a 10% interest rate and this "imputed interest" is then added to Puget's per books interest expense to arrive at an adjusted interest expense. As a matter of judgment, S & P applies a 25% risk factor to Puget's take or pay contracts and a 15% risk factor to its take and pay contracts. Id.

Mr. Olson had no idea why S & P applied a 25% risk factor to Puget's extremely inexpensive, Mid-Columbia take or pay contracts. (Tr. 800; Ex. T-700, p. 45). He did say that he wouldn't agree that S & P has chosen the right risk factors. (Tr. 809). He has no idea what a risk factor of 25% means. (Tr. 4347). According to Puget's own estimate, only 37.6% of its purchased power expense is capacity-related, not 50%, (Ex. T-700, p. 47), yet this information was never given to S & P. Moreover, Mr. Olson testified that Puget's cost of total debt is only 7.57%, not 10% as the S & P adjustment mechanism assumes. (Ex. 918, p. 3).⁷⁵

Perhaps the threats of the rating agencies explains why Mr. Olson didn't even bother to discover the basis for the risk factors S & P assigned to Puget's purchased power (Tr. 800) or

⁷⁵ Dr. Lurito showed in uncontroverted testimony that using inputs related to Puget itself, Puget's debt ratio and pre-tax coverage, even after adjustment, would still meet the S & P guidelines for an "A" rating. (Ex. T-700, p. 50). Neither Mr. Dell nor Mr. Olson deigned to rebut this evidence, or even discuss it, nor did they controvert Dr. Lurito's analysis that under Staff's capital structure, Puget could withstand an earnings drop that occurs only 1 in 160 times. PRAM assures that 1 in 160 chance is more like one in a million.

question their applicability to Puget. Puget did not even bother to send its response to a Moody's questionnaire concerning its specific capacity cost portion of purchased power expense to S & P or to Duff & Phelps! (Ex. 582, 2nd page). That information could well have led S & P to reconsider the risk factors it applied to Puget's purchased power.

Mr. Elgin testified that "Staff continues to be concerned about Puget's apparent inability to convince both Wall Street analysts and Puget's shareholders of PRAM's benefits. Instead, Puget presented two consultants to tell the Commission how much additional risk purchased power imposes on the utility." (Ex. T-670, p. 27). Mr. Elgin later noted that:

Puget's cost of purchased power under the PRAM is guaranteed recovery through rates. The impact of earnings stability is highly significant. I have not seen any quantitative analysis by Puget addressing this aspect of Puget's financial profile, nor do I see any explicit statement in Puget's annual report to shareholders to that effect. (Id., p. 29).

This Commission must not reward a company that hasn't tried to protect ratepayers' interests by either explaining to the rating agencies why their adjustments to Puget's financial ratios for purchased power do not apply to Puget or why the regulation in this state, which allows timely recovery of all its purchased power expense, should exempt Puget from this adjustment process.

11. The Commission Should Not Abdicate Its Regulatory Authority in Favor of Regulation By Rating Agency.

The Commission should reject Puget's proposed capital structure because the Commission must not abdicate its regulatory responsibility to set fair and reasonable rates to rating agencies who threaten to downgrade a company's debt:

This Commission ... has a public service responsibility, which I know they're certainly aware of, and that is to regulate the utilities under their jurisdiction in such a manner as to balance the interests fairly of investors and ratepayers. Rating agencies should not be allowed to dictate regulation to this Commission or any Commission because that is abdicating regulatory responsibility... (Lurito, Tr. 2302-03).

Dr. Lurito's recommended capital structure for Puget is in line with what his group and what Dr. Olson's group of comparable-risk electrics experienced at year-end 1992. (Tr. 4436). Dr. Lurito's

recommended capital structure contains a common equity ratio of 41.0%, just slightly below the 41.5% the Commission used in Puget's last base rate case. Dr. Lurito's capital structure is in line with the S & P guidelines for an "A" rating. Dr. Lurito's capital structure is safe and economical as sound regulation requires it to be. Finally, Puget can achieve Dr. Lurito's capital structure recommendation in the future by selling debt and preferred stock. (R. Olson, Tr. 4338-39).

D. Summary.

The evidence clearly shows that Puget's recommended 12.25% return on equity is far above the current and prospective cost of equity; Staff and Intervenor return on equity findings also reflect the reality that interest rates have reached historically low levels. While Puget's market-to-book may fall regardless of whether Puget's or Staff's equity recommendation is adopted, this is as it should be. Ratepayers cannot be asked to continue to pay to maintain excessive market-to-book ratios.

Puget's recommended capital structure is based on a false premise; while purchased power may create a risk that needs to be offset by a higher equity ratio and, perforce, higher rates, since Puget receives timely recovery of this expense under the unique regulatory treatment accorded Puget under PRAM, Puget's recommendations are excessive. As Dr. Lurito stated:

During the years when this company was building nuclear plants ... when in fact a higher percentage of Puget's output was accounted for by purchased power than today these analysts weren't here telling us ... we have to recognize this off books financing right in the middle of nuclear construction. Now that these things are better they show up with another aspect of risk and frankly I don't buy it either. (Tr. 2320).

To set rates on a 45% equity ratio as Puget proposes, would ask ratepayers to pay twice for PRAM. They already pay once for PRAM since rates are designed to stabilize Puget's earnings;⁷⁶ now Puget would have them pay again for PRAM because it doesn't think PRAM protects Puget against the risk of purchased power. Paying once is sufficient. If the Commission sees fit to set rates based on a 45% common equity ratio, Staff recommends that PRAM be discontinued. Puget's proposed

⁷⁶ The \$76 million PRAM 3 deferral amount is the explicit cost of PRAM to ratepayers.

capital structure in this case has gone beyond any reasonable bounds. Staff's overall rate of return recommendation accurately reflects the current economic, financial and regulatory environment; it is fair to ratepayers and it is fair to investors. Hence, it should be used to set Puget's rates in this case.

V. RESULTS OF OPERATIONS.

Both contested and uncontested adjustments are shown in Appendix A, Table 2.⁷⁷ The adjustments proposed by Staff total \$98,180,849, with a net operating income after adjustments of \$113,293,573. Tables 3-5 detail the results of operations, working capital, and the revenue requirements calculation, respectively.

Before proceeding to a discussion of the adjustments, two topics are addressed:

- 1) Whether Puget has demonstrated that it has operated efficiently and controlled costs; and
- 2) Whether Puget has provided sufficient evidence to justify the prudence of its new resource acquisitions.

A. Efficiency of Operations.

In the face of unprecedented rate increases in recent years, Puget believes its overall performance merits a "high end" equity return. (Sonsteli, Ex. T-878, p. 9-10). This is not the time to add further obligations to the burdens the ratepayers already bear. Reasonable service should not require an extra payment to shareholders.

1. The Statistics Presented Provide Insufficient Evidence to Show Whether or Not Puget Has Effectively Controlled Costs.⁷⁸

Puget chose to present statistics for the period from 1981-1991 in four areas; average annual residential bills, total other O&M expenses, employment levels, and salary and benefits expenses.

⁷⁷ Uncontested adjustments are labeled on the table by the italicized letters "UC" and are not addressed further in this brief. Adjustments that differ due only to the difference in Production Factor are labeled "CP".

⁷⁸ Staff shares Towers Perrin's concerns that "much of the performance reporting takes the form of advertising" and that a "lack of focus on critical success factors and key cost and quality attributes leads to lots of data but relatively little information." (TP Report, Ex. 1 of Ex. 619, p. 39). Puget summed it up best when stating that "in using any of these statistics one would have to examine what was going on during the period of time in question." (Knutsen, Ex. 619, p. 13). Puget presented little or no such examination.

(Knutsen, Ex. T-539). Curiously, these performance measurements were not the ones identified by Puget's management through Towers Perrin (hereafter "TP") surveys, (Ex. 893) and recommended for Puget's use in August or September of 1992. (Patterson, Tr. 4133). The record evidence is inconclusive on the issue of whether Puget has or has not properly controlled its costs.

An analysis of Puget's inflation adjusted residential bills statistic provides no evidence of cost control:

- The 1981-1991 statistics on average annual residential bills is neither consistent with the rest of Puget's testimony nor indicative of an overall trend. (Kelly, Ex. T-713, p. 6).
- Puget's analysis failed to consider several exogenous factors which impact average annual residential bills. (Id., at 7).
- If one were to accept Puget's assumptions, the analysis shows that Company costs have increased 37.7% in excess of inflation since 1981 and have not stayed as low or lower as Puget contends. Id.

Likewise, there is no clear relationship between the change in number of customers and the change in Total Other Operation and Maintenance (O&M) expenses. (Ex. 715). While customer growth has been fairly stable at 3%, wide swings in O&M expenses can be seen throughout the past ten years. (Kelly, Ex. T-713, p. 10). The customer per Total Other O&M statistic proves little.

Puget's employment level statistics are equally inconclusive:

- Although Puget alleges it manages employee numbers with respect to number of customers (Knutsen, Ex. 619, p. 15), since 1981 there has been no relationship between growth in customers and growth in employees. (Kelly, Ex. 716).
- Although Puget's customer base has continued to grow in 1993, Puget recently laid off enough employees to bring it back to test year levels. (Tr. 4114).
- Puget provided little analysis of its increasing use of contract labor (Ex. 717) although this certainly impacts the need for employees. (Kelly, Ex. T-713, p. 13).⁷⁹

⁷⁹ Likewise, Puget's inter-utility chart (Knutsen, Ex. 544) does not provide an "apple to apple" comparison, diminishing the ability to draw conclusions from such a chart. (Kelly, Ex. T-713, p. 15).

Puget's salaries may have kept pace with the rate of inflation (Knutsen, Ex. 545), but salaries per employee exceed the median when compared with other utilities. (Ex. 718, p. 2). In addition, Puget's overtime wages not related to storm damage have increased dramatically since 1990, and according to Puget, the trend "appears to be continuing unabated." (Ex. 718, p. 4). Statistics on Puget's benefits expenses seemed to reflect cost control (Kelly, Ex. T-713, p. 16; Ex. 718, p. 2.), but TP identified significant savings that could result from improvements in the administration and changes in the "philosophy" of Puget's employee benefits package. (Ex. 688, TP Report, p. 53 & 61).

Internal company reports show Puget's wages per employee are above the median and benefits per employee are below the median. (Ex. 718, p. 2). But the scales for the two graphs are different: wages exceed the median by about \$3000/employee while benefits are below the median by about \$1000/employee, a net of \$2000/employee above the median for the package. Id. Multiply this \$2000 by 2775 (year end 1992 employees, Knutsen, Tr. 1241), and the resulting \$5.55 million above the median is significant.

2. TP Testimony Was Inconsistent With Its Previous Reports.

Puget retained TP to give it an "outsider's viewpoint" of Puget's management efficiency. (Knutsen, Ex. T-53, p. 11). Unfortunately, the filing of this rate case appears to have caused Patterson to be concerned about "interpretations that could be drawn" (Tr. 4141)⁸⁰, leading to glaring inconsistencies between the findings reported prior to the rate case (Ex. 1 of Ex. 619, TP Report 8/11/92) and those filed as rebuttal testimony.⁸¹

⁸⁰ Staff is also distressed at TP's lack of cooperation with Staff requests for data. It refused to provide Staff with copies of the survey instruments or results because the information was "proprietary", (Tr. 4134) yet submitted them as pre-filed Ex. 892 and 893. (Tr. 4135).

⁸¹ The first 19 pages of Patterson's testimony focus on the results of Phase I of TP's study. (Ex. T-888). This phase lasted a mere nine weeks, through mid-September of 1992. (Id., p. 7). Two summaries of Phase I are part of the record. (Ex. 619). In contrast, only 3 pages of Patterson's testimony discuss Phase II, all of which describe the "team approach". (Ex. T-888, p. 20). Phase II lasted 5 months (Tr. 4130) and was the phase for which TP was paid approximately \$700,000. (Ex. 619, p. 68). Phase II was where TP identified up to \$3.2 million in annual savings through efficiencies over the next 6 to 18 months. (TP Report Ex. 688, p. 54). Nowhere in Patterson's testimony are these mentioned.

Patterson's summary of Puget's strengths (Ex. T-888, p. 10) must be viewed in light of two limiting factors:

1. TP's observations are based on just four weeks at Puget, after which it focused exclusively on weakness areas. Id.
2. TP's conclusions were drawn from interviews with Puget's senior management and a review of some Puget supplied documents. TP did not interview any customers, shareholders, or members of the financial community.⁸²

Patterson's overview of Puget's improvement areas (Ex. T-888, p. 16) must be viewed with equal caution. Inconsistencies abound:

August, 1992: TP depicts Puget's weaknesses far outweighing its strengths. (TP Report, Ex. 1 of Ex. 619, 8/11/92 p. 7).

Now: Patterson contends that this picture was a "standard format" used "because of the graphics people", (Patterson, Tr. 4141), yet his graphics capabilities enable him to present more balanced scales. (Final TP Report 4/16/93, Ex. 688, p. 58).

August, 1992: TP noted a "lack of a collegial environment" (Patterson, Tr. 4145) and a "tendency for turf battles" between managers (Tr. 4148).

Now: Patterson insists that Puget's "senior and middle management are working as a real team," yet TP conducted no further review of management in Phase II. (Ex. T-888, p. 15, 20).

August, 1992: TP stated "performance measurement processes are inadequate". (TP Report 8/11/92, Ex. 1 of Ex. 619, p. 39).

Now: Patterson contends that Puget's "capabilities in this area are advanced beyond most utilities we have studied," yet performance measurements were not within the scope of Phase II and were not examined after August, 1992. (Ex. T-888, p.18, 20).

Obviously, no conclusions favoring Puget appear from this record.

B. Prudence of DSM and Other New Power Resources.

Since the last rate case, Puget acquired approximately 50 aMW of conservation and over 600 aMW of purchased power, despite the fact that its 1989 RFP sought only 100 aMW and its 1991 RFP sought only 100-200 aMW. (Lauckhart, Tr. 4672). Given this tremendous growth in Puget's

⁸² The only outside interview was conducted with WUTC staff (Patterson, Tr. 4131); TP found "our session with the WUTC correlates surprisingly well with our own early findings" in August of 1992. (Ex. 1 of Ex. 619, p. 42).

resource portfolio, the Commission required that Puget demonstrate the prudence of these resource acquisitions. (PRAM 2 Order, p. 18). Puget's direct case was virtually devoid of any such evidence. In supplemental testimony, which was to address this specific issue, only procedural processes in future cases was given.⁸³ Staff was required to bear Puget's burden absent a direct case on the subject;⁸⁴ Puget even asked Staff to prove prudence! (Ex. 789-90).

1. The Standard of Prudence - Puget Must Demonstrate That its Decisions Were Proper Given the Circumstances it Faced.⁸⁵

Much confusion (generated by Puget) on this record as to the standard of prudence could have been eliminated had there been direct evidence on this subject as requested. For Staff's part, the prudence standard is an evaluation of the propriety of Puget's decisionmaking process, given the information it had at the time. This is not a "new" standard, as one Puget witness put it.⁸⁶ It is the standard applied in prior Commission cases when it considered the prudence of the Pebble Springs and Skagit/Hanford projects.⁸⁷

It is Puget's case that calls for a "new" standard for prudence determination. First, Puget asks us to accept as factual that Puget's new resources are consistent with its IRP and are below avoided costs. Next, it asks us to accept that its new purchased power contracts were acquired through competitive bidding.⁸⁸ Finally, it attempts to suggest that since Staff was briefed on Puget's decision to acquire specific projects, Staff is somehow fully informed on Puget's decisionmaking. (Sonsteli, Ex. T-878, p. 9). Puget's new prudence standard diffuses the specific

⁸³ See Lauckhart, Ex. T-533, p. 7.

⁸⁴ Puget has offered the view that it has no motive not to pursue cost-effective resources. (Sonsteli, Ex. T-878, p. 9). But this rationale applied in the nuclear construction era as well (Tr. 4019-21). Nonetheless, the WUTC denied recovery of substantial amounts of these projects on prudence grounds.

⁸⁵ Superficially, it may appear that a different analysis is applied by Staff to evaluate Puget's DSM vs. contracts for purchased power. The standard is the same, though practical application of the standard may not be. For example, DSM constitutes thousands of small projects; making a prudency determination of each such project exceedingly impractical. (Weaver, Tr. 4593). DSM is acquired through a tariff under a total resource cost test. The programs are evaluated on an ongoing basis, and the tariff is changed as needed. There is no other analysis that is practical for DSM. By contrast, for supply side resources, the projects are relatively few, and practical considerations are not as limiting.

⁸⁶ Rittenhouse, Ex. T-929, p. 15.

⁸⁷ See Orders in Cause U-82-38 and U-83-54.

⁸⁸ Later qualified to include a resource acquired through competitive bid "framework." Sonsteli, Tr. 4018.

requirement that Puget demonstrate in a comprehensive fashion that its decisions were in fact prudent given the situation and information it had available.

2. The IRP Is Not Intended To Be A Document Upon Which Prudence Can Be Demonstrated.

Puget submits that consistency with the IRP and pricing below avoided costs is a prudence demonstration. (Lauckhart, Ex. T-938, p. 23-25). But as the coauthor of the WUTC's IRP rule testified:

In the case of Puget there is a lack of specific information in the integrated resource planning process that makes it difficult to assess whether the resources that Puget has identified are in fact least cost and how the weighting of indirect costs has been accomplished. (Bell, Tr. 2037).

Mr. Elgin and Mr. Moast agreed the IRP document is not rigorous enough to demonstrate prudence. (Elgin, Ex. T-670, p. 21-23; Tr. 2204-05, 2221-22; Moast, Ex. T-778, p. 27-34). They showed:

- a. The IRP is not approved by the WUTC;
- b. The IRP only generally states a resource preference; it does not justify a specific resource decision;
- c. The 1989 IRP did not even provide a preferred resource stack;
- d. The IRP does not quantify capacity and dispatchability issues;⁸⁹
- e. The IRPs address specific, key supply options only cursorily, or did not include them at all.
- f. The 1989 IRP did not quantify purchased power as an available option.

3. Puget's Specific Resource Decisions Do Not Reflect the Scenario Analysis in the 1989 IRP.

Puget's 1989 IRP did not model purchased power in the scenario analysis. (Moast, Ex. T-778, p. 30, citing Puget's 1989 IRP) yet the company seeks recovery of some 600 aMW of new purchased power resources. It is also clear that the IRP process has been undermined by Puget's failure to quantify its position on equity ratio and its view that conservation is financed exclusively

⁸⁹ Dispatchability can be a major factor that merits quantification. Dr. Blackmon's testimony shows that such a quantification can change the economics of a project substantially. Ex. T-832, p. 28-39.

with equity.⁹⁰ The failure to quantify these issues, and thus focus legitimate review on the IRP, is inexcusable, particularly since Puget was aware of the issues.⁹¹

4. Contracting Below Avoided Cost is Not Proof of Prudence. A Demonstration That All Factors were Appropriately Considered is Imperative.

It is not disputed that price is an element of prudence; it is a "broad check" of prudence. (Elgin, Tr. 2513). But a competitively bid price does not offer a comparison to other bids nor, in Puget's case, address dispatchability or transmission issues. (Moast, Ex. T-778, p. 31). That information was requested (Ex. 784), but it was not delivered.

5. Puget Has Not Shown Its Newer Purchased Power Contracts to Be Prudent - Puget's Rebuttal Case Adds Little to the Analysis.

In bearing Puget's burden of proof in this case, Staff and Public Counsel attempted to discover the basis for Puget's decision-making. Ex. 784 is an example of the type of response. There was no documentation of the details of Puget's decision-making process. Mr. Blackmon visited Puget, and asked for the proposals in the RFP and Puget's evaluation of same: "They said they didn't have those." (Blackmon, Tr. 3489-90). Puget's rebuttal case shows the weakness of its proof of decisionmaking. In Mr. Lauckhart's Ex. T-938, p. 28, Puget lists the type of information it provided in "briefing" Staff during the bidding process. Absent from this list is a comparison of alternatives or justification for the resource selected. Staff is correct; this was a very "summary" showing; no details. (Moast, Tr. 2849-51). Puget cannot even produce documentation of the "briefings" it now relies on. (Ex. 963).

Ex. 944 is another example. Here the company relies on studies from 1986, used to discuss the potential conversion of a turbine to combined cycle, to justify decisions in 1989 and 1991! The paucity of information provided is remarkable, given the huge amount of new capacity and its cost.

⁹⁰ Elgin, Ex. T-778, p. 22. While Mr. Lauckhart testified he "believed" these changes might not change the result (Tr. 966), Puget never produced any supporting analysis.

⁹¹ Sonstelie, Tr. 429; C. Olson, Ex. T-924, p. 13; R. Olson, Tr. 4341.

Staff has not offered a "new standard" of prudence. It was simply seeking to have Puget justify its decisionmaking. Commissioner Casad's comment opposing "Monday morning quarterbacking," but looking to the decisions made at the time given the facts involved (Tr. 2894) is correct and Staff has simply attempted to apply this standard. (Moast, Tr. 2905).

6. Bidding is Not Sufficient to Determine Prudence.

Puget claims that its supply-side resources are prudent because they were acquired through a competitive bid "framework." The point is misleading because in fact much of the new supply identified in Ex. 530 was acquired outside of the bidding process. (Moast, Tr. 2905). Mr. Sonsteliie was specifically asked whether in a subsequent bid, lower priced resources were bid; he did not know (Tr. 4016) and indicated that such an analysis was irrelevant (Tr. 4016). The Staff respectfully disagrees. Puget specifically decided to acquire outside the bidding process. What prompted that decision? What type resources were subsequently bid and at what price? What did Puget consider as the cost of waiting and only acquiring new resources from a bid? Because of Puget's failure to produce the information and criteria it used to evaluate the offered resources, and support its decision at that time, we have no answers in this record regarding prudence.

Staff does not recommend any prudence disallowance. Puget should be ordered to maintain all documents related to its decisions to enter into specific contracts, to address at a minimum the factors listed by Mr. Moast in Ex. T-778, p. 31, l. 13-19, and to provide a meaningful case on this issue in subsequent filings.

C. Contested Adjustments

2.01 General Revenues; 2.04 Temperature Adjustment Taken together with the PRAM offsets, these adjustments show no substantial net Staff/Company difference. However, in its presentation, Staff excluded the impact of PRAM rates from its adjustment. Puget annualized the impact of the PRAM rates as a pro forma adjustment to revenues. Staff included the PRAM offset in its revenue requirement calculation. This allows one to measure the actual general rate increase created by the

proposed filing. Puget's method is improper because PRAM 2 rates will expire on Sept. 30, 1993. Staff also recognizes the impact of the requested increase in the returned check charge amount. Puget did not reflect the impact of this increase because it deemed it immaterial. (Ex. 1019). Staff shows it as distribution of revenue requirement. (See Appendix A, Table 5, l. 13).

2.02 Power Supply This item addresses the contested power supply adjustments.⁹² In Ex. 947, Puget shows the approximate values of the contested adjustments, using the new production factor. Staff agrees with Puget that the Commission should require the PCS model to be rerun with the adjustments the Commission accepts.⁹³

a. Rebuttal Filing of Revised Load Forecast.

Puget has proposed to lower its load forecast due to Boeing's announced employment plans. (Knutsen, Ex. T-882, p. 2). Puget also lowered its actual starting point number of customers, upon which new growth is added. Id. Staff opposes these changes. Apart from the fact that no party opposed Puget's original forecast, the major input to the revised forecast⁹⁴ improved significantly in the June forecast, showing a higher employment forecast. (Knutsen, Tr. 4094-96). Also, the more recent issue of the Washington State Labor Area Summaries, issued by the Washington State Department of Employment Security (a statistical reference used by Puget in its forecasts) states:

the Seattle PMSA employment situation continues to hold up better than expected when Boeing first announced a 1993 work force reduction...but those job losses have been more than out-balanced by job gains in other parts of the economy. (Knutsen, Tr. 4097-98).

Puget's new forecast is unduly pessimistic. It should not be accepted. The different load forecast results in a change in the production factor from .936 to .955.⁹⁵

⁹² Several power supply adjustments were uncontested: Stone Creek, Recomp Power Plant, Line Losses, and the 5 updating adjustments in Winterfeld, Ex. T-858, p. 5-6. See Lauckhart, Ex. T-938, p. 3. Uncontested adjustments are not discussed further in this brief.

⁹³ Thus, the Commission would accept power supply adjustments as a matter of policy with a good idea of their magnitude, given Ex. 947. However, power supply adjustments have significant "ripple effects" through secondary sales modeling as one example, that can cause a larger or smaller difference than Ex. 947 shows.

⁹⁴ The March 1993 Washington Economic and Revenue Forecast, Office of the Forecast Council.

⁹⁵ Ex. 526, line 77; Ex. 939, line 83.

b. Colstrip 1&2 Coal Costs.

Puget used a Colstrip 1&2 coal price of \$6.45 (\$7.45 less a \$1.00 price adjustment; Ex. 589, p. 14; Lauckhart, Tr. 4663); Staff used \$5.51 (Moast, Ex. 778, p. 7), (both before royalties and taxes). Upon reflection, neither price is a proper pro forma price, due to the pending arbitration. Therefore, Puget's proposal to true-up this price in PRAM 4 is accepted. (Lauckhart, Ex. T-938, p. 18).⁹⁶

c. Tenaska.

Puget proposes to recover five months (April 94, June-Sept 94) of anticipated purchased power costs for Tenaska as "allowed costs" through rates, (Ex. 939, p. 1-4, l. 55) even though the project will not be on-line for at least 7 months of the rate year. Tenaska should not be permitted in rates for the following reasons:

- Equity dictates that recovery of purchased power costs begin in rates at the time construction is completed and commercial operation begins. Customers should not pay in advance for power which is not yet available. (Moast, Ex. T-778, p. 9);
- The Commission has previously agreed that it is inequitable for cost recovery of new purchased power agreements to take place prior to commercial operation of new resources. (PRAM 2 Order, p. 8-9);
- The April 1, 1994 on-line date is a projection, with construction still underway. Puget did not provide evidence supporting its April, 1994 commercial operation date projection in response to Staff's discovery requests. (Ex. 780, p. 1).

d. Black Creek and HEDC Costs. (See Adjustments 2.21 and 2.22).

e. Out of Period Expenses.

Staff recommends that "Other Power Supply Expenses" be reduced by \$57,333 and "Transmission Expense" by \$11,825. Because these expenses were incurred prior to the test year,

⁹⁶ This true-up is a one-time exception in consideration of the arbitration. It is not Staff's recommendation to make this true-up a permanent feature of the PRAM/SDM. The Commission should make it clear that this is a one-time exception to the operation of the PRAM/SDM.

it is proper to exclude them. (Moast, Ex. T-778, p. 19). This adjustment was not rebutted. It should be accepted.

f. Planned Capacity Purchase Agreement.

Puget proposes to recover \$4,296,000 associated with a hypothetical purchased capacity agreement. (Ex. 939, p. 4, l. 34). It also proposes to true-up actual costs in the PRAM process in order to limit deferrals. (Lauckhart, Ex. T-938, p. 20). This proposal should be rejected. Mr. Lauckhart testified that its method is only a "general indicator of what might happen and should not be construed as indicating a high level of confidence." (Ex. T-521, p. 9-10). Puget thus acknowledges that its method of forecasting extreme peak needs is uncertain. Second, Puget cannot explain the inconsistent set of energy numbers included in its Ex. 952 ("Load before Cons"), to justify peak and energy needs under its proposed revised sales forecast in its rebuttal filing, (Lauckhart, Tr. 4742-43). There is simply insufficient data to justify cost recovery of 358 MW of planned capacity needs in this proceeding.

Staff recommends that Puget file in PRAM 4 for recovery of its projected capacity needs. Puget should be ordered to review and improve its peak forecast methods, and include an improved forecasting as part of its PRAM 4 filing.

g. Thermal Plant Availability.

Puget proposed to base the equivalent availability factors ("EAFs") for each of its coal fired resources on the EAF for similarly sized coal units in the Generating Availability Data System ("GADS") of the North American Electric Reliability Council ("NERC"). There are three reasons for rejecting Puget's proposal:

- Puget was "not at all familiar" with either GADS (Lauckhart, Tr. 884) or NERC's procedures and definitions. (Lauckhart, Tr. 893-95). Puget cannot sustain its burden of showing the propriety of a NERC benchmark when it knows so little about the source.
- Puget initially did not segment the GADS data base so as to account for factors other than power plant size that affect plant performance, such as location, age, coal type, etc. (Tr. 886-88), thereby failing to

show that the mass group of units was homogeneous with Puget's resources. (Winterfeld, Ex. T- 858, p. 10).

- There was an obvious error or inconsistency between Puget's reporting of unit maximum capacity and the definition as used in the GADS information.⁹⁷ Puget's records contained several months of sustained operation in excess of Puget's declared maximum capacity for its units, a situation not compatible with NERC definitions for use in GADS. (Id., p. 10-11).

Given this incompatibility in the data and lack of showing as to applicability by Puget, each unit's EAF should be based on a five-year average of historical performance, a period long enough to dampen maintenance cycles, but short enough to capture trends in age-related performance. Id.⁹⁸

Puget did finally produce analysis of the GADS data base (Ex. 951), which demonstrates that Puget's "size only" theory is invalid. Segmentation of the GADS data base by size does not produce homogenous, consistent results as compared to segmentation based on additional factors. Ex. 951 shows that adding year in-service and type of loading significantly reduces the standard deviation for the sample applied to Colstrip 3&4, compared to the sample derived based on size alone.⁹⁹

Puget argued that a national average EAF provided a stronger and more rational incentive and that using historical performance of each unit as a prospective benchmark unfairly penalized Puget for the past good performance of its units, which is not expected to be maintained. (Lauckhart, Ex. T- 938, p. 13). Puget's position on incentives is equally without basis. Puget's selected benchmark is arbitrary since performance is not well correlated to size. The fact that the benchmark

⁹⁷ Note also the inconsistencies regarding reported maximum capacity rating of Puget's units. (Lauckhart, Tr. 4659-61).

⁹⁸ Staff would also find acceptable any period between three to seven years. Staff opposed Mr. Blackmon's proposal to use all year's of EAF data for a unit, since this may include periods of abnormal performance based on current operating results. Periods of such abnormal performance could include lower availability of an immature plant in the initial "shakedown" years of unit operation, or periods of high availability indicative of a mature plant, close to economic retirement and therefore being maintained less diligently.

⁹⁹ Ex. 951, p. 23 shows that the EAF goes to 84.01% with a standard deviation of 9.12%; significantly superior to Puget's assumed 79.14% EAF and a 11.70% standard deviation. (Ex. 951, p. 8) (See Lauckhart, Tr. 4653-58). The lower standard deviation indicates a more homogenous sample, with characteristics more representative of Puget's own units. (For Centralia, segmentation of the GADS data base using other unit characteristics failed to improve the sample's homogeneity. However, this does not justify Puget continuing to ignore the effect of factors other than size on thermal plant performance).

happens to be a "national" statistic adds nothing.¹⁰⁰ No incentive is gained from a benchmark based on a national average which Puget well expects it can exceed with little management effort and little shareholder risk. The Commission should reject this giveaway. The recent average performance at each unit is the best indicator of what that unit is capable of achieving. Used consistently, historical performance does not penalize Puget for extraordinary good performance of a unit, since this performance will, by definition, exceed average, allowing Puget to keep the benefits.

h. Hydro Adjustment.

Puget proposed to reduce its estimated hydro-generation from the Mid-Columbia projects by 4%, as a supposedly "conservative" estimate of the error in the results of the regional hydroregulation model. (Lauckhart, Ex. T-938, p. 8-9). The study upon which the adjustment was based was shown to be of limited analytical value, for three reasons:

- The study failed to control for specific factors, other than modeling error, such as unit outages, unplanned spill, and reservoir drawdown, that could explain the lower than estimated hydrogeneration. (Winterfeld, Ex. T-858, p. 7-8).
- The study included only 47 months of data. The limited data did not include enough months in upper range of flows to allow development of an accurate model. Indeed, over 20% of the months in the 50 year water record used by Puget fell in a range covered by only two months' of data, in the example of the Rock Island project. (Id., p. 8-9, Tr. 3543).
- No study of the magnitude of the error was made, although another utility (WWP) has done such a study. (Id., p. 9).

Puget then misapplied its already faulty study by using a uniform percentage to each month. (Lauckhart, Tr. 4636). The WWP detailed study found larger relative error (as well as absolute error) during high flow months and less relative error in lower flow months. Id. This justified a

¹⁰⁰ Puget's position is analogous to that of a salesman having the most productive territory, who wants his compensation goals based solely on the average sales level for the entire company. If the company simply wants to satisfy the salesman, it could do just that; however, if the salesman is to be provided any incentive to maintain or even exceed past performance in the most lucrative territory his goals must be based on the territory, not the company average. Like the salesman, Puget is looking for a similar deal, tilted decidedly in its favor.

variable percentage, not a uniform percentage. Puget's own study tends to confirm this pattern. (Winterfeld, Tr. 3543-45). By overstating the adjustment during lower flow months and understating it in higher flow months, Puget's method could put more of the reduction in months having a higher value for secondary energy and less in months with lower value. Puget's adjustment is likely to be biased, even if the error in the regional hydroregulation model is present.

Public Counsel also found several flaws in the study underlying Puget's proposed adjustment, including the lack of data in the 47-month sample for higher flow months. One remedy offered to this problem by Public Counsel was to omit the upper range from the study analysis.¹⁰¹ (Blackmon, Ex. T-832, p. 15-18).

Puget has not met its burden to justify a 4% reduction in Mid-Columbia hydrogeneration. While Puget's study suggests there may be a systematic bias in the regional hydroregulation model, the analysis itself raised more questions than it resolves. Puget's lack of analytic rigor, the lack of historic data representative of more than one-fifth of the monthly flow data used in the regional hydroregulation model, and Puget's failure to even address why it applied a uniform percentage reduction each month, rather than a percentage adjustment proportionate to monthly flows. The adjustment should be denied.

i. Bonneville Power Sale.

Puget included a four year firm energy sale to the Bonneville Power Administration ("BPA") as part of its base resource transactions. Puget argued that the BPA sale, which had been negotiated as part of a settlement with the BPA over a lawsuit brought by Puget, would benefit Puget and its ratepayers by providing a market for Puget's short-term surplus energy at attractive prices. (Lauckhart, Tr. 909). The price paid by the BPA in the first year of the contract is about 25 mills per KWH.

¹⁰¹ Although Puget initially declined to prepare a revision to its study, it eventually did respond to Public Counsel's request 3508, indicating that the study results were reduced from 6.1% to 4.8% when the data was limited to an appropriate range. (Ex. 959, 960).

Puget argues there were significant net benefits to the BPA sale over its four-year term which demonstrated the prudence of the agreement. Puget purported to show that the annual benefits were \$6.7 million, based on an updated schedule of energy deliveries that decreased the amount to be sold in the first year by about 50%, and corresponding increases in energy deliveries in the four-years of the agreement. (Lauckhart, Ex. T-938, p. 21-22).

This adjustment is wholly unjustified. Puget has not shown the net benefits of such sale under a reasonable range of market and resource conditions that could be expected to occur. When asked to substantiate the benefits of the agreement across a range of reasonable assumptions, Puget could not or would not provide any documents describing or quantifying the financial risk associated with the BPA sale, although projections of load growth, in-service dates of new resources, and secondary energy prices, and hydro conditions were all recognized as factors affecting the net benefits of the sale. (See Ex. 950).

While one may hope there will be substantial net benefits enjoyed by the ratepayers as a result of the BPA sale, simplistic projections of a rosy future can go awry in practice, leaving the ratepayers to pay the price. Puget is asking the ratepayer to accept the financial risk of this sale without being fully informed as to what those risks are. If loads grow more quickly than projected, hydro conditions remain below average, and secondary prices increase a marked amount, the net benefits could readily evaporate and leave, instead, net costs that are quickly flowed through the working of the SDM in the PRAM to be recovered by Puget. Given that Puget was asked to provide a reasonable analysis of these risks but failed to do so, ratepayers should not be obligated to accept the risk if the BPA sale does not produce net benefits. Staff recommends that the BPA sale be included as part of the determination of Puget's net power supply expense in this proceeding. Puget should also be required to hold the ratepayer harmless should conditions in the future, which

reasonably could have been foreseen as part of a thorough risk analysis, cause the anticipated \$6.7 million benefit to evaporate.¹⁰²

j. Water Year Analysis.

Staff recommends the Commission continue to rely on the 40 years of most currently available streamflow records for determining normalized hydrogeneration for Puget. Although Puget's filing was based on 50 years of data, it has produced no new evidence or analysis of this issue that had not been previously presented to the Commission in prior proceedings. (Winterfeld, Ex. T-858, p. 15, Tr. 3556). Staff wonders how many times the Commission will be presented with the same arguments and same evidence on the same issue.¹⁰³

PP&L argued that the full streamflow record, currently 50 years, should be included in the normalization process as this provides the maximum amount of information. It opined that eliminating the first 10 years of data implies that conditions during this 10 year period were abnormal, which has not been shown to be the case. It also stated that no trends or cycles have been shown to exist in the historical streamflow record. (Lozovoy, Ex. T- 804, p. 4). WWP argued that a 40-year rolling average of streamflow would lower cumulative error of the normalization process only if used over a long time period, but is otherwise less reliable than the 50-year average, and thus causes future ratepayers to make up for "undercollection" through current ratepayers. It posited that the 40-year period is not representative of average streamflow conditions. (Norwood, Ex. T-807, p. 8).

Upon analysis, none of these arguments justify a departure from Commission policy and practice. The issue is not whether the "maximum amount" of information should be used, but

¹⁰² Puget may argue that this provides ratepayers with the benefits from the sale while insulating them from the risks. But this a reasonable result of Puget's apparent lack of appreciation of the need to present complete information to the Commission and other parties regarding the financial risks of such transactions, rather than a "trust-me" attitude toward the regulatory process and then relying on the PRAM mechanism to make it whole should conditions change.

¹⁰³ Both WWP and PP&L complain that the 40 year analysis should be in place for a long period to assure accuracy. (Norwood, Tr. 3170; Lozovoy, Tr. 3140). But it is the utilities, not the Staff, that are clamoring for change. The Commission's policy has been consistent.

whether the information used is reliable and statistically defensible. On this record, the 40 year rolling average clearly meets this test. Indeed, when Mr. Norwood was asked to what degree the rolling 40 year analysis was less reliable than the 50 years, he didn't know! (Tr. 3182-83). His argument regarding "underpayment" by current ratepayers to the detriment of future ratepayers is simply a tautology based on the assumption that the 50-year average was a "correct" predictor of future streamflows.

Both PP&L and WWP failed to analyze the potential trends or cycles in the historical streamflow data, even though WWP's own exhibit clearly portrayed a cyclic pattern in the historic data. (Ex. 808; Norwood, Tr. 3175-76). Instead, they simply presume that such trends or cycles had not been shown to exist. Mr. Winterfeld testified that evidence in this proceeding by Public Counsel¹⁰⁴ and by other witnesses in prior proceedings had reasonably demonstrated that the historic streamflow record was not completely random. Mr. Winterfeld showed that use of a rolling average was superior to use of continuous records given the likelihood of streamflows being other than completely random, the lower cumulative error, and only a slight decrease in statistical reliability. (Ex. T-863, p. 3).

Staff continues to support the use of a 40-year rolling average of streamflow data. There has been nothing to contradict the conclusions upon which Staff's position is based:

- Use of a rolling average of streamflow records will reduce the cumulative error in normalization in a period of 10 to 15 years, if streamflow is a completely random process.
- If streamflow is not a completely random process, the period to realize lower cumulative error will be less than 10 to 15 years.
- There is strong evidence that the amounts of annual streamflow is not a completely random process.

¹⁰⁴ Public Counsel presented a statistical analysis of streamflow, hydrogeneration, and annual net power supply expenses, and concluded that use of a 30-year rolling average as the time period expected to best represent normal hydrogeneration in the future. Underlying its recommendation was the conclusion that Puget's hydro data exhibited a clear trend or cycle, rather than only random variations, as argued by some. (Blackmon, Ex. T-832, p. 9-10; Ex. 834).

These conclusions are based on the prior analysis performed by Mr. Winterfeld in Docket No. UE-921262, the summary of which Puget introduced as Ex. 870. In its rebuttal testimony, Puget failed to address either the analysis in Ex. 870 or its conclusions.¹⁰⁵ Instead, it focused, as did PP&L and WWP witnesses, on a strawman: Were the first 10 years in the 50-year record abnormal or an aberration? This is a non-issue, since it does not affect Staff's conclusions or the analyses upon which the conclusions were based. Staff's analysis, summarized in Exhibit 870, is based on all 50 years of streamflow data representing the range of future streamflow conditions. It did not exclude the first 10 years, but instead showed that the rolling average methodology was superior, even if the 50 years of existing data was reflective of future conditions. (See also Winterfeld, Ex. T-863, p. 3).

Puget and other parties have not presented any new evidence or new arguments on this issue. The Commission should continue to use a 40-year rolling average.

k. Inclusion of the 3rd AC in the PCS model.

Puget modified its PCS model to assume full utilization of its future entitlement in the 3rd AC intertie. The modification assumes that Puget's 3rd AC entitlement in excess of its PG&E exchange and its own surplus energy sales will be fully utilized for regional surplus transactions. In its direct case, Puget recommended a 5.0 mills per kWh net benefit estimate of surplus 3rd AC entitlement. In rebuttal, Puget accepted Staff's recommended 4.0 mills per kWh estimated net benefit of these transactions, (Lauckhart, Ex. T-938, p. 3). (Winterfeld, Ex. T-858, p. 5-6; 17-18).

With no track record to evaluate actual market performance, it is unclear how actual market conditions will impact Puget's entitlement at the estimated average net benefit of 4.0 to 5.0 mills per kWh and how the net benefits of this projected generic surplus sale will be recognized in the true-up

¹⁰⁵ In rebuttal, Puget reiterated the argument that the full 50 years of streamflow data should be used, since the first 10 years have not been shown to be an aberration. It pointed out that the Columbia River system was not expected to refill at the end of the prior water year and that future hydrogeneration was likely to be impacted from environmental restrictions associated with the Endangered Species Act. (Lauckhart, Ex. T-938, p. 7-8). None of these arguments proves that 50 years is preferable to the 40-year rolling average.

of future PRAM filings. Assumed benefits of the projected surplus sales may either: 1) not flow through to the PRAM; or 2) shortfalls of the estimates included in the PCS model may result in greater increases in PRAM 4 and PRAM 5 true-up adjustments. (Ex. T-858, p. 18).

Staff recommends that the issue of treating projected benefits of Puget's 3rd AC intertie entitlement for nonfirm energy transactions and the acceptance of risk by Puget and/or ratepayers in the PRAM for these net benefit estimates be addressed in PRAM 4. (Winterfeld, Ex. T-858, p. 17).

Regarding 3rd AC revenue requirement projections, since the projected revenue requirement of the 3rd AC investment embedded in the proforma power costs as expense was calculated using the company's proposed rate of return, Puget should be ordered to synchronize such calculations using the level of return approved by the Commission (Ex. 589, p. 265), in Puget's compliance filing in this case. (See Ex. 589, p. 265).

2.05 Conservation. The amount of new conservation investment to be included in rates in this case is the amount incurred from May 1992 through April 1993. Staff's adjustment differs from Puget's only in the use of a different production factor. One issue remains: the appropriate amortization period. Staff recommends maintenance of the 10 year conservation and amortization period. A ten year period balances the need to keep the total cost of conservation down (Sorrells, Ex. T-722, p. 17), with the actual lives of conservation measures (Blackmon, Ex. T-831, p. 51), and the security of the financial investment. (Weaver, Ex. T-504, p. 3). Most utilities use between a five and ten year period. (Swofford, Ex. T-896, p. 8).

2.07 Property Sales. This adjustment passes on to customers the gains or losses from former utility property transactions taken place since March 1989, the cut-off date from the last rate case, and it treats \$28,596 which was deferred from the last case. Disposition of these properties is to be pursuant to Ex. 743, the settlement agreement ("Agreement").

a. Gains Deferred From the Last Rate Case Should Be Amortized Over One Year To Comply with the Agreement.

Puget's proposal to amortize the \$28,596 in gains deferred from the last case over 3 years violates page 2 of the Agreement, which changed the period of deferral of that vintage of gains from 15 to 5.25 years. Since 3.75 years have already elapsed, another 3 years would result in a 6.75 year period (Nguyen, Tr. 2641-42), in violation of the Agreement.¹⁰⁶ Staff's 1 year proposal is correct and prevents double amortization. (Nguyen, Ex. T-738, p. 7-8).

b. Gains Should Be Based on the Value of the Property at Sale or Transfer to a Subsidiary. If the Value at the Time of Transfer to Non-Utility is Used, All Such Transactions Should Be Included.

Paragraph 6 of the Agreement (Ex. 743) provides:

The amount to be allocated to the customer in future rate cases will be based on the amount of time the property was included in ratebase in relationship to the total time the property was held by the Company.

Puget, however, did not reflect the total time the property was held. Rather, it assumed the property ceased to be held upon transfer to non-utility. It therefore used the market value at the time of transfer to non-utility, rather than the value at sale or transfer to a subsidiary. (Nguyen, Ex. T-738, p. 9). Many properties now in non-utility accounts have increased in value since the time of transfer. (Ex. 987).¹⁰⁷ The following is Staff's position:

- If Puget wants to use the market value of property determined at the time of its transfer to non-utility to account for the gain/loss, this accounting should be done at that time. This means that the net gains from all the 13 non-utility properties identified in Ex. 640, with a total appraised value of approximately \$6.2 million should be included in the property sales adjustment in this case; or
- If Puget desires to delay the accounting of gain/loss to the time the property is disposed of, then the market value determined at this disposal time should be used in this accounting. (Ex. T-738, p. 12).

¹⁰⁶ Indeed, if a rate case is filed within two years, the remaining one third of this amount would have to be amortized over yet another 3 year period, under Puget's theory.

¹⁰⁷ E.g., Value for the Midway O'Brien property: at transfer to non-utility = \$67,500; Now = \$590,300. (Ex. 987 vs. Ex. 988).

Puget cannot mix and match these methods. Staff's adjustment correctly allocates the gain/loss on the 12 properties sold or transferred to subsidiaries, based on the time they were in Puget's accounts. (Ex. T-738, p. 14-16). This method is consistent with the method used in the last rate case, and the method approved in the Agreement.

Puget criticized Staff for using Puget's Ex. 640 analysis. (Story, Ex. T-965, p. 18). Staff had no other choice; Puget failed to provide proper data. (Nguyen, Ex. T-738, p. 12-13). Puget's adjustment is similar to Staff's. (Story, Ex. 966, p. 2.07; Tr. 4813).¹⁰⁸ Puget then criticized Staff's adjustment because, of the 12 properties contained in Ex. 642, some have not been sold or transferred to a subsidiary. (Ex. T-965, p. 19). However, Staff based its analysis on Puget's testimony that these properties would be sold or so transferred. (Ex. T-738, p. 13). As Ex. 985 shows, only 3 of the properties at issue are undisposed at this time. (Story, Ex. 634, p. 49). It is appropriate to take these gains now.

Puget's adjustment (which contains 9 of the 12 properties) should be rejected for an additional reason: the values Puget used fail to reflect current market value. (See Story, Tr. 4823-30). It also omits 3 properties¹⁰⁹ without explanation (Tr. 4830-31) even though one was sold in June, 1992, well before the cut-off date. (Tr. 4831; Ex. 642, p. 4).

Puget's treatment of these property transactions does not conform to the Agreement. Staff's adjustment is consistent with past practice as well as the Agreement, and should be accepted.

2.08 Storm Damage.

a. The Commission Never Established The Storm Damage Account as a Regulatory Asset.

Puget argues that the storm damage deficit reported in the Company's books is recoverable as a regulatory asset created by past regulatory practices of the Commission. (Weaver, Ex. T-935, p. 3-4). To support its position that the deficit balance is recoverable as a regulatory asset, it

¹⁰⁸ Puget also criticizes Staff's excise tax amount (Story, Ex. T-965, p. 19), but that amount differs only slightly from Puget's. (\$6,277 vs. \$6,283; Ex. 739, p. 1, col. B, l. 3 vs. Ex. 966, p. 2.07, l. 5).

¹⁰⁹ They are (1) Malony Creek Sub, (2) Lake Meridian Sub, and (3) Kitts Corner Sub.

compiled Ex. 912 which consists of portions of testimony and Commission Orders from other dockets. That exhibit does not support Puget's position.¹¹⁰

Puget holds that "[s]trong regulatory support is required in order to create and maintain regulatory assets in the first place. . ." (Weaver, Ex. T-935, p. 5). Puget further agrees that the Commission should "clearly state and understand that any part of the revenue requirement that is deferred will earn interest and will be fully recovered in the subsequent periods identified." (Weaver, Tr. 4590). The general rule is that expenses must be booked in the year incurred. The exception to the general rule occurs when the Commission in response to a company request explicitly creates a regulatory asset by order.¹¹¹ The Commission has never explicitly created a regulatory asset for storm damage.

Indeed, Puget concedes that "Staff is correct that there is not a specific order that accepts the Company's method of calculating storm damage. . ." (Story, Ex. T-965, p. 8). Here, Puget relies on implied "regulatory promises" as the basis for its fabrication of a regulatory asset. No such promises were made. Nor can Staff's proposal be termed "retroactive ratemaking." Similar to the Commission's order denying recovery of accrued costs involving Skagit/Hanford (U-83-54); an elimination of the storm damage reserve account would not be retroactive ratemaking. Although Staff's proposal involves a "write-off," that fact should not deter the Commission from adopting Staff's proposal. Puget is free to come before the Commission and seek an accounting order anytime a departure of the general accounting rules is necessary.

b. The Commission Should Establish a Reasonable Level of Expense for Storm Damage.

At the very least, policy direction from the Commission is needed to establish a reasonable method of determining the storm damage expense in general rate cases on a prospective basis. Puget

¹¹⁰ E.g., the Commission allowed inclusion of the storm damage deficit balance in Cause No. U-83-54, not to create a regulatory asset for storm damage, but to recognize the deficit balance in that case reflected an inflation factor which would not otherwise be recovered. 4th Supp. Order, at 26.

¹¹¹ E.g., Commission treatment of the fixed deficit balance in the Pebble Springs adjustment in Docket No. U-82-38. In this case, Puget's rate moderation proposal is an example of a request for the creation of a regulatory asset. (Weaver, Tr. 4590).

should be required to cease its current storm damage accounting practices. The degree of damages due to storms and the deficit or surplus in the storm damage reserve account varies from year to year. For this reason, Staff proposes normalizing storm damage expenses for ratemaking purposes.

Just as temperature normalization is an accepted ratemaking principle, so is storm normalization. Ordinary weather in Puget's service territory is mild with occasional storms; generally these storms are local in scope, not disastrous, and occur regularly. (Ex. 902). A certain level of storm damage is normal and, in fact, expected. (Olson, Tr. 4365). Exceptions to this norm do occur but they are rare. (Schooley, Tr. 2553; Olson, 4365). By virtue of its creation of this regulatory asset without explicit Commission authority, Puget is the only utility in the nation which enjoys the privilege of recouping all costs caused by weather events. (Schooley, Ex. T-728, p. 5). This privilege represents a shift of considerable risk from the shareholder to the ratepayer. (Schooley, Ex. T-728, p. 17; Olson, Tr. 4370). In short, Puget's storm damage accounting and its requested ratemaking treatment of storm damage are unreasonable, unjust, and unfair.

The purpose of a general rate case is to set an expense to revenue relationship which allows the utility the opportunity to earn a fair return. (Schooley, Tr. 2545). When the Commission determines the overall revenue requirement, the expense to revenue relationship is prospective (Ex. 912, p. 1, 14), based on normalized historic costs corrected for known and measurable changes. Re Iowa Elec. Light & Power Co., 123 PUR 4th 114 (1991). Recovery of individual expenditures is not guaranteed. Id. The deferral of expenditures in excess of an amount determined in a general rate case as an asset has been rejected by the Commission as "inconsistent with accounting theory."¹¹² Puget's storm damage, self-insurance,¹¹³ and retirement plan¹¹⁴ "reserve" accounting methods violate this principle; they should not be allowed to continue. The fact that a representative dollar amount for storm damage expense is included when an overall revenue level is set does not mean

¹¹² WUTC v. PP&L, Cause No. U-82-35, 4th Supp. Order, p. 24 (1983).

¹¹³ Staff's self-insurance adjustment is discussed below in 2.09.

¹¹⁴ Staff's retirement plan adjustment is discussed below in 2.16.

that Puget is thereafter required to spend that exact amount annually, nor does it guarantee that Puget will recover precisely that amount.

Staff proposes a normalized amount for storm damage repairs as a representative level for ratemaking purposes. (Ex. 729, l. 23). This is not the authorization of an expense for financial reporting purposes. (Schooley, Ex. T-728, p. 13). The inherent variability of a weather-related adjustment is better mitigated by the use of a six year average rather than a four year average as proposed by Puget. The addition of the deficit balance in the reserve to the average is particularly egregious. This represents a blatant double recovery of expenses which must not be allowed. (Schooley, Tr. 2546; Tr. 2563).

c. Recovery of Extraordinary Property Losses is Appropriate.

Although FERC directed Puget to transfer a debit balance from liability account 228 to the extraordinary property loss account 182.1, (Ex. 737), this does not give Puget carte blanche to create regulatory assets. The WUTC has given no such permission. (Story, Ex. T-965, p. 8). Puget's unilateral creation of a regulatory asset should not be condoned. Staff presents an equitable method to recover the expenditures necessary to repair extraordinary property damage. Staff proposes a specific amount, \$11,086,660, for extraordinary property losses incurred in December 1990 and November 1991.¹¹⁵ (Ex. 729, l. 12). This creates a regulatory asset in a fixed amount and provides for its recovery over six years. This recommendation is based on the procedure prescribed by FERC in Ex. 737. It is fair and should be adopted.

Puget disagrees with Staff's proposed definition of a catastrophic event as one affecting 25% or more Puget customers. (Olson, Ex. T-917, p. 24). Staff's proposed categorization includes the additional criteria that catastrophic storms occur infrequently (less than once a year), and affect a

¹¹⁵ Puget argues in this case that the Arctic Express event was in reality three events, but in seeking cost recovery from its insurance carrier it argued that it was one prolonged event. (R. Olson, Ex. T-917; Schooley, Tr. 2557). Either way, Staff considers this period as unusual and the damages extraordinary, therefore direct recovery is proposed. (Ex. 729, l. 10).

widespread area. (Schooley, Ex. T-728, p. 8). It is important to distinguish between normal and unusual weather events. The 25% threshold can be considered directory rather than mandatory. All weather-related damage is considered current year expense. Puget can then request extraordinary accounting treatment when it deems it necessary. Staff's intent is to reduce the number of requests by establishing a threshold beyond which it is apparent that a catastrophic weather event has occurred.

d. Puget's Threat to Leave Service Unrestored Should Be Ignored.

Puget claims that without the current system of reserve accounting it has less incentive to restore service. (Olson, Ex. T-917, p. 25). Such a claim is alarming. It is Puget's statutory responsibility and Puget's alone to restore service after an outage. RCW 80.28.010(2). It is management's responsibility to develop systems that accomplish this in the most cost-effective manner possible. Puget's obligation to provide reliable service is not voided by an appropriate change in how these procedures are treated for accounting purposes. Puget's unique accounting treatment should cease. Staff's proposal is reasonable and provides the proper incentives to effectively manage these costs, and fulfill its public service obligations. It should be adopted in this case.

2.09 Self Insurance. In this adjustment, Staff proposes a six year average of the three categories of self-insurance (all risk property damage, liability, and worker's compensation) as a representative level for ratemaking purposes. Puget opposes this. It sums the past four years with a deficit in the property damage account to determine an "average" expense. Puget considers the rate case determined expense to be an amount allowed for financial reporting purposes.

Staff also seeks policy direction for the treatment of Puget's so-called "self-insurance" expense.¹¹⁶ The title of this adjustment is a misnomer. "[S]elf-insurance' is not insurance; and is the antithesis of insurance. Insurance shifts the risk of loss from an insured to an insurer. Self-

¹¹⁶ Staff's self-insurance adjustment is similar to its storm damage adjustment, 2.08.

insurance is the retention of the risk of loss by one upon whom it is directly imposed by law or contract." Physicians Ins. Co. of Ohio v. Grandview Hosp. and Medical Center, 542 N.E.2d 706, 707, (1988). In essence, this adjustment provides Puget guaranteed recovery of all expenditures over \$10,000. Puget's accounting provides no incentive to management to control costs since no risk is allocated to shareholders. (Olson, Tr. 4370; Olson, Ex. T-917, p. 23). This is not "self-insurance."

For ratemaking purposes, a representative level of expense is determined as the six year average of the amount expended for claims in the three self-insurance categories. (Ex. 731). This amount is not an authorized level for financial reporting. (See Schooley, Ex. T-728, p. 17). The current practice creates an incentive for Puget to load the reserve with normal operating expenses. Most of the costs accrued in the property damage reserve are for equipment failures. (Ex. 730). This leads to the deficit in the all-risk property damage reserve for which Puget for the first time is seeking recovery. (Story, Ex. T-556, p. 11). Puget claims these are properly accrued items and that Staff is asking the Commission to reverse its prior position. (Weaver, Ex. T-935, p. 4). Once again, no Commission order explicitly authorizes this "regulatory asset." (Story, Ex. T-965, p. 14). As in the storm damage adjustment described above, FERC directed Puget to transfer the debit balance in account 228 to account 182.1. Only this Commission can authorize such a transfer for intrastate purposes. Moreover, FERC authorized the use of account 182.1 pending this Commission's decision in this case. (Ex. 737). Because Puget lacks authority to unilaterally create regulatory assets, and for the reasons discussed in Staff's storm damage adjustment, 2.08, Staff's proposal is reasonable and should be accepted.

2.10 Environmental Remediation Staff's adjustment differs from Puget's in two areas: (1) the amortization period for deferred costs; and (2) Puget's normalization of costs not covered by the accounting order. Deferred costs under the accounting order should be amortized over a six-year period to minimize ratepayer impact, rather than the three-year period proposed by Puget. Puget argues that the adjustment is unnecessary because the size of the adjustment is relatively small.

(Story, Ex. T-965, p. 41). This argument should be rejected as self-serving.¹¹⁷ Puget compares this adjustment to the total general rate increase level rather than to other adjustments that are equally small. (Story, Tr. 4790, 4793). A six year period is appropriate because it will afford Puget more time to pursue insurance claims and prevent any potential swings in amortization arising from insurance recoveries. (Martin, Tr. 2697). Additionally, Puget does not agree with Staff's "normalization" adjustment for environmental costs not covered by the accounting order. Puget argues that this is not an appropriate ratemaking adjustment because it does not meet the test for a pro forma adjustment. (Story, Ex. T-965, p. 43). Puget is incorrect. As the Commission stated in its Second Supplemental Order in Cause No. U-71-34:

as infirmities may exist in actual record keeping, an immediate past actual year usually requires correction and reshaping before it is useful for rate-making purposes. (Ex. 627, p. 10).

Staff's normalizing adjustment is necessary to correct infirmities in the test period results. (Martin, Ex. T-749, p. 15). Staff's proposed treatment of Puget's environmental remediation costs should be adopted.

2.11 Employee Insurance. Both Puget and Staff adjust employee insurance costs to give effect to the level of insurance rates that would be in effect during the rate year. Using the updated amount of average monthly contribution per employee of \$362.66 for salaried employees and \$352.33 for union employees in the calculation (Ex. 740, p. 2), Staff's adjustment would result in a decrease in NOI of \$611,136. The only difference between Puget and Staff is Puget's use of the end-of-period employees versus Staff's use of the test year average of monthly averages numbers of employees for this purpose.

¹¹⁷ Puget also argues that lengthening the amortization period based on rate impacts is not persuasive where Staff is overall recommending a rate decrease. (Ex. T-965, p.5). Because Staff is recommending a slight increase in revenue requirement, this argument should be disregarded.

Puget's calculation using end-of-period numbers of employees would amount to an annualization of test year expense while not similarly annualizing the test year revenue and the amount of productivity generated by the employees during the test year. (Nguyen, Ex. T-738, p. 19). Puget's proposal is asymmetrical and disturbs the measured relationship between test year revenues and expenses, and should be rejected.

2.12 SFAS 106, Post-retirement Benefits other than Pensions.

Puget's adjustment reflects the impact of SFAS 106 effective January 1, 1993. Puget determines the amount as the difference between the pay-as-you-go level of expense and the actuarially determined expense for its retiree medical plans and life insurance plans under SFAS 106.

Staff contends that Puget's retiree medical benefits prior to January 1, 1992, were imprudent and should, therefore, not be allowed in rates. Staff applies the current retiree medical benefit scheme to all retirees and current employees and recasts the SFAS 106 determined expense.

Puget's recent shift from a defined benefit plan to a defined contribution plan was prudent. This shift, however, in no way changes the imprudent status of the earlier plan. Regardless of when costs were incurred, if imprudent, they should not be allowed in rates. Puget's own studies support this conclusion. Ex. 649 states that the "open-ended promise to provide lifetime health care benefits to all retirees and their dependents no matter what the cost, is no longer affordable." The use of cash-based accounting made these plans appear affordable. The advent of SFAS 106 requires corporations to reveal this large liability and therefore the imprudence of these plans. (Schooley, Ex. T-728, p. 29). The record is clear that Puget did not evaluate either the ultimate cost or the present value of the costs of its plan until the issuance of SFAS 106 was imminent.¹¹⁸ (Story, Ex. 634, p. 85). The increase in medical care costs has exceeded ten percent per year in most years since 1975.

¹¹⁸ Some Puget retirees apparently assume that Staff is directing Puget to eliminate the plan offered to its older retirees. (Tr. 3630, 3782). That is untrue. Staff explicitly stated that its proposal determines an expense level for ratemaking purposes only and that management alone is responsible for any changes made to company benefits. (Schooley, Ex. T-728, p. 30).

(Ex. 732). The Financial Accounting Standards Board identified post-retirement benefits as a separate Statement of Financial Accounting Standard in 1984. (SFAS 106). The need to amend retiree benefit plans was evident nearly a decade ago. (Schooley, Ex. 728, p. 29).

The Policy Statement issued in Docket No. A-921197 explicitly precludes a return on the deferred portions of the SFAS 106 expense prior to its inclusion in rates. *Id.*, at 2. Puget's request that \$897,750¹¹⁹ be included in rate base should be denied because (1) Puget has no cash outlay at this time; (2) these funds are not the property of Puget, they are the legal property of Puget's employees and retirees; and (3) the funds generate their own investment return. (Story, Tr. 4799-4800). Puget's claim that Staff is forcing yet another "write-off" of a regulatory asset is without merit. (Ex. 969). Again, this is not a regulatory asset until the Commission grants it such status.¹²⁰

2.13 Company Insurance. There are two differences between Puget and Staff concerning the treatment of Directors and Officers (D&O) insurance. Staff proposes: (1) to disallow D&O insurance above a \$25 million level; and (2) to allocate a portion of D&O insurance to Puget's subsidiaries. Staff's proposal to limit Puget's D&O insurance to \$25 million is presented in detail in Ex. T-738, p. 21-23. The only evidence provided by Puget to support its proposed level of D&O insurance consists of selected portions of the "Wyatt Report," it indicates a very low claim frequency during the nine year study of participating companies (.57 claim per utility), and a fairly moderate average payment amount per claim (\$3,022,958). (Nguyen, Ex. T-738, p. 21-22). Puget also claimed that its level of D&O insurance is necessary to retain qualified officers and board members. (Olson, Ex. T-917, p. 26). This alone does not justify excessive coverage.

Puget further claimed that companies of similar size have similar or higher D&O policy limits. (Ex. T-917, p. 26-27). Ex. 921 demonstrates the contrary. Several utilities have a lower

¹¹⁹ The calculation of the \$897,750 figure appears in Ex. 1008.

¹²⁰ FEA proposes to extend the phase-in of the deferred portions of the SFAS 106 expense. (Larkin, Ex. 792, p. 49). Staff does not oppose this proposal.

amount of D&O insurance despite the fact that these companies have higher revenues than Puget.¹²¹ In fact, the exhibit demonstrates that, based on revenue size, Puget ranks 49th among the 50 utilities listed, yet 11th in coverage limit as a percentage of gross revenues. (Olson, Tr. 4360, as corrected). Puget's D&O insurance limit is excessive based on its revenue size.¹²² If Puget chooses to fund excessive coverage, it should absorb the excessive costs. (Nguyen, Tr. 2666). Staff's adjustment should be accepted.

Regarding the allocation of a portion of D&O insurance premium to subsidiaries, Puget and Staff agree that the proper allocation factor is 3.07%. Applying this 3.07% allocation factor to the calculation in Ex. 992, Staff's insurance adjustment would be revised to reflect an increase in NOI of \$142,451.

2.14 Wage and Salary. The purpose of this adjustment is to adjust test year wages and payroll taxes amounts to reflect the levels that would be in effect during the rate year.

Four differences remain between Puget and Staff:

1. Puget removed from the wage increase calculation only \$2,266,369 of the total test year bonus amount of \$2,741,810. Staff removed the whole test year bonus amount from this calculation;
2. Puget increased the test year Pay-at-Risk bonus amount from \$375,000 to \$609,801. Staff removed the total amount of this bonus;
3. Staff removed \$1,452,244 of the Energy Plus bonus; and
4. Puget did not apply the result of its "slippage" study to the adjustment of management wages, whereas Staff did. Staff's adjustment would result in a decrease in NOI of \$1,112,187; the Company's adjustment would decrease NOI by \$3,036,457.

¹²¹ See companies numbered 5, 24, 40, and 50 in the listing.

¹²² Puget was asked to provide data evaluating D&O premiums per director, claim experience, and coverage limits for the Ex. 921 companies; it could not provide the data. (Ex. 922). Puget has not carried its burden to show that its insurance level is reasonable.

In addition, the total amount of D&O insurance premium for Puget was \$693,750. (Story, Ex. 626, p. 88). Part (d) of Ex. 650 indicates that only 9 directors and officers are covered by D&O insurance. Thus, the average amount of D&O insurance premium for each Puget director or officer would be as high as \$77,083. Puget's D&O insurance is excessive in both the coverage limit and the amount of premium. Staff's adjustment to remove the additional premium amount of \$216,000 associated with the extra \$25 million of coverage is justified.

a. Removal of Bonuses from the Calculation of Wage Increase.

The amounts of bonus paid by Puget to its employees during the test period were in flat amounts, and were not based on base wages. (Nguyen, Tr. 2669-70). Therefore, these bonuses should be excluded from the calculation of wage increase. Puget stated that "Bonuses have been removed from the wage increase calculation" (Story, Ex. T-965, p. 24), but as shown in Ex. 944, Puget's calculation inexplicably removed only \$2,266,369 of the total amount of bonus embedded in the test year wage which was \$2,741,809. (Ex. 656). The total amount should be removed.

b. Pay-at-Risk Executive Bonus Program.

For the first time, Puget seeks ratepayer funding of \$609,801 associated with the Pay-at-risk bonus program. (Ex. 966, p. 2.27; Ex. 634, p. 93-94). Pay-at-risk covers Puget's 50 officers and directors and sets a "target" bonus of between 10% and 35% in excess of base salary. (Kelly, Ex. T-713, p. 26). The actual bonus is set by the Board. (Ex. 625).

Ratepayers should not provide funding for this executive bonus program for the following reasons:

- Puget's Earnings Per Share (EPS) is the primary determinant of the size of the pot for these bonuses.¹²³ (Ex. 625). PRAM substantially secures EPS; attaining this target is largely the result of regulatory action, not employee action. Indeed, were it not for the PRAM deferrals, Puget's 1992 EPS would have been \$.50/share less, (Tr. 4020), there would have been no Pay-at-risk bonus at all for executive management.
- These bonuses represent more of a distribution of earnings than an operating expense. The amount of the bonus pot may vary considerably depending on final EPS data. (Ex. 625). (It is not known or measurable for that reason.) In WUTC v. Pacific Inland Tariff Bureau, Cause TV-995/1002 (1/28/78), under similar circumstances, the Commission refused to allow recovery of bonuses.
- The individuals who participate in the Pay-at-risk program identified EPS as the measurement of greatest importance regarding shareholder value, (Ex. 893, p. 4), so shareholders should pay for it.

¹²³ It is interesting to note that despite the fact that EPS is the primary focus of this bonus program, there was absolutely no mention of it in Puget's direct case. (Knutsen, Tr. 1278).

- Earnings-based bonuses that become embedded in rates have an unfair spiraling effect. (Kelly, Ex. T-713, p. 24).

Puget has argued that if its total executive compensation levels are not above market then it should be left with the discretion to design its bonus program. (Sonstelie, Ex. T-878, p. 17). But when this expense was below the line, Puget had complete discretion. Keeping it below the line does not reduce Puget's discretion. Also, Puget's "not above market" theory could not be tested, so its position lacks foundation.¹²⁴

If this program is to be recognized in rates at all, the test-year figure must be reduced by 9.5% or \$57,931 to reflect year-end manipulations that increased the overall 1992 payout. (Kelly, Ex. T-713, p. 30). Puget's proposal to increase these bonuses by the wage increase inflation rate should also be rejected since the amount of the actual bonus is unknown.

c. Energy Plus Bonus Program.

Puget seeks recovery of \$1.9 million in employee bonuses associated with its Energy Plus program. (Ex. 656). Energy Plus is a bonus program designed so that every employee below the department head level receives the same amount of bonus if company-wide goals are accomplished. (Sonstelie, Tr. 4088). The program was initially intended to pay for itself out of the realized savings, (Knutsen, Tr. 1264-65), but since this has not occurred, Puget began budgeting for the entire bonus in 1993. Id.

(1) Employee Bonuses in the Energy Plus Program Should Be Denied in Rates Since the Offsetting Benefits Have Not Been Measured.

Although Puget has requested recovery of Energy Plus bonuses, it has not attempted to quantify the offsetting ratepayer benefits resulting from the program. (See Ex. T-539). This violates accepted ratemaking principles which seek to match expenses with revenues, and costs with benefits.

¹²⁴ The survey relied upon was neither provided to Staff for analysis nor available to be examined on the record, even under confidential treatment. (Sonstelie, Tr. 4039). Though other companies may have similar programs, Puget provided no analysis concerning the regulatory treatment of comparable industry bonus programs. (Sonstelie, Tr. 4037). Since Puget provided no data from which to determine market level executive compensation allowed for ratemaking purposes, it is impossible to test whether Puget is at, above, or below market.

(2) The 1991 Energy Plus Payout Should Be Reduced by 25% to Reflect Actual Achievement of Five, Not Six, Program Targets.

Puget initially represented that six Energy Plus targets had been achieved. (Ex. 550). Test-year expenses include the amount that Puget paid to its employees as if six targets had been achieved; a bonus of \$800/employee rather than \$600/employee (a 25% increase) was paid in 1991 and reflected in test year expenses. (Knutsen, Tr. 1276). The facts show Puget's initial representations to be misleading. First, one of the targets, meeting O&M budget, was not met, since the budget was exceeded by \$393,300 in 1991. (Ex. 624). This fact is uncontested. (Sonstelie, Ex. T-878, p. 13). Second, despite the fact that an EPS goal has been an integral element of the Energy Plus program since 1990, there is absolutely no mention of the EPS goal in Puget's direct case. (Knutsen, Tr. 1267).

Puget nonetheless seeks recovery of these amounts on the basis that since revenues were higher than expected, certain expenditures were accelerated by senior management in the fourth quarter of 1991. (Sonstelie, Tr. 4027). Further, Puget maintains that it was this acceleration of expenditures that caused Puget to exceed its O&M Budget. (Sonstelie, Ex. T-878, p. 14). Senior management, in Puget's view, was responsible for exceeding the budget and the employees should not be "penalized" for senior management's actions. (Knutsen, Tr. 1274).

Puget's arguments do not justify rate recovery of these bonuses. First, the accelerated expenses were unusual and not representative of the rate year and should not be reflected. Second, there is no quantification of the benefits to ratepayers that offset the requested expense. The \$393,300 by which Puget exceeded its O&M budget more than offset savings from other aspects of the program, leaving a negative balance from which the Company funded the \$2.03 million bonus payout. (Kelly, Ex. 719). Third, while "senior management" may have been responsible for

exceeding the budget, the Board of Directors awarded senior management the 1991 bonus as if the budget had been achieved. (Kelly, Ex. T-713, p. 30-31).¹²⁵

Finally, it is important to note that the Energy Plus bonus program rewards employees for attaining an EPS target. Since PRAM substantially secures EPS; attaining this target is largely the result of regulatory action, not employee action.

(3) If Recovery is Allowed, the Test Year Energy Plus Bonuses Should be Adjusted to Reflect a 73.5/26.5% Split Between Shareholders and Ratepayers.

Puget characterizes the Energy Plus program under the heading: "Cost Control-based Employee Compensation" (Knutsen, Ex. T-539, p. 6), yet the goals are also oriented toward service. (Knutsen, Tr. 1265). Much of the conduct fostered under the program is not cost control related, and 73.5% of the program provides shareholder, not ratepayer benefit. (Kelly, Ex. T-713, p. 24-25).

EPS is the measurement of greatest importance regarding shareholder value. (Patterson, Ex. 893, p. 4). The EPS goal in Energy Plus encourages higher earnings that flow directly to the shareholder; the shareholder should bear the expenses associated with the EPS goal.

The Community Service and Environmental targets of the Energy Plus program encourage charitable work and donations. (Kelly, Ex. 721, p. 3-4). For example, Puget employees may give blood or donate to United Way or establish a backyard wildlife sanctuary. Id. There is nothing wrong with these charitable activities; the issue is who should pay for them. Jewell v. WUTC, 90 Wn.2d 775 (1978), says the shareholder should bear these costs. This is particularly true since there is no requirement these activities even take place in Puget's service territory.

Puget's witness Patterson criticizes Staff for only considering quantifiable benefits in the analysis of the Energy Plus program. (Ex. T-888, p. 22). It is true that the analysis to which he refers (Ex. 719) examines the quantifiable savings of the program. This is done to demonstrate that

¹²⁵ Puget notes that it is not unusual for top management to authorize certain projects given changed circumstances. (Sonsteli, Tr. 4031). This simply underscores the fact that what was unusual in the test year was for Puget to exceed the budget target but still pay the bonus. (Tr. 4020).

Puget has been unsuccessful in its goal to fund the bonuses from the quantifiable savings, resulting in the need to budget for Energy Plus and recover the expenses in rates. Patterson did not examine the Energy Plus program in the course of his consulting work with Puget (Tr. 4152), nor was he even aware that Puget has not budgeted for the bonuses (Tr. 4152), despite the fact that these critical facts were included in the discussion of the exhibit which he criticized. (Kelly, Ex. T-713, p. 21).

Puget also criticizes Staff for its alleged "criticism that goals addressed to service not cost control are a negative". (Sonsteli, Ex. T-878, p. 13). However, Staff made no such statement. Although it may not be clear to Puget, Staff's concern was with the characterization of Energy Plus as a cost-control based program when, in reality, the goals are also oriented toward service.¹²⁶

If these costs are to be allowed in rates, Staff's proposed allocation is reasonable and appropriate. (Kelly, Ex. 720).

(4) Application of the "Slippage" Study to the Adjustment of Management Wage.

In its calculation of the pro forma management wage increase, Puget failed to recognize the fact that the effective increases in management wage during a period may not equal the percentages of increase granted by the Company to this group during the same period. In Puget's last general rate case, a study by Staff found that the effective increases in the Company's management wage equalled only 48.08% of the increases granted, and the finding was accepted by the Commission in that case. That Commission Order instructed Puget to present a study of "slippage" as a part of its management wage adjustment in this case.¹²⁷

Puget did not present the required "slippage" study to the Commission in this proceeding. At Staff's request, it provided a "Management Wage Increase Analysis" for the period of January 1, 1986 through January 1, 1993. Puget's own analysis (Ex. 742, p. 7) indicates that the actual management wage increase during the study period equalled only 47.84% of the percentages of

¹²⁶ Upon clarification, witness Sonsteli remarked, "if I had interpreted Miss Kelly's testimony the way you have laid it out, I would not have made this comment. I did not interpret it that way." (Tr. 4023).

¹²⁷ Third Supplemental Order, Docket No. U-89-2688-T, p. 40).

increase granted by the Company during that period. Staff applied the result of this "analysis" in its management wage adjustment after some modification to reflect the elimination of the unknown additional 1.5% mid-year management increase originally proposed by Puget as the pro forma level.

Although Puget recognized Staff's calculation of management wage adjustment was the same type of calculation that the Commission accepted in the last rate case, it disagreed with this calculation. (Story, Ex. T-965, p. 26). Puget compared the amounts of total management wage for the years 1986 through 1993 and claimed that in every year the total salary increase was greater than the increase granted by the Company. Id. However, it also recognized that "The reason for this difference is due not only to salary increases but to increases in the number of employees as well." Id. Puget fails to recognize that in the pro forma calculation of payroll adjustment, only the increase in pay rates is taken into account, not the increase in the number of employees. If Puget had divided the amount of total management wage each year by the number of management employees in that year, and compared the amounts of wage on a per employee basis, the result would have been as shown in Ex. 742, p. 7.

2.15 Investment Plan. This adjustment updates Puget's portion of investment plan expense to give effect to the pro forma increase in wages during the rate year. Staff accepts Puget's reallocation of test year expense on page 2.15 of Ex. 966. However, Staff increased the portion of test year investment expense associated with management employees by only 2.86%, consistent with the Staff's wage and salary adjustment.

2.16 Retirement Plan. In this adjustment both Puget and Staff recalculated the retirement plan expense for the rate year to (1) reflect the average amount of Puget's actual contributions to this plan in the most recent four years; and (2) account for the deficit in Puget's Pension Liability Reserve account.

Consistent with Staff's treatment of the deficit amounts in the Self-Insurance adjustment, any deficit amount found in the Pension Liability Reserve account should be excluded. As stated above,

Puget's proposed recovery of deficit amounts has never been approved by the Commission. (See Story, Tr. 4846). Staff's original calculation of the Retirement Plan adjustment should therefore be revised accordingly.

When the amount of "Debit in Reserve at 9/30/93" of \$915,355 shown on line 8 of Ex. 1000 is removed, Staff's calculation on line 13 is changed to reflect a decrease in NOI of \$1,516,658. The use of a four year average amount of actual company contributions to the retirement plan determines the rate year level of this expense for ratemaking purposes only; such level of expense should not be booked by Puget.

2.19 Creston. There are three differences between Puget and Staff regarding the proposed recovery of Puget's expenditures in the terminated Creston project: (1) AFUDC, (2) amortization period; and (3) rate base treatment. Staff does not contest the issue of whether the Creston project was appropriately pursued or terminated. The issues relate to how the project was accounted for, how it should be written off, and the proper treatment for rate making purposes.

a. Puget Inappropriately Capitalized AFUDC.

The accrual of AFUDC on this project was never authorized by the Commission. (Ex. 626, p. 43). Further, the project sponsor (WWP), did not accrue AFUDC and correctly recorded expenditures to account 183-Preliminary Survey and Investigation Costs. (Story, Ex. 626, p. 42). Puget incorrectly booked expenditures to account 186-Misc. Deferred Debits. (Ex. 626, p. 43). Puget claims it followed the appropriate guidelines in accruing AFUDC, alleging that Creston required ongoing expenditures associated with its construction. (Story, Ex. T-965, p. 34). However, the Creston expenditures were not ongoing and were not associated with actual construction, since the project faced numerous delays. (Martin, Tr. 2705). The accounting guidelines require Commission approval when departures are requested, (Ex. 637; Story, Tr. 4788), which Puget neither sought nor obtained. (Story, Ex. 626, p. 43). Recovery of AFUDC should be denied.

b. Staff's Proposed 10 Year Recovery Period is More Appropriate Than Puget's Proposed Five Year Recovery Period. Staff's Amortization Period Is Consistent with the Recovery Period for Other Terminated Projects.

"The trend across the nation seems to be where amortization is allowed to amortize expenses of this sort over ten years...Amortization also serves another purpose. While the dollar value of the prudent expense is recovered, the time value of money indicates the present value of that expense is not recovered. This means there is a sharing of the costs. The commission views this as a proper mechanism to provide an incentive (or disincentive) to Puget to be sure that its initiation and management of large construction programs are in all respects prudent." WUTC v. Puget, Cause No. U-83-54, Fourth Supp. Order, p. 34-35.

When Puget created a loss reserve in its financial statements, it expected a ten year recovery period. (Martin, Ex. T-749, p. 18). Staff's proposed ten year recovery period is not only consistent with the Commission's Order, but with Puget's expectation. This longer recovery period minimizes the rate effects of the costs the ratepayers will be required to pay. Puget argues that the Creston project costs should not be treated similar to Pebble Springs and Skagit/Hanford because Creston is not an abandoned nuclear plant. (Story, Ex. T-965, p. 35). This argument lacks merit. All are planned, large generating projects. Staff's amortization period should be adopted.

c. Rate Base Treatment Should Not Be Permitted.

Staff recommends no rate base treatment for the balance of recoverable Creston costs, consistent with the sharing principle discussed above. Puget argues it has already borne its share of the costs because it was not reimbursed for its carrying costs while maintaining the site as a resource option under the Regional Power Planning Council's regional plan. (Story, Ex. T-965, p. 35, 36). Again, it is not appropriate to accrue AFUDC on a project that never reached construction stage. It is likely that Puget did not come before the Commission to request reimbursement of carrying costs out of an expectation that its request would be denied. (Ex. 626, p. 43).

Denial of rate base recovery is also consistent with the Court's decision in POWER v. WUTC, 101 Wn.2d 425 (1984). It is also consistent with prior Commission decisions regarding the treatment of preliminary survey and investigation costs in the investor supplied working capital calculation. (See Martin, Ex. T-749, p. 17-18). Although Puget booked its costs in account 186,

it agrees that the most appropriate account is 183-Preliminary Survey and Investigation costs. (Ex. 626, p. 43). Such working capital treatment prevents a return from being earned on the account balance. Puget's rate base proposal and its account 183 working capital treatment are inconsistent. The Commission has denied a current return; therefore there is no basis for deferred return. (AFUDC).

2.20 Stone Creek. See 2.22 below.

2.21 Black Creek. In this adjustment, Staff proposes to remove Black Creek costs for the following reasons:

- Black Creek is being built by Puget's subsidiaries, not by Puget, and Puget's failure to provide Staff the amounts of profit charged by the subsidiaries has made the determination of the reasonableness of such profit impossible. (Nguyen, Ex. T-738, p. 37-39);
- Black Creek is still in the early stages of construction. To date, only 24.3% of the total estimated construction cost has been actually incurred. (Story, Tr. 4867 as corrected);
- Puget has delayed Black Creek's projected commercial operation date from November 1993 (see column "Nov-93" in Ex. 526, p. 1) to December, 1993. (Lauckhart, Ex. T-938, p. 22);
- Puget's rebuttal representation of Black Creek's expected commercial operation date is internally inconsistent. Mr. Lauckhart identifies December, 1993 as the projected commercial operation date (Ex. T-938, p. 22), but in his proposed "allowed costs" assumptions for the SDM, he shows Black Creek as coming on line in "Nov-93" as "Small Hydro". (Ex. 939, p. 1, l. 59).

Since the PRAM contemplates general rate case filings every three years, Staff recommends that Black Creek compete through Puget's RFP process before its costs are allowed for recovery through rates. WAC 480-107-160 specifically allows utility subsidiaries to participate in electric utility RFP competitive bidding. As a bid resource, ratepayers are given more assurance that the resource will be proven cost-effective if acquired.¹²⁸ Puget is provided recovery of the cost of the

¹²⁸ Treating Black Creek as purchased power through bidding eliminates the need for complex accounting associated with a non-regulated, subsidiary transaction yet provides a cost recovery item for Puget, since the resource will be treated as purchased power and recovered through the PRAM.

resources through the SDM. In the next general rate case, Puget's investment in the resource could then be included in rate base. This treatment avoids the problem of pro forming rate base without consideration of other impacts.

2.22 Small Hydro Write-Offs. Puget originally proposed that the costs associated with discontinued projects be amortized over five years with rate base treatment of the balance. Puget's alternative approach is to allocate the expenses or gains to projects which are ultimately developed. (Story, Ex. T-556, p. 21). On rebuttal, Puget proposed that the estimated gain from the sale of Stone Creek minus the cost of undeveloped projects, be offset against the costs of Black Creek. (Story, Ex. T-965, p. 37). The Commission should not be swayed by Puget's offer to allow recovery of unknown, unjustified, and unevaluated small hydro program costs based on potential profits from the sale of Stone Creek. If Puget's proposals were adopted, the following would result:

- The Commission would be ignoring its accounting rules. (See Weaver, Tr. 4602, 4607);
- The Commission would be authorizing deferral accounting in circumstances where costs are accumulated for various hydro projects with no certainty of their being either developed or cost effective. (Tr. 4606). There are numerous HEDC projects with unknown costs which are in various stages of development, which could end up as Puget resources or as losses. (Ex. 943, p. 2-3);
- Ratepayers would pay the many unknown and potential HEDC related losses if HEDC claims the losses are related to work for Puget. (Weaver, Tr. 4601);
- The Commission would be relieving Puget of its burden to prove that the 15% overhead markup and "cost plus" construction arrangement among its subsidiaries is fair, just and reasonable. To date, the total project costs are estimates. (Ex. 1004).

Staff's recommendations for Black Creek (2.21) and Small Hydro Write-offs (2.22) are consistent. The competitive bidding process provides an opportunity to evaluate the reasonableness and cost-effectiveness of the individual elements of Puget's small hydro program. In this way, Puget's customers have some assurance that costs do not exceed benefits, the power is actually delivered, at competitive prices, and customers will be relieved of the complications and uncertainties

of weighing and tracking profits and losses from subsidiary hydro construction and merchandising. (Tr. 586). Indeed just as Puget argues there is no regulatory requirement that the gain from Stone Creek be flowed through to customers to reduce rates, (Story, Ex. T-965, p. 37), neither is there any regulatory requirement that past losses from the abandoned hydro projects, as well as present and future subsidiary losses, be flowed through to customers to increase rates.

Puget admits that absent Stone Creek profits, "Black Creek would then be a candidate for rate base treatment at a level in excess of the costs of the small hydro program." (Weaver, Ex. T-935, p. 16). If the Commission adopts Puget's proposal to include the Black Creek project in rate base, it should explicitly state that actual costs, when known, will be subject to thorough review for prudence, compliance with accounting rules, and cost-effectiveness.

Staff's specific and alternative proposals which adhere to the cost accounting provisions of the USOA are discussed in detail in Mr. Martin's Ex. T-749, p. 27-31. Staff's proposals regarding the treatment of the costs of the five abandoned hydro projects are fair and reasonable and should be adopted.

2.24 Working Capital. There are several issues of contention in connection with the working capital adjustment. Puget has added several adjustments to its initial case, including certain proposals by Staff and Navy. These are reflected in Ex. 980 (col. "Adj. for general rate case rebuttal"). These additional adjustments are appropriate. To facilitate understanding of the remaining Staff/Company differences, Staff has prepared its updated calculation based on Ex. 980 which is included as Appendix Table 4.

a. Dividends Declared

Staff and Navy excluded dividends declared from the invested capital because dividends declared constitute zero cost capital. When Puget charges retained earnings, the equity of the stockholders is reduced and the book value of common stock is reduced. On the other hand, a current liability is created. Puget has in fact demonstrated that a mere reallocation of retained

earnings is not what occurred, but rather a distinct and distinguishable liability was created. A current liability is certainly distinct from equity. (Martin, Ex. T-749, p. 20-21). Puget claims that although a portion of invested capital has been transformed to a short-term liability, the dividends declared, having a zero cost, should be of no consequence. (Story, Ex. T-965, p. 46). Because Puget is not obligated to pay dividends (Olson, Tr. 1420) and does not accrue interest on dividends declared, this capital is zero cost. Therefore, Puget should not be permitted to charge the customers a return on an item that costs Puget nothing.

The dividend liability is owed to stockholders as of a certain record date. The stockholders of record may no longer be owners of stocks when the dividend payment is made which normally occurs after the record date. If dividends are allowed to earn a return through working capital, Puget will retain that return because former stockholders are neither expecting that return, nor entitled to it.

Puget argues that an item does not become cost-free simply because it has become a short-term liability, citing as an example short-term debt, which has interest calculated until it is paid. (Story, Ex. T-965, p. 46). However, short-term liability is a component of Puget's capitalization and should be compared with equity. Short-term debt requires interest and equity requires dividends. Interest and dividends are both returns on invested capital. Puget's proposed treatment requests a return on return, which would enable shareholders to double-earn. (Martin, Ex. T-749, p. 20-21).

Puget also claims the Commission accepted its argument regarding dividends and working capital in Cause No. U-85-53 but in fact this specific issue was never raised in that case. (Story, Tr. 4773-74). Staff's adjustment properly reflects the nature of dividends and it should be accepted.

b. Residential Exchange Account (Docket UE-920433-P).

This item relates to the petition for an accounting order re: the BPA residential exchange ("RE") credits. BPA, Puget, and Staff agree that the exchange balances should accrue interest

monthly, on actual account balances, at the short-term debt rate, and be payable only to eligible customers. The petition should be granted to that extent.¹²⁹

The ratemaking treatment is where the proposals differ. Puget proposes to treat RE balances as short-term debt. (Story, Ex. T-556, p. 24). This has the effect of including these balances as invested capital in the investor supplied working capital ("ISWC") analysis. (Martin, Ex. T-749, p. 22). Staff opposes this treatment.

- (1) Puget's Short-Term Debt Method Overcollects from Customers the Proper Level of Residential Exchange Credits.

Adding RE balances to Puget's short-term debt increases invested capital, and the working capital allowance which is added to rate base and gives Puget an overall return on these balances, while it pays only a short-term debt rate. This is an unfair overcollection. (Martin, Ex. T-749, p. 22). Puget contested this fact in Ex. T-965, p. 48-49. However, Puget's analysis mismatched test year RE balances with the higher RE balances at 9/92. (Story, Tr. 4777). Its conclusions are therefore without factual support.

- (2) Any of Staff's Proposals Preserves the Benefits of Exchange Credits for Puget's Customers.

Staff proposes three alternatives for ratemaking treatment of RE balances:

1. Deduct the account from rate base. (This is analogous to the Commission's treatment of customer deposits). This is Staff's preferred option.
2. Treat balances as non-investor supplied working capital, with allocated interest cost recovered as an operating expense.
3. Assume RE balances fund utility non-operations and, as a result, treat the cost as non-operating. (Martin, Ex. T-749 p. 24-25).

As to alternative 1, Puget disputes the analogy to customer deposits, claiming the RE account is more variable. (Ex. T-965, p. 49). This is a non-issue, since "variability" does not affect rate base; in

¹²⁹ Specifically, the proposed "Order" on p. 4, lines 14-28, and 35-38 should be granted. (Accrual of interest on actual monthly balances should be added as detail). The discussion in the draft "Order" that deals with ratemaking treatment and the working capital allowance should not be accepted.

the ISWC, a lower balance increases average investment, which lowers working capital, all else equal. Simultaneously, there is less rate base reduction which offsets the effect of the reduced working capital.

Puget also alleges that Staff's proposals effect an improper recovery of RE interest from operating and non-operating. (Story, Ex. T-965, p. 50). This argument is premised on a lack of understanding of Staff's proposals. Under alternative 2, allocation of the interest is necessary because the undistributed funds are not used solely for operating purposes. (Story, Tr. 1383). The working capital allowance allocation referred to by Puget has no relevance because the residential exchange balance is considered non-investor supplied funds, as it was in the last general rate case. Therefore, it is not a part of the investor supplied working capital that is subject to allocation. There is no double allocation. Under Staff's third alternative, all interest should be allocated to non-operating because the assumed use of the funds is for non-operating purposes.

Staff's proposals meet the spirit and letter of BPA's concerns, and do not over-recover costs from the general ratepayers. Staff's first proposal should be accepted.

(3) Other Work in Progress

Puget contends that Staff's adjustment is inappropriate in that it removes the costs associated with: (1) Tenino and Renton underground tank restorations; (2) Northwest Transformer; and (3) other utility costs related to transformers and damage repair. (Story, Ex. T-965, p. 51). Since these items are ongoing expenses, and were not subject to deferral under the accounting order, they should not earn a return through the working capital allowance.¹³⁰

(4) Plant Held For Future Use

Puget disagrees with this adjustment in the working capital calculation while agreeing that certain plant held for future use should be removed from rate base. (See 4.05, Future Use Plant).

¹³⁰ In its adjustment 2.10, Puget recognized that these items are ongoing expenses and removed the prior expenses from the test year. Staff agreed that such removal is proper. (See Martin, Ex. T-749, p. 14).

Such a reclassification indicates that an operating investment will be a non-utility property. There is no impact on the working capital allowance, but the reclassification impacts the allocation to non-utility. Staff is simply applying the cost-causation principle. The working capital allowance allocation to non-utility should be proportionately adjusted because the non-utility investment has been increased by the future use adjustment.

(5) Depreciation Reserve, A/C 108

This adjustment removes from the depreciation reserve the balance of remediation program expenses which were reclassified to deferred and expense accounts under the Commission's accounting order. The depreciation reserve in rate base has been similarly adjusted to reflect the test year reclassification provision of the accounting order. Apparently, Puget misunderstood Staff's adjustment in regard to this item. Puget's testimony originally reflected a concern that the items adjusted by Staff "would have been included in working capital..." (Ex. T-965, p.52). Staff's adjustment did precisely that: it removed the items from operating investments and included them in working capital. Puget later changed its testimony on this point. See corrections to Ex. T-965.

(6) Extraordinary Property Loss, A/C 182.10/182.11

This adjustment reflects in the working capital calculation the effects of Staff's proposals regarding storm damage (2.08) and property damage (2.09). This is an appropriate adjustment if Staff adjustments 2.08 and 2.09 are accepted by the Commission. The working capital and rate base adjustments reflected in Appendix A, Table 4 should be accepted.

2.26 Rate Case Costs. Staff proposes to disallow a portion of Puget's rate case expenses. First, the Staff has determined that all outside consultant expenses other than those offered by Puget to verify Puget's SFAS 106 liability are improper. Puget has considerable expertise which should enable it to present an analysis of its financial condition and investor return requirements in a rate proceeding. Puget executives are paid nearly \$1 million per year and have some 73 years collective experience in financial matters. (Ex. 698; Tr. 4770-71).

The consultant witnesses represented the interests of Puget's shareholders in this proceeding. The shareholders should pay for that representation. On rebuttal, Puget criticized Staff for not itself having "in-house" expertise, but Puget failed to acknowledge that Staff has on numerous occasions presented rate-of-return testimony (Story, Tr. 4772) and in the most recent cases involving the other jurisdictional electric utilities, company personnel have presented rate of return testimony. (Tr. 4455). Finally, it cannot be overlooked that Puget will pay its rate of return witness, Dr. Olson, \$100,000 for his services. (Ex. 693).

Puget also expects to pay over \$500,000 in legal costs associated with this case. Id. Puget claims that it had no control over the complexity of these proceedings. (Story, Ex. T-965, p. 54). However, Puget was ordered to file this case for the purpose of PRAM evaluation. Instead, it chose to file an aggressive revenue requirements case, focusing largely on issues other than PRAM. It chose not to include in its filing, testimony on the issues the Commission clearly asked to be addressed. This is prima facie evidence that Puget can and does control the presentation of issues and the level of complexity of the case. There is also evidence which shows Puget is unable to control its expenditures for outside legal expenses. (Elgin, Ex. T-670, p. 35; Kelly, Ex. T-713, p. 34). For these reasons, Staff recommends that the only equitable manner for controlling these expenditures is to share them between Puget and ratepayers. Until it can be demonstrated that Puget exercised reasonable effort to limit the contested issues (filing a responsive case is a significant first step) it should not be allowed to recover all legal fees associated with processing the case. Staff's proposed sharing is fair and should be adopted.

Mr. Story calls the calculation of Staff's adjustment a "fundamental misunderstanding of ratemaking." (Story, Ex. T-965, p. 55). Mr. Story is referring to Mr. Schooley's extension of the amortization of the costs of the prior rate case to October 1993 as an amount embedded in rates. (Ex. 733). This misunderstanding is also practiced by Puget when it deems it convenient. A prime example of this is the practice of using the rate case determined level of expense for storm damages

or self-insurance as an amount for financial reporting purposes. (Ex. 876). Another example is Puget's continuation of the Pebble Springs amortization beyond its expiration in the PRAM 2 proceeding, which was rejected by the Commission in the PRAM 2 Order. This "fundamental misunderstanding" is acknowledged, and Puget's proposed adjustments, 2.08, 2.09, and 2.16 must also be corrected. Staff will apply this principle on a consistent basis, for all these adjustments, including rate case expense.

Therefore, Staff's proposed rate case costs of \$265,000 should be divided by three for an amortization of \$95,000 per year. Comparing this to the test year expense of \$158,439, a decrease in operating expenses is indicated. This results in an increase in NOI of \$41,870.

2.27 Non-Recurring and Operating Expense Adjustments.¹³¹

2.27b Corporate Dues. Staff has updated its adjustment with data from Puget's rebuttal filing. The remaining substantive differences are the percentage allocated below the line for EEI's regular and Media Communications dues, and Staff's allocation of dues to various other organizations for lobbying activities. Staff maintains its position as stated in Ex. T-728, p. 38 (Schooley), and itemized in Ex. 734.

Puget allocated a percentage of corporate dues below the line based on a questionnaire which requests the percent of an organization's activities related to lobbying on energy issues. (Ex. 885). WAC 480-100-043 forbids utilities from recovering expenses for any lobbying. Puget's analysis is too narrow. As listed in Ex. 734, many organizations have goals to influence the public or governmental entities. The Association of Washington Businesses (AWB), for example, must specifically be excluded, as lobbying the state legislature is its primary activity. (Ex. 734, p. 3). Yet Puget includes all dues paid to AWB.

¹³¹ See Footnote 77.

Puget's contributions to economic development councils and supporters of growth in the region are of great concern to Staff. These contributions promote increased consumption and an increase in Puget's customer base and should be excluded. (Schooley, Ex. T-728, p. 40).

2.27i Colstrip Interest Income. This adjustment removes from the test year, items pertaining to the Colstrip settlement income which was subject to deferral and amortization. (Story, Tr. 4794). Staff and Puget agree on the income effects (Tr. 4795), but differ in the rate base adjustment. Both Puget and Staff removed the per books rate base deferred tax balance. Puget, however, also inappropriately removed the deferred interest balance by increasing the per books working capital. (See Story, Tr. 4797). The interest income balance was not included as a direct reduction to the per books rate base, and the per books working capital was adjusted to the pro forma amount in the working capital adjustment, 2.24. The Commission should reject Puget's adjustment as double counting.

2.27j Conservation Advertising. Puget seeks recovery of \$4.1 million in rate base and \$520,000 in amortization for conservation advertising expenses. (Ex. 734). Since Puget has not demonstrated a connection between its advertising and its acquisition of conservation, Staff recommends that at least one-half of the advertising expenses be disallowed. (Sorrells, Ex. T-722, p. 2).¹³² Public Counsel shares Staff's concerns and has proposed similar adjustments. (Blackmon, Ex. T-832, p. 51). Public Counsel also proposes to expense conservation advertising expenditures annually. This proposal has merit. (*Id.*, p. 49-51).

a. Puget Has Not Demonstrated That Its Advertising Campaign Contributed to Its Acquisition of the Conservation Resource.

The ultimate goal of Puget's Corporate Communications Plan was to deliver conservation as a resource and encourage participation in Puget's conservation programs. (Swofford, Tr. 4217). However, Puget has made no attempt to measure the specific energy savings resulting from the

¹³² \$2,057,367 in rate base and \$259,896 to the amortized portion.

campaign. (Swofford, Tr. 4221). In evaluating the effectiveness of Puget's campaign, a clear distinction must be made between a customer who is aware of the ad campaign and one who responds to that campaign by participating in Puget's programs. Puget's campaign evaluations have focused on the former and ignored the latter. (Swofford, Ex. 614).

Puget's claim that "the campaign achieved its short-term goal of increasing participation in the Company's conservation programs" (Ex. T-896, p. 5) is unsubstantiated:

- Puget claims to have received 150,831 calls over the past two years in response to its campaign. Id. However, only half of these calls were on the 800-numbers related to the advertising campaign (Swofford, Tr. 4169), at a cost of \$84.07 per call. (Swofford, Tr. 4170 as corrected).
- Puget has no idea how many of these callers went on to participate in its conservation programs. (Swofford, Tr. 4173).
- In the first two tracking studies customers were asked if they had received any assistance with conservation from Puget. (O'Neill, Tr. 4283).¹³³ Only 15% of the surveyed customers had received any assistance. Id.
- Inexplicably, this question was dropped from the subsequent two surveys. Id.

b. Puget Has Not Demonstrated That Its Corporate Communications Plan Was Conducted in a Cost-Effective Manner.

Puget was asked to provide evidence that the \$5 million it spent over the past two years was an appropriate amount. (Swofford, Tr. 4170). Mr. Swofford indicated that witness O'Neill had such evidence, (Tr. 4283), but Ms. O'Neill said she did not. Id. In addition, Puget has not performed a cost-effectiveness analysis to compare advertising media. (Sorrells, Ex. T-722, p. 10).

Six months into the campaign, Puget added television, the most costly medium, to its advertising. (Swofford, Tr. 1177; O'Neill, Tr. 4282). Evidence indicates that it has not been an effective or appropriate medium for Puget:

¹³³ Assistance was identified as information, audits, financing, equipment or products. (Ex. 614, 2/92 study, p. 4 of survey).

- Puget maintains that it developed its ad campaign based on focus group research held in 1990. (Tr. 4298). However, Ms. O'Neill's summary of customer recommendations stated that "traditional commercial television advertising is not likely to be of benefit to Puget." (Ex. 1005, p. 25). Puget did not heed its customers' advice as reported by Ms. O'Neill.
- The customers' advice was correct. In the initial six months of the campaign, the number of calls to Puget's conservation hotline averaged 3500/month. (Swofford, Tr. 4171). For the twelve months after television was added to the advertising mix, the average number of monthly calls to Puget's conservation hotline decreased by 23%. (Swofford, Tr. 4171).

Although it would be a simple and informative way to track the effectiveness of campaigns, Puget does not ask its callers what medium or message prompted them to call. (Swofford, Tr. 4174). Puget cannot demonstrate it appropriately incurred the costs of this campaign.

c. The Advertising Campaign Encompassed Far More Than Conservation.

Puget's Corporate Communications Plan has addressed many "extra" issues; sales of power to California, power line placement and EMF, rate increases and notifications, and why Puget advertises. (Sorrells, Ex. T-722, p. 8). Mr. Swofford and Ms. O'Neill both conceded that these topics are "controversial issues of public importance." (Swofford, Tr. 1177-78; O'Neill, Tr. 4285). Advertising on such topics are made expressly unrecoverable under WAC 480-100-043. There are two types of advertising specifically exempt from this rule:

- (1) advertising which informs customers how they can conserve energy or can reduce peak demand for energy.
- (2) advertising which promotes the use of energy efficient appliances, equipment, or services.

Puget would now have us believe that advertising to address customer concerns about how Puget conducts its business is also exempt. (Ex. 536, p. 4). It clearly is not. Puget has already established, and ratepayers have funded, various forums for the discussion of these issues; the Speakers Bureau, Consumer Panels, and other educational programs are designed for this purpose. (Swofford, Ex. T-535, p. 19). Enough is enough.

Under the current PRAM treatment of conservation advertising expenses, the potential for abuse is great. The following raise serious concerns:

- In the most recent "conservation advertising" focus groups, participants were handed rewritten rate increase notifications and rate fact sheets; reactions and suggestions were sought. (O'Neill, Tr. 4289). These notices pertained to this docket (O'Neill, Tr. 4291). Yet the entire costs of the focus groups were charged to conservation advertising to be added to ratebase. (Swofford, Tr. 4161).
- Puget contends that focus groups held in 1990 formed the basis for the conclusion that customers would not conserve without answers to their questions. (Ex. 536, p. 4). However, Ms. O'Neill indicated that focus groups do not provide an indication of how widely held an opinion might be. (O'Neill, Tr. 4276). The telephone surveys do provide statistically significant results. (O'Neill, Ex. T-913, p. 15).
- Puget ran an ad, "Why we Advertise", because focus group members allegedly expressed skepticism as to why Puget would ask them to use less of their product. (O'Neill, Ex. T-913, p. 9). However, the results of the baseline survey prior to the start of the campaign indicated that "an overwhelming majority" of customers think this is wise business practice. (O'Neill, Tr. 4284). The survey indicates that there was no need for this ad.

When asked what criteria should be used to determine which issues are appropriate for the conservation campaign, Puget could not specify any. (Swofford, Tr. 4164). Staff holds that WAC 480-100-043 provides such criteria, and recovery of advertising should be limited per Staff's recommendations.

The record shows that Puget has not demonstrated the millions it spent on advertising was prudent. Staff's adjustment is reasonable and should be accepted.

2.28 Production Adjustment. This adjustment removes improper amounts of corporate dues paid by Puget in the test year. Staff's and Puget's adjustments are made in a similar manner. The amounts differ primarily due to Puget's use of an updated production factor based on revised load forecasts. The production factor/load forecast issue is discussed above. The remaining differences between Staff and Puget are due to the differences in the inputs which are tied directly to individual restating and pro forma adjustments to various operating expenses and rate base.

3.03 Montana Corporate License Tax. This tax is charged by the state of Montana based on the portion of Puget's taxable income generated from its Montana plant. Staff agrees with Puget's calculation on page 3.03 of Ex. 966, except for the amount of "Pro Forma Interest Adjustment" of \$22,696,542 appearing on line 3. This amount should be the amount determined by Staff in its pro forma interest adjustment calculation, that is \$20,442,390. Staff's calculation of the Montana Corporate License Tax adjustment results in a decrease in NOI of \$143,110.

3.04 Pro Forma Interest. This adjustment provides the pro forma impact of interest on federal income taxes. The only issues associated with this adjustment are in the two inputs, rate base and the weighted cost of debt.

3.05 Montana Energy Tax. This tax is based on the net output from the generating plant owned by Puget in the state of Montana and a tax rate of \$.0002 per KWH. At rebuttal, Puget changed the amount of pro forma KWH from 4,480,740,000 KWH to 4,404,163,000 KWH and arrived at an increase in NOI of \$86,323. (Ex. 966, p. 3.05). Staff's adjustment using the amount of pro forma KWH provided by Mr. Winterfeld of 4,838,900,000 KWH results in an increase in NOI of \$28,938.

4.03 Company Publications. Staff's adjustment removes the costs of producing The Quarterly Review for stockholders, and 20% of the costs of The Outlet as non-utility expense.¹³⁴ (Schooley, Ex. T-728, p.44). Puget accepts the portion of Staff's adjustment which pertains to the reduced production cost of The Outlet and the discontinued publication, The Livewire. (Story, Ex. T-965, p. 60).

4.05 Future Use Plant. This adjustment removes from rate base certain items of property which were booked in FERC account 105 - Plant Held For Future Use. The ratepayers should not be required to pay in rates the carrying costs and return on the cost of properties which are either surplus properties or are held for speculation and do not meet the criteria of Account 105.

¹³⁴ We add that "interest stimulating" items in a Washington Water Power publication did not benefit ratepayers, and recovery was denied. (Cause No. U-85-36, Third Supp. Order, p. 24).

Exhibit 754 presents Staff's detailed analysis of items booked in account 105 and the specific reasons why certain items should not be included in rate base. Puget agrees with Staff's "Group A" adjustment. (Story, Ex. T-965, p. 21). Puget does not agree with Staff's adjustment for the remaining "Groups B, C and D." Puget asserts that the proposal is either the retroactive application of the proposed 20-year benchmark holding period, or an overly restrictive interpretation of the definition of the account. (Ex. T-965, p. 21).

The account definition is straightforward: it requires a definite plan as a prerequisite to booking costs in account 105. (Ex. 760). Puget opposes Staff's adjustment because it limits Puget's ability to speculate on property acquisition. (Ex. T-965, p. 22). It is not surprising that there are several transactions involving transfers of properties from utility to non-utility and that accounting for the gains and losses on those properties continues to be a controversial issue. (See Property Sales, 2.07).

The ratepayers will suffer if Staff's recommendation is not adopted. Plant that is acquired without a determinable in-service date yet allowed to be included in rate base fosters a regulatory environment riddled with speculation, and grants Puget recovery without the requisite prudent planning required of management. Puget's claim that speculative acquisition is beneficial to ratepayers due to lower cost (Story, Tr. 1323) is without merit. The facts show the cumulative rate of return amount (uncompounded) already paid by ratepayers on the properties recommended for exclusion by Staff, not counting the associated expenses which were likewise paid, exceeds both the book and current assessed values of these properties. (Martin, Ex. T-749, p. 36).

Staff's proposal to declare a benchmark holding period for properties in account 105 is not unprecedented. Other jurisdictions have adopted similar policies to protect ratepayers. (Ex. 759). Puget ratepayers deserve similar protection.

4.06 Miscellaneous Adjustments.¹³⁵

¹³⁵ See Footnote 77.

4.06a Public Utility Tax. Puget has agreed with Staff's adjustment (Story, Ex. T-965, p. 60). Staff has recalculated its adjustment using the updated data provided by Puget. The remaining \$ 34,978 difference is due to Staff's removal of the tax deductions associated with the DSM advertising costs proposed to be disallowed in Non-Recurring and Operating Expense Adjustments, 2.27.

4.06c & j Vehicles-other and OBC Relocation. In these adjustments, Staff includes additional cost-cutting benefits based on Ex. 1010. That exhibit indicates that displaced vehicles are still being identified. The end of test year rate base amount of \$109,657 for disposed vehicles is a conservative estimate and should be used as a minimum. The benefit of vacating a floor of the One Bellevue Center office is calculated by comparing the foregone lease savings versus one third of the relocation budget assuming a three year amortization period. These adjustments supplement those included in Ex. 978. They reflect the productivity and efficiency measures recommended by Towers Perrin and should be accepted by this Commission.

4.06g Outside Services. In this adjustment are costs incurred in connection with (1) analysis and review of legislative bills, and meetings on Capitol Hill; and (2) a lawsuit filed to prevent taxation. In Staff's view, these costs were incurred for political and lobbying purposes and should therefore be brought below the line. Puget claims it is necessary to have this legal work performed so that it can be assured of compliance with new laws. (Story, Ex. T-965, p. 62-63). However, it is Puget's duty to comply with current laws. Any attempts to influence proposed legislation should be paid for by the shareholders.

The lawsuit filed to challenge the state of Montana's taxing authority was found to be without merit by the courts, and Puget does not plan further legal action on that issue. (Story, Tr. 4790). Consequently, this test year expense is not expected to recur and should be removed. Id.

4.06h Nintendo/Tanner. Despite a Service Area Agreement (Agreement) which placed Nintendo's facility in Tanner Electric Cooperative's (Tanner) territory, Puget elected to serve Nintendo. It continued to serve even after receiving a ruling from this Commission that while no Commission law

precluded the service, the matter of breach of the Agreement would have to be resolved by the court. (Ex. 673, p. 8). The Court resolved the issue by concluding as a matter of law that Puget did breach the Agreement. (Ex. 675, Instruction 2.01). But Tanner's damages claim also covered the time after the Agreement expired in September, 1991; its theory was that Nintendo would have no reason to leave Tanner after that time. (Elgin, Ex. T-670, p.32). Given the fact that the jury was instructed that Nintendo was entitled to reasonable service (Ex. 675, Instruction 4.02), and that Tanner stated that it was able to serve Nintendo (Lauckhart, Tr. 4685), it is clear that the jury resolved the reliability issue against Nintendo. Puget now faces a \$2.5 million judgment for its breach. (Ex. 675, p. 2).

Staff's adjustment first removes from the test year the litigation costs (\$80,234 at NOI) associated with this litigation. Puget has not shown that litigation of this type is common and expected to recur. It has not even shown that the level of expense is representative of legal costs normally incurred.

Staff also proposes to adjust the PRAM to make Puget's customers neutral on Puget's decision to serve the Nintendo load, by removing the highest price resource at the level of the Nintendo load. (Elgin, Ex. T-670, p. 30-31; Moast, Ex. T-778, p. 27; Ex. 783). Puget responded by claiming that in serving Nintendo, it was simply responding to a customer request for service (Lauckhart, Ex. T-938, p. 34-35), that it informed the Commission it had an obligation to serve (Ex. 945, p. 4-5), that it was concerned with anti-trust consequences (Ex. 945, Ellis transcript) and that its tariff calls for "point of delivery" to be where its facilities ends and the customer's begins. Id.

None of these arguments withstand scrutiny:

1. The sole rationale formally presented to the Commission at the time was "obligation to serve" based on a Pennsylvania PUC decision.¹³⁶ Puget might have relied on Lawson v. Duke Power Co., 37 PUR 3d 264 (N.C. PUC 1961) in which an investor-owned utility declined to serve a customer served by a cooperative. The North Carolina Commission found nothing to require the service.

¹³⁶ Lauckhart, Ex. 945, 12/11/90 letter to Commission.

2. If Puget was truly concerned with anti-trust implications, it could have come to the Commission for "state action" protection. It failed to do so. (This might also have given Puget what it needed to prevail against Tanner's claim. We will never know.)
3. Nintendo was not "just another customer" seeking service. Puget was aware, or should have been aware, that this was a highly volatile situation. It did little to protect itself or its ratepayers; it did not independently evaluate Tanner's ability to serve¹³⁷; it did not come to the Commission for relief; it has made no showing and made no claim in this proceeding that it did all it possibly could to assist Tanner in serving this load.
4. There is nothing in Puget's tariff that establishes a geographic service territory. Indeed, Puget's tariff does not even refer to Service Area Agreements. If its tariff theory is correct, Puget would have to serve any customer who requested service, regardless of an Agreement.

Decoupling was intended to remove the incentive to build load.¹³⁸ Yet Puget engaged in load-building by electing to serve Nintendo. The ratepayers should not pay for that decision.

Puget objects to the mechanisms of Staff's adjustment as "punitive and produc[ing] illogical results." (Lauckhart, Ex. T-938, p. 36). Puget's arguments miss the point. The point isn't that Puget would not have purchased a specific resource but for Nintendo. The point is to make ratepayers indifferent to Puget's decision, since we cannot redo Puget's cost of service as if Tanner served Nintendo. Nor does Staff require Puget to demonstrate that each customer added must benefit the system. (See Lauckhart, Ex. T-938, p. 38). Staff's adjustment focuses on Puget's conduct under a service area agreement which it has been found to have violated, and Puget's failure to protect its ratepayers when it could have done so. It should be accepted.

4.06i Account 930.24 Misc. General Expenses. The ratepayers should not be required to bear the costs of Puget's image-building efforts. Puget's hiring an outside consultant to assist an economic development group is contrary to its own policy. (Ex. 634, p. 17). Puget admitted its error in hiring this consultant during the test year, stating that it "missed one". (Ex. 634, p. 17). The beneficiaries

¹³⁷ Lauckhart, Tr. 4684.

¹³⁸ Sonsteli, Ex. T-878, p. 7.

of the consultant's services (the economic development group) should bear the costs; not the ratepayers.

VI. RATE MODERATION/RATE SPREAD/ELASTICITY.

A. Puget's Rate Moderation Proposal Should Be Rejected.

While complaining about the risk of creating new regulatory assets (Story, Tr. 4877) Puget wants to create more, through its rate moderation proposal. This proposal will permit deferral, with full recovery of capital costs, of any revenue requirement not instituted October 1. Creating yet another regulatory asset is unwise. (See Elgin, Tr. 2218). Ratepayers should pay current costs now.

B. Puget's Elasticity Adjustments Should be Rejected.

Puget has proposed elasticity adjustments as a result of rate design changes which affect proposed rates, by adjusting pro forma billing determinants. (Hoff, Ex. T-1016, p. 15). These elasticity adjustments should be rejected for three reasons:

1. The proposed adjustments do not meet the pro forma, known and measurable criteria;
2. The PRAM mechanism takes into account elasticity if it occurs; and
3. The Commission has consistently rejected elasticity adjustments of this nature in the past (Buckley, Ex. T-791, p. 3-8).

Puget suggests that adjusting billing determinants does not have to meet the known and measurable criteria and should be treated in the same manner as projections of customers, loads, and power costs. (Hoff, Ex. T-1016, p. 5). But elasticity adjustments are different than such projections, which are factors that can be measured or "trued-up" in subsequent filings if projections are inaccurate. By contrast, elasticity may not occur and cannot be explicitly measured. The Commission has consistently rejected elasticity adjustments, even when sophisticated models have been proposed (Cause U-75-40), and even when a rate decrease was implemented. (WUTC v. US West, Docket U-89-2698-F/3245-P, 4th Supp. Order, p. 23). That policy should be maintained until such effects can be accurately measured and explained.

C. Allocation to Firm Resale Customer Class.

Puget agrees with Staff's recommendation to move the firm resale class to a 100% parity ratio. (Lynch, Ex. T-1011, p.4). It is also agreed that rerunning the Cost of Service (COS) model will calculate the adjustment correctly. However, the parties disagree on which "short-cut" method is appropriate. Although Staff's "short-cut" method produced a result much closer to the model run than Puget's parity ratios approach (Ex. 777 vs. Ex. 1013), the proper approach would be to rerun the COS model based on the revenue requirement level set by the Commission in this case. A difference between a short-cut method (if adopted) and the COS model run can be tracked and deferred to offset future increases to the retail class.

VII. CONCLUSION.


The Commission should adopt the recommendations of the Staff for the reasons stated above.

Respectfully submitted,

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August 13, 1993.

APPENDIX A

TABLE 1 – Overall Cost of Capital Recommendations

TABLE 2 – Statement of Operating Income and Rate Base Adjustments

TABLE 3 – Staff Results of Operations for Ratemaking Purposes

TABLE 4 – Calculation of Average Investor Supplied Working Capital

TABLE 5 – Revenue Requirements Calculation

TABLE 1

PUGET SOUND POWER & LIGHT COMPANY – Docket No. UE-921262
OVERALL COST OF CAPITAL RECOMMENDATIONS

<i>A. Company Recommendation – Mr. R.E. Olson, Ex. 918, p. 3</i>			
	Ratio	Cost	Weighted Cost
	-----	-----	-----
Long-term Debt	45.00%	7.91%	3.56%
Short-term Debt	2.00%	4.42%	0.10%
Preferred Stock	8.00%	8.10%	0.65%
Common Equity	45.00%	12.25%	5.51%
	-----		-----
Total	100.00%		9.82%
	=====		=====
<i>B. Staff Recommendation – Dr. R.J. Lurito, Ex. 703, p. 11</i>			
	Ratio	Cost	Weighted Cost
	-----	-----	-----
Long-term Debt	46.50%	7.89%	3.67%
Short-term Debt	5.00%	4.00%	0.20%
Preferred Stock	7.50%	8.09%	0.61%
Common Equity	41.00%	10.80%	4.43%
	-----		-----
Total	100.00%		8.91%
	=====		=====
<i>C. Public Counsel Recommendation – Mr. Hill, Ex. 797, Sch. 12</i>			
	Ratio	Cost	Weighted Cost
	-----	-----	-----
Long-term Debt	46.34%	7.99%	3.70%
Short-term Debt	4.12%	4.51%	0.19%
Preferred Stock	9.14%	7.29%	0.67%
Common Equity	40.40%	10.00%	4.04%
	-----		-----
Total	100.00%		8.60%
	=====		=====
<i>D. FEA Recommendation – Dr. Legler, Ex. 678, Sch. 24, Ex. T-677, pp. 11-13</i>			
	Ratio	Cost	Weighted Cost
	-----	-----	-----
Long-term Debt	45.81%	7.99%	3.66%
Short-term Debt	2.04%	4.63%	0.09%
Preferred Stock	8.15%	8.12%	0.66%
Common Equity	44.00%	11.25%	4.95%
	-----		-----
Total	100.00%		9.37%
	=====		=====
<i>E. WICFUR Recommendation – Dr. Peseau, Ex. T-809, p. 17</i>			
	Ratio	Cost	Weighted Cost
	-----	-----	-----
Long-term Debt	49.50%	7.91%	3.92%
Short-term Debt			
Preferred Stock	8.00%	8.10%	0.65%
Common Equity	42.50%	10.5-10.8%	4.46-4.59%
	-----		-----
Total	100.00%		9.03-9.16%
	=====		=====

PUGET SOUND POWER & LIGHT COMPANY – DOCKET NO. UE-921262
 STATEMENT OF OPERATING INCOME & RATE BASE ADJUSTMENTS
 FOR THE TEST YEAR ENDED JUNE 30, 1992

TABLE 2

		NET OPERATING INCOME *****			RATE BASE *****		
		Staff (a)	Company (b)	Difference (c) = (a) - (b)	Staff (d)	Company (e)	Difference (f) = (d) - (e)
Actual (Per Books)		\$211,474,422	\$211,474,422	\$0	\$1,976,593,766	\$1,976,593,766	\$0
<i>Effect of adjustment: (Contested-C, Uncontested-UC, Contested solely due to prod. factor diff. -CP)</i>							
UC 2.06	Deprec./Amortization	7,242,533	7,242,533	0	2,553,047	2,553,047	0
UC 2.17	Bad Debts	(307,290)	(307,290)	0	0	0	0
UC 2.18	Int. Cust. Dep.	(291,878)	(291,878)	0	0	0	0
UC 2.23	Pebble Springs	4,856,240	4,856,240	0	0	0	0
UC 2.25	OBC Lease Inc.	292,937	292,937	0	48,673	48,673	0
UC 2.27.a	Non-recur & Oper. Exp.a-Advertising	(18,815)	(18,815)	0	0	0	0
UC 2.27.c	Non-recur & Oper. Exp.c-N.Div. W-off	434,067	434,067	0	0	0	0
UC 2.27.d	Non-recur & Oper. Exp.d-Supl.Pension	298,093	298,093	0	(155,000)	(155,000)	0
UC 2.27.e	Non-recur & Oper. Exp.e-OH Lines	363,000	363,000	0	0	0	0
UC 2.27.f	Non-recur & Oper. Exp.f-PTO Adj.	58,252	58,252	0	0	0	0
UC 2.27.g	Non-recur & Oper. Exp.g-PCI	9,024	9,024	0	0	0	0
UC 2.27.h	Non-recur & Oper. Exp.h-Software Amort.	46,155	46,155	0	0	0	0
UC 2.27.i	Non-recur & Oper. Exp.i-Remove Oper Exp	16,500	16,500	0	0	0	0
UC 2.27.k	Non-recur & Oper. Exp.k-Idea\$ Plu\$	138,903	138,903	0	0	0	0
UC 3.01	WUTC Fee	(520,600)	(520,600)	0	0	0	0
UC 3.02	Property Taxes	(1,048,512)	(1,048,512)	0	0	0	0
UC 3.06	Federal Income Tax	(10,714,201)	(10,714,201)	0	0	0	0
UC 4.01	Company Car	88,661	88,661	0	0	0	0
UC 4.02	Skagit/Hanford	11,925	11,925	0	0	0	0
UC 4.06.b	Misc.Adj. b-Bank Fees	16,216	16,216	0	0	0	0
UC 4.06.d	Misc.Adj. d-Kirkland Project Center	135,705	135,705	0	0	0	0
UC 4.06.f	Misc.Adj. f-Executive Expenses	1,663	1,663	0	0	0	0
CP 2.05	Conservation	(7,704,875)	(8,142,402)	437,527	74,260,098	78,081,911	(3,821,813)
CP 4.04	Vegetation	3,425,985	3,332,252	93,733	0	0	0
CP 4.06.e	Misc.Adj. e-Tree trimming sales tax	(321,429)	(327,954)	6,525	0	0	0
C 2.01	General Revenues	(17,268,396)	44,728,226	(61,996,622)	0	0	0
C 2.02	Power Costs	(92,183,382)	(121,154,191)	28,990,809	0	0	0
C 2.03	Sale/resale sec.	7,796,183	9,820,972	(2,024,789)	0	0	0
C 2.04	Temp. Adj.	16,152,179	18,100,891	(1,948,712)	0	0	0
C 2.07	Property Sales	429,799	242,865	186,934	(1,025,408)	(1,025,408)	0
C 2.08	Storm Damage	(2,145,630)	(4,247,103)	2,101,473	0	0	0
C 2.09	Self Insurance	(238,024)	(531,460)	293,436	0	0	0
C 2.10	Environmental	1,033,957	(374,807)	1,408,764	0	0	0
C 2.11	Employee Ins	(611,136)	(637,485)	26,349	0	0	0
C 2.12	SFAS 106	(289,029)	(801,292)	532,263	0	897,750	(897,750)
C 2.13	Company Insurance	142,451	(3,470)	145,921	0	0	0
C 2.14	Wage & Sal(w/ retired officer adj.)	(1,112,187)	(2,802,117)	1,689,930	0	0	0
C 2.14a	Pay At Risk Bonus	0	(154,969)	154,969	0	0	0
C 2.15	Investment Plan	(79,723)	(93,878)	14,155	0	0	0
C 2.16	Retirement Plan	(1,516,658)	(2,195,954)	679,296	0	0	0
C 2.19	Creston	(309,924)	(786,928)	477,004	0	3,541,177	(3,541,177)
C 2.20/21/22	Stone Creek,Black Creek, Sm.Hydro	0	(203,135)	203,135	0	6,806,627	(6,806,627)
C 2.24	Working Capital	(250,020)	0	(250,020)	(8,185,876)	13,872,836	(22,058,712)
C 2.26	Rate Case Exp	41,870	(131,380)	173,250	0	0	0
C 2.27.b	Non-recur & Oper. Exp.b-Corp. Dues	261,386	108,047	153,339	0	0	0
C 2.27.j	Non-recur & Oper. Exp.j-Conservation Adv.	171,531	0	171,531	(2,057,367)	0	(2,057,367)
C 2.27.i	Non-recur & Oper. Exp.i-Colstrip Int.Inc.	(203,180)	(203,180)	0	(61,000)	272,503	(333,503)
C 2.28	Production Adj.	1,767,958	1,247,334	520,624	(39,966,932)	(28,408,047)	(11,558,885)
C 3.03	Montana Corp Tax	(143,110)	(152,271)	9,161	0	0	0
C 3.04	Pro Forma Int.	(6,950,412)	(7,716,824)	766,412	0	0	0
C 3.05	Montana Energy Tax	28,938	86,323	(57,385)	0	0	0
C 4.03	Corporate Publications	95,162	84,337	10,825	0	0	0
C 4.05	Future Use Plant	28,653	4,328	24,325	(4,129,038)	(994,882)	(3,134,156)
C 4.06.a	Misc. Adj. a-Public Utility Tax Credit	188,315	223,293	(34,978)	0	0	0
C 4.06.c	Misc.Adj. c-Vehicles-Other	202,136	202,136	0	(109,657)	0	(109,657)
C 4.06.g	Misc. Adj. g-Outside Services	58,151	0	58,151	0	0	0
C 4.06.h	Misc. Adj. h-Nintendo	80,234	0	80,234	0	0	0
C 4.06.i	Misc. Adj. i-Misc. General	20,790	0	20,790	0	0	0
C 4.06.j	Misc.Adj. j-OBC Relocation	72,011	0	72,011	0	0	0
SUB TOTAL ADJUSTMENTS		(98,180,849)	(71,371,219)	(26,809,630)	21,171,540	75,491,187	(54,319,647)
ADJUSTED TOTAL		\$113,293,573	\$140,103,203	(\$26,809,630)	\$1,997,765,306	\$2,052,084,953	(\$54,319,647)

TABLE 3.a

PUGET SOUND POWER & LIGHT COMPANY
 RESULTS OF OPERATIONS FOR
 RATEMAKING PURPOSES
 For The 12 Months Ended 6/30/92
 DOCKET NO. UE - 921262

LINE NO.	DESCRIPTION	ACTUAL RESULTS 1	GENERAL REVENUES 2.01	POWER COSTS 2.02	SALE/RESALE SECONDARY 2.03	TEMPERATURE ADJUSTMENT 2.04	CONSERVATION PROGRAM 2.05	DEPRECIATION AMORTIZATION 2.06	PROPERTY SALES 2.07	STORM DAMAGE 2.08	SELF INSURANCE 2.09	ENVIRONMENTL COSTS 2.10	EMPLOYEE INSURANCE 2.11
1	OPERATING REVENUES:												
2	SALES TO CUSTOMERS	937,995,509	(46,307,560)			25,584,834							
3	SALES FROM RESALE - FIRM	3,649,949											
4	SALES TO OTHER UTILITIES	26,051,646	11,907,854						636,478				
5	OTHER OPERATING REVENUES	16,996,717	(89,301)										
6	TOTAL OPERATING REVENUES	984,683,821	(46,307,560)	0	11,808,553	25,584,834	0	0	636,478	0	0	0	0
7	OPERATING REVENUE DEDUCTIONS:												
8	POWER COSTS:												
9	FUEL	47,731,940		(5,878,240)									
10	PURCHASED AND INTERCHANGED	266,936,331		87,777,869									
11	WHEELING	24,361,940		15,930,160									
12	SUBTOTAL	339,030,211	0	97,828,789	0	0	0	0	0	0	0	0	0
13	OTHER POWER SUPPLY EXPENSES	4,559,593		41,678,107								(189,950)	
14	TRANSMISSION EXPENSE	8,280,788		139,592									
15	DISTRIBUTION EXPENSE	45,969,228								3,250,954			
16	CUSTOMER ACCOUNTS EXPENSES	21,792,808	(144,570)			76,568							
17	CUSTOMER SERVICE EXPENSES	2,723,082											
18	CONSERVATION AMORTIZATION	17,356,224					8,106,566						
19	ADMIN & GENERAL EXPENSE	68,583,967	(89,369)			47,332							
20	DEPRECIATION/AMORTIZATION	99,807,823											
21	AMORTIZATION OF PROPERTY LOSS	19,590,348											
22	OTHER OPERATING EXPENSES	(100,978)											
23	TAXES OTHER THAN F.I.T.	90,081,596	(21,909,385)		(3,846)	987,935							
24	FEDERAL INCOME TAXES	53,565,500	(6,895,840)	(47,478,106)	4,016,216	8,320,820							
25	DEFERRED INCOME TAXES	1,949,419											
26	TOTAL OPERATING REV. DEDUCT.	773,209,399	(31,039,164)	92,163,382	4,012,370	9,432,655	7,704,875	(7,242,533)	206,679	2,145,630	238,024	(1,033,957)	611,136
27	NET OPERATING INCOME(NOI)	211,474,422	(17,268,396)	(92,163,382)	7,796,183	16,152,179	(7,704,875)	7,242,533	428,799	(2,145,630)	(238,024)	1,033,957	(611,136)
28	RATE BASE (RB)	1,976,593,766					74,260,098	2,553,047	(1,025,408)				
29	RATE OF RETURN	10.70%											
30	NOI IMPACT @ 95.5% PROD.FACTOR	211,474,422	(17,268,396)	(97,741,306)	11,340,228	16,152,179	(8,142,402)	7,242,533	428,799	(2,145,630)	(238,024)	1,033,957	(611,136)
31	RB IMPACT @ 95.5% PROD.FACTOR	1,976,593,766					78,081,911	2,553,047	(1,025,408)				

TABLE 3.b

PUGET SOUND POWER & LIGHT COMPANY
RESULTS OF OPERATIONS FOR
RATEMAKING PURPOSES
For The 12 Months Ended 6/30/92
DOCKET NO. UE-921282

LINE NO.	SEAS 106 2.12	COMPANY INSURANCE 2.13	WAGE AND SALARY 2.14	INVESTMENT PLAN 2.15	RETIREMENT PLAN 2.16	BAD DEBITS 2.17	INTEREST ON CUST. DEPOSITS 2.18	CRESTON 2.19	STONE, BLACK CREEK & SM. HY 2.20/2.21/2.22	PEBBLE SPRINGS 2.23	WORKING CAPITAL 2.24	OBC LEASE INCOME 2.25	RATE CASE EXPENSES 2.26	NON-RECURRING OPER. EXP. 2.27*	PRODUCTION ADJUSTMENT 2.28	
1																
2																
3																
4																
5																
6																
7												443,844		(307,849)		
8												443,844		(307,849)		
9																
10																
11																
12																
13																
14																
15																
16																
17																
18																
19																
20			293,018													
21			159,850													
22			1,288,047													
23			670,717													
24			70,049													
25			(1,297,274)	120,762	2,287,967											
26	407,619	(215,659)						469,203								
27																
28																
29																
30			300,725													
31	(138,590)	73,384	(572,949)	(41,069)	(781,309)	(142,109)	60,676	(158,279)				150,907	21,569	811,320	(745,482)	782,469
32																
33																
34	269,029	(142,451)	1,112,167	79,723	1,516,659	307,280	291,878	309,924	0	(4,856,240)	250,020	150,907	(41,870)	(1,882,794)	(1,767,959)	
35																
36	(269,029)	142,451	(1,112,167)	(79,723)	(1,516,659)	(307,280)	(291,878)	(309,924)	0	4,856,240	(250,020)	282,937	41,870	1,574,915	1,767,958	
37																
38																
39																
40																
41																
42	(269,029)	142,451	(1,112,167)	(79,723)	(1,516,659)	(307,280)	(291,878)	(309,924)	0	4,856,240	(250,020)	282,937	41,870	1,574,915	1,243,086	
43																
44																

*ADJ. 2.27 - NON-RECURRING & OPER. ADJ.:

REVENUE	EXPENSE	FIT	NET OPER. INC.	RATE BASE
2.27.a - Advertising	28,508	(9,693)	(18,815)	
2.27.b - Corp. Dues	(396,040)	134,654	261,386	
2.27.c - N.Division Write-offs	(657,677)	228,610	429,067	
2.27.d - Supplemental pension	(451,659)	133,363	299,089	
2.27.e - Overhead Lines	(950,000)	187,000	363,000	(155,000)
2.27.f - PTO Adjustment	(86,260)	30,008	56,252	
2.27.g - PCI	(13,672)	4,648	9,024	
2.27.h - Software Amortization	(69,932)	23,777	46,155	
2.27.i - Remove Oper. Expense	(25,000)	6,500	18,500	
2.27.j - Conservation Advertising	(259,899)	83,365	171,531	(2,057,367)
2.27.k - Ideas\$ PLUS	(210,459)	71,566	138,903	
2.27.l - Corstrip Interest Income	(307,849)	(104,669)	(203,180)	(61,000)
TOTAL NET ADJUSTMENT 2.27	(\$307,849)	\$811,320	\$1,574,915	(\$2,273,367)

TABLE 3.C

PUGET SOUND POWER & LIGHT COMPANY
 RESULTS OF OPERATIONS FOR
 RATEMAKING PURPOSES
 For The 12 Months Ended 6/30/92
 DOCKET NO. UE-921262

LINE NO.	WA UTILITY TAX&FILING FEE 3.01	PROPERTY TAXES 3.02	MONTANA CORP TAX BENEFIT ON LICENSE TAX 3.03	PRO FORMA INT ENERGY TAX 3.04	MONTANA ENERGY TAX 3.05	FEDERAL INCOME TAX 3.06	Company Car 4.01	Skagit/Hanford 4.02	Corporate Publications 4.03	Vegetation Management 4.04	Future Use Plant 4.05	Miscellaneous Adjustments 4.06*	SUBTOTAL ADJUSTMENTS	ADJUSTED YEAR ENDED 6/30/92
1														
2														
3														
4														
5														
6														
7														
8	0	0	0	0	0	0	0	0	0	0	0	0	(22,722,726)	915,262,783
9														3,649,949
10														37,959,500
11														11,907,854
12														37,959,500
13														17,669,889
14														17,669,889
15														17,669,889
16														17,669,889
17														17,669,889
18	0	0	0	0	0	0	0	0	0	0	0	0	(10,141,700)	974,542,121
19														
20														
21														
22														
23														
24														
25														
26	104,341													
27														
28														
29	684,447	1,588,655												
30	(268,186)	(540,143)	216,834	6,950,412	(43,845)	7,269,340	45,674	12,053	49,022	1,764,902	(49,414)	(285,326)	(19,252,702)	70,828,684
31			(73,724)		14,907	3,444,661					14,761	233,772	(91,167,444)	22,378,056
32														
33														
34	520,600	1,048,512	143,110	6,950,412	(28,938)	10,714,201	(88,661)	(11,925)	(95,162)	(3,425,985)	(28,653)	(453,792)	88,039,149	861,248,548
35														
36	(520,600)	(1,048,512)	(143,110)	(6,950,412)	28,938	(10,714,201)	88,661	11,925	95,162	3,425,985	28,653	453,792	(98,180,849)	113,293,573
37														
38														
39														
40														
41														
42	(520,600)	(1,048,512)	(118,096)	(6,744,003)	31,723	(10,714,201)	88,661	11,925	95,162	3,332,252	28,653	553,569	(100,936,667)	110,537,555
43														
44														

*ADJ. 4.06 - MISCELLANEOUS ADJUSTMENTS:

REVENUE	EXPENSE	FIT	NET OPER. INC.	RATE BASE
4.06a - Public Utility Tax Credit	(265,326)	97,011	188,315	
4.06b - Bank Fees	(24,570)	8,354	16,216	
4.06c - Vehicles - Other	(306,266)	104,130	202,136	
4.06d - Kirkland Project Center	(205,614)	69,909	135,705	
4.06e - Tree Trimming Sales Tax	487,014	(165,585)	(321,429)	
4.06f - Executive Expenses	(2,520)	857	1,663	
4.06g - Outside Services	(88,107)	29,956	58,151	
4.06h - Nintendo	(12,567)	41,333	80,234	
4.06i - Misc. General	(31,500)	10,710	20,790	
4.06j - OBC Relocation	(109,106)	37,097	72,011	
TOTAL NET ADJUSTMENT 4.06	\$0	\$233,772	\$453,792	(\$109,657)

PUGET SOUND POWER & LIGHT COMPANY
 CALCULATION OF AVERAGE INVESTOR SUPPLIED WORKING CAPITAL
 FOR THE TWELVE MONTHS ENDED JUNE 30, 1992
 DOCKET NO. UE-921262

TABLE 4

LINE NO.	DESCRIPTION (a)	Per Company Ex. 980 (b)	Staff Adjustments Ex. T-749, pp. 19-27 & Ex. 752 (c)	Per Staff (d) = (b) + (c)
1	AVERAGE INVESTED CAPITAL			
2	COMMON STOCK	555,616,470		555,616,470
3	PREFERRED STOCK	165,885,984		165,885,984
4	ADDITIONAL PAID IN CAPITAL	199,977,066		199,977,066
5	UNAMORTIZED DEBT EXPENSE	(7,821,844)		(7,821,844)
6	UNAPPROPRIATED RETAINED EARNINGS	209,679,669	A (8,610,811)	201,068,858
7	NOTES PAYABLE-MISC.	107,757		107,757
8	LONG TERM DEBT	1,093,276,054		1,093,276,054
9	SHORT TERM DEBT	84,886,950	B (9,470,462)	75,416,488
10	ACCUMULATED DEFERRED ITC	7,315,104		7,315,104
11	DEFERRED DEBITS-OTHER	(654,457)	G (3,345,268)	(3,999,725)
12	UNAMORT. GAIN/LOSS ON DEBT	(8,735,654)		(8,735,654)
13				
14	TOTAL AVERAGE INVESTED CAPITAL	2,299,533,099	(21,426,541)	2,278,106,558
15				
16	AVERAGE INVESTMENTS			
17	OPERATING:			
18	ELECTRIC PLANT IN SERVICE	2,716,469,013		2,716,469,013
19	FUTURE USE PROPERTY	15,198,916	E (4,129,038)	11,069,878
20	CUST. ADVANCES FOR CONSTRUCTION	(15,666,716)		(15,666,716)
21	CUSTOMER DEPOSITS	(5,786,337)		(5,786,337)
22	DEFERRED TAXES	(187,607,719)		(187,607,719)
23	DEFERRED DEBITS-OTHER	140,914,215	B (9,470,462)	131,443,753
24	LESS: ACCUMULATED DEPRECIATION	(818,616,489)	F (2,312,689)	(820,929,178)
25	COMPLETED CONSTRUCTION NOT CLASSIFIED	39,995,813		39,995,813
26	CONSERVATION INVESTMENT	156,261,242		156,261,242
27				
28	TOTAL AVERAGE OPERATING INVESTMENT	2,041,161,938	(15,912,189)	2,025,249,749
29				
30	NONOPERATING AND PLANT NOT IN SERVICE:			
31	NON UTILITY PROPERTY AT COST	1,411,577	E 4,129,038	5,540,615
32	INVESTMENT IN ASSOCIATED COMPANIES	54,495,586		54,495,586
33	OTHER INVESTMENTS	4,307,987	C 0	4,307,987
34	CWIP	83,251,103		83,251,103
35	OTHER WORK IN PROGRESS	897,279	D 1,188,141	2,085,420
36	DEFERRED DEBITS-OTHER	52,650,943		52,650,943
37	LESS: RELATED DEFERRED FIT	(15,065,335)		(15,065,335)
38	TEMPORARY CASH INVESTMENTS	29,650,730		29,650,730
39	PRELIMINARY SURVEYS	230,159		230,159
40				
41	TOTAL NONOPERATING INVESTMENTS	211,830,029	5,317,179	217,147,208
42				
43	TOTAL AVERAGE INVESTMENTS	2,252,991,967	(10,595,010)	2,242,396,957
44				
45	TOTAL INVESTOR SUPPLIED WORKING CAPITAL	46,541,132	(10,831,531)	35,709,601
46				
47				
48	TOTAL AVERAGE INVESTMENTS	2,252,991,967		2,242,396,957
49	LESS: CWIP	(83,251,103)		(83,251,103)
50	OTHER WORK IN PROGRESS	(897,279)		(2,085,420)
51	PRELIMINARY SURVEYS	(230,159)		(230,159)
52				
53	TOTAL	2,168,613,426		2,156,830,275
54				
55	WORKING CAPITAL %	2.15%		1.66%
56	NONOPERATING WORKING CAPITAL	2,740,207		2,184,237
57				
58	OPERATING WORKING CAPITAL	43,800,925		33,525,364
59				
60	WORKING CAPITAL INCLUDED IN RATEBASE AT 6/30/92	29,928,089		29,928,089
61				
62	ADJUSTMENT TO INVESTOR SUPPLIED WC ALLOWANCE	13,872,836		3,597,275
63	DIRECT RATE BASE ADJUSTMENTS			(11,783,151)
64	TOTAL ADJUSTMENTS			(8,185,876)

Individual Staff Adjustments:

	WORKING CAPITAL ADJUSTMENTS
A- Dividends Declared (A/C 238) - excluded from the invested capital	\$8,610,811
B- BPA Res. Cr (A/C 253.12) -excluded from invested capital	9,470,462
C -FIT-Puget Western (A/C 236.02) -Included in Co. Rebuttal(Col.b) -Uncontested	0
D- OWIP A/C 186.01 -Adjusted back to OWIP	1,188,141
E- PHFU - (A/C 105) - (Corrected to reflect reclass to non-util investment)	4,129,038
F- Depreciation Reserve (A/C 108) -Reclass to Working Cap-RB Reduction	2,312,689
G- Extraordinary Prop. (182.10/11) -Offsets to invested capital	3,345,268

Subtotal Direct Rate Base Adj.	(\$11,783,151)
ISWC Adjustment	3,597,275
Total Rate Base Adj. (Net) (ISWC ALLOW. + DIRECT RB ADJ.)	(\$8,185,876)
Net Oper. Income Adj. (BPA Int. Exp.)	(\$250,020)

PUGET SOUND POWER & LIGHT COMPANY — DOCKET NO. UE-921262
REVENUE REQUIREMENTS CALCULATION
FOR THE TEST YEAR ENDED JUNE 30, 1992

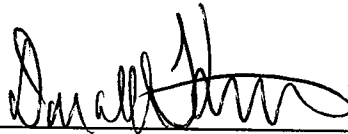
TABLE 5

Line No.				Staff (a)	Company (b)	Difference (c) = (a) - (b)
1	PRO FORMA RATE BASE			\$1,997,765,306	\$2,052,084,953	(\$54,319,647)
2	PROPOSED RATE OF RETURN			8.91%	9.82%	-0.91%
3	RETURN ON RATE BASE			178,000,889	201,514,742	(23,513,853)
4	PRE '91 CONSERVATION INVESTMENT - (Diff. due to prod.factor)	64,353,364	65,659,682			
5	ADDED RETURN ON CONSERVATION	0.82%	0.90%	527,698	590,937	(63,240)
6	OPERATING INCOME REQUIREMENT			178,528,586	202,105,679	(23,577,093)
7	PRO FORMA OPERATING INCOME			113,293,573	140,103,203	(26,809,630)
8	OPERATING INCOME DEFICIENCY			65,235,013	62,002,476	3,232,537
9	CONVERSION FACTOR			0.6313185	0.6313185	0
10	REVENUE REQUIREMENT DEFICIENCY			103,331,382	98,211,087	5,120,295
11	ASSIGNMENT TO FIRM WHOLESAL CLASS (STAFF PER EX.777, CO. PER EX.1017 METHODS)			(1,848,915)	(1,239,909)	(609,006)
12	PRAM OFFSET			(100,963,409)	0	(100,963,409)
13	RETURNED CHECK CHARGE PROPOSED INCREASE (EX.1019)			(36,689)	0	(36,689)
14	NET RETAIL RATE INCREASE/(DECREASE) *			\$482,369	\$96,971,178	(\$96,488,809)
15				=====		
16	* Staff's net retail increase would be \$7,079,707 if its proforma result of operations was prepared based on Puget's revised forecasted loads and production factor.					

C E R T I F I C A T E

I hereby certify that I have this day served a true copy of the foregoing document upon Charles F. Adams, Assistant Attorney General, Public Counsel Division, 900 Fourth Avenue, Suite 2000, Seattle, WA 98164-1012; James Van Nostrand, One Bellevue Center Suite 1800, 411 - 108th Avenue NE, Bellevue, WA 98004; David J. Meyer, 1200 Washington Trust Financial Center, 717 W. Sprague Avenue, Spokane, WA 99204; Mark P. Trincherro, Davis Wright Tremaine, 2300 First Interstate Tower, 1300 S.W. Fifth Avenue, Portland, OR 97201; Norman J. Furuta, Department of the Navy, 900 Commodore Drive, San Bruno, CA 94066; Carol S. Arnold, Preston Thorgrimson Shidler Gates & Ellis, 5400 Columbia Center, 701 Fifth Avenue, Seattle, WA 98104, James C. Paine, Stoel Rives Boley Jones & Grey, Suite 2300, 900 S.W. Fifth Avenue, Portland OR 97204; John Cameron, 222SW Columbia, Suite 1800, Portland OR 97201; Barry Bennett, P.O. Box 3621, 905 Northeast 11th, Portland, OR 97208-3621; and Linda K. Williams, 1744 N.E. Clackamas Street, Portland, OR 97232 in this proceeding by mailing a copy thereof properly addressed to each such party by first class mail, postage prepaid.

Dated this 13th day of August, 1993.



DONALD T. TROTTER
Counsel for Washington Utilities and
Transportation Commission