# Exhibit No. ___(JHS-1T)

## Revisions of July 19, 2004

**PUGET SOUND ENERGY, INC.**

**PREFILED DIRECT TESTIMONY OF JOHN H. STORY**

## I. INTRODUCTION

**Q. Please state your name, business address, and present position with Puget Sound Energy.**

A. My name is John H. Story. I am the Director of Cost and Regulation at Puget Sound Energy. My business address is 10885 N.E. Fourth Street, Bellevue, Washington, 98009.

**Q. Would you please provide a brief description of your educational and business experience?**

A. Please see Exhibit No.___ (JHS-2).

**Q. What topics are you covering in your testimony?**

A. I will present the calculation of the adjusted test period, ratebase, working capital, conversion factor and the overall revenue requirement for the electric results of operations. I will explain the various adjustments to the results of operations for the current test year and, after taking into account these adjustments, present the adjusted test period and the resultant revenue requirement. Based upon the adjusted test period revenues of $~~1,425,200,434~~ 1,414,825,578 for sales to customers, the total requested electric revenue increase is $~~81,446,431~~ 82,819,884 which is an average ~~5.71~~ 5.84%

A. The next adjustment is:

**General Revenues**

This is a restating and proforma adjustment, as shown on Exhibit No.___ (JHS-E3), page E3-A, column 2.02, which removes from operating revenues all rate schedules that are a direct pass through of specifically identified costs or credits to customers, such as municipal taxes, the conservation rider, low income program, and residential exchange. A proforma adjustment has been included that reflects the revenue that would have been collected during the test year if the PCORC revenues had been implemented at the beginning of the test period. For purposes of this general rate case filing, we have used the Company's rate increase as presented in the rebuttal testimony of the PCORC proceeding. We will correct this adjustment when the Commission Order in Docket No. UE-031725 is issued if the amount is different.

Net operating income is increased by $~~123,253,360~~ 116,819,939 as a result of these adjustments.

**Power Costs**

This schedule, shown on Exhibit No.___ (JHS-E3), page E3-A, column 2.03, adjusts the test year power cost to reflect the power cost resources that will be used during the rate year. The calculation of rate year normalized power cost is explained in Ms. Julia Ryan's testimony, Exhibit No.___ (JMR-1T), and is shown in Exhibit No.___ (JMR-10). This adjustment and the Sales for Resale-Secondary adjustment are calculated using 60-year water, for the reasons described in the testimony of Mr. Jeffrey Dubin, Exhibit No.___ (JAD-1T). As the last general rate case used 40-year water, a work paper showing the equivalent power costs has been provided to all parties.

Net operating income is decreased by $~~38,095,594~~ 32,191,708 by this adjustment.

**Q. Will you update the Power Cost Adjustment (PCA) baseline rate in this proceeding?**

A. Yes. The schedule shown on Exhibit No.___ (JHS-4) adjusts the PCA baseline rate to reflect the new Power Cost Baseline. The methodology applied is consistent with that set forth in the PCA Settlement Agreement, under Docket No. UE-011570, and the PCA Compliance Settlement Agreement, under Docket No. UE-031389.

**Q. Please continue describing the restating and proforma adjustments?**

A. The next adjustments are:

**Sales for resale-Secondary**

This adjustment, shown on Exhibit No.___ (JHS-E3), page E3-A, column 2.04, adjusts the revenue for Sales for Resale/Other Utilities and Wheeling for Others to the levels determined by Ms. Julia Ryan as shown on her proforma power cost schedule, Exhibit No.___ (JMR-10).

Net operating income is decreased $114,160,749 by this adjustment.

**Federal Income Taxes**

This schedule adjusts actual Federal Tax expense to the restated level based on the test year for this case. As our normal tax year ends December 31st, this adjustment recalculates the test year using expenses and a tax adjustment for the twelve months ended September 30, 2003 and removes the current tax year estimates from the test period.

The effect of this adjustment, shown on Exhibit No.___ (JHS-E3), page E3-A, column 2.05, is to decrease net operating income by $4,651,347.

**Tax Benefit of Proforma Interest**

This proforma adjustment, shown on Exhibit No.___ (JHS-E3), page E3-A, column 2.06, uses a ratebase method for calculating the tax benefit of proforma interest. As adopted by this Commission in prior rate cases, the customers receive the tax benefit associated with the interest on debt used to support ratebase and construction work in progress that has associated tax deductible interest. The effect of this adjustment is to decrease net operating income by $~~7,835,231~~ 7,809,142.

**Depreciation and Amortization**

Test year depreciation has been restated based on the Average of Monthly Averages using the rates from the depreciation study performed in 2001 and applied in the Company's last general rate case Docket Nos. UE-011570 and

No. UE-011571. An adjustment to annualize the amortization of WUTC authorized AFUDC has also been made.

This restating and proforma adjustment, shown on Exhibit No.___ (JHS-E3), page E3-A, column 2.07, decreases net operating income by $~~149,619~~ 97,252 and decreases ratebase by $74,810.

**Conservation**

This restating and proforma adjustment, shown on Exhibit No.___ (JHS-E3), page E3-B, column 2.08, removes the amortization associated with the conservation rider. A proforma adjustment removes amortization related to the 1995 Conservation Trust as the Trust will be fully amortized by the rate year, and the ratebase has been reduced accordingly. A proforma adjustment has been made to remove the affect of one time credits that represent refunds to customers, related to various transactions that were processed through the conservation rider.

The effect of this adjustment is to increase net operating income by $26,189,031, and decrease ratebase by $11,569,864.

**Bad Debts**

This restating adjustment calculates the bad debt rate by using the actual amounts from the test year, consistent with prior rate cases. The bad debt percentage for the rate year is calculated by taking the actual write-offs for the test year and dividing them by the net revenues for the test year. The net revenues from line 1 to increase ratebase by $1,711,055.

**Property Taxes**

This proforma adjustment, shown Exhibit No.___ (JHS-E3), page E3-B, column 2.11, reflects the estimated property tax levy rates to be paid in 2004 based upon 2003 value. These rates will be adjusted to actual during the course of this proceeding.

The effect of this adjustment is to lower net operating income by $2,496,853.

**White River Licensing**

This proforma adjustment, shown on ~~shown~~ Exhibit No.___ (JHS-E3), page E3-B, column 2.12, adds to ratebase the Company's Licensing, and other costs deferred in accordance with the Company's Accounting Petition filed in December 2003, Docket No. UE-032043. Included in this amount are Licensing charges of $15,201,438, costs related to water rights acquisition of $2,585,017, and other safety and regulatory costs of $2,758,997. Amortization of the total amount of $20,545,452, over a 10-year period, is also reflected in this adjustment. As discussed by Mr. Eric Markell, Exhibit No.___ (EMM-1CT), the customers have received the benefit of these expenditures as the Company was able to keep the plant in operation during the 1983 through 2003 time period that the license process and subsequent appeal were underway, thereby avoiding higher cost market power during that time period. Since the beginning of the licensing process, these costs had been included in construction work in progress in compliance with FERC accounting requirements. When the FERC license requirements were not accepted by the Company, these costs were moved to Deferred Debits per the Accounting Petition in Docket No. UE-032043. As proposed in the Accounting Petition, the Company is now requesting recovery of these costs by recording the costs in Account 182 and including the average balance of these costs in ratebase for the rate period. The Company continues to operate the diversion dam in accordance with an agreement with the Army Corp of Engineers, and expects to invoice the Corp for the related operating costs incurred.

The effect of this adjustment is to decrease operating income by $~~1,335,454~~ 1,408,735 and increase ratebase by $~~19,518,180~~ 21,455,442.

**Filing Fee**

This restating adjustment, shown on Exhibit No.___ (JHS-E3), page E3-B, column 2.13, adjusts the test year estimates to actual expense for the Washington filing fee.

The effect of this adjustment is to decrease net operating income by $~~143,941~~ 143,538.

**Director and Officer Insurance**

This restating adjustment, shown on Exhibit No.___ (JHS-E3), page E3-B, column 2.14, removes the portion of Director and Officer insurance that should be allocated to Company subsidiaries. The amount is determined by dividing nonutility assets by Puget Sound Energy, Inc. assets and applying that percentage to this insurance cost.

The effect of this adjustment is to increase net operating income by $~~26,853~~ 5,175.

**Montana Energy Tax**

This restating adjustment, shown on Exhibit No.___ (JHS-E3), page E3-B, column 2.15, adjusts the test year amount of this tax to the amount that would be incurred during the rate year based on the power generated as reflected in the power cost adjustment.

The effect of this adjustment is to decrease net operating income by $107,939.

**Interest on Customer Deposits**

This proforma adjustment to operating income is the result of customer deposits being treated as a reduction to ratebase. This proforma adjustment adds the cost of interest for this item to operating expense. This presentation is consistent with decisions in prior general rate cases, and as shown on Exhibit No.___ (JHS-E3), page E3-C, column 2.16, reduces net operating income by $151,631.

**SFAS 133**

This restating adjustment, shown on Exhibit No.___ (JHS-E3), page E3-C, column 2.17, removes the effect of SFAS 133, which represents gains or losses recognized for derivative transactions but is not considered for rate making

This proforma adjustment, shown on Exhibit No.___ (JHS-E3), page E3-D, column 2.25, adjusts this tax to the current taxable income computed in the proforma income tax adjustment. This Corporate License Tax is based upon Federal taxable income.

The effect of this adjustment is to decrease net operating income by $~~1,274,583~~ 1,274,436.

**Storm Damage**

This proforma adjustment, shown on Exhibit No.___ (JHS-E3), page E3-D, column 2.26, reflects the difference between the test year expense level of "normal" storms to that of the six-year average. The six-year average is used to determine the annual expense allowed for ratemaking purposes. Also, deferred balances related to catastrophic storms are amortized over three years. This adjustment would not be impacted for this proceeding by the proposal presented by Ms. Susan McLain to change this category of adjustment to catastrophic events as described in Exhibit No.___ (SML-1CT).

The effect of this adjustment is to increase net operating income by $366,405.

**Frederickson Plant**

This proforma adjustment, shown on Exhibit No.___ (JHS-E3), page E3-D, column 2.27, reflects the inclusion of the Company's investment in and operating costs of the Frederickson 1 Generating Plant. This amount is the same amount proposed by the Company and Commission Staff in the PCORC hearings, adjusted to reflect the average amount that would be in ratebase for the rate year in this proceeding. This adjustment will be trued up to projected costs based on the actual recording of this plant addition once the various regulatory approvals are received and the transaction closes.

The effect of this adjustment is to decrease net operating income by $~~2,665,480~~ 2,684,243 and increase ratebase by $~~74,634,936~~ 75,444,529.

**Low Income Amortization**

This proforma adjustment, shown on Exhibit No.___ (JHS-E3), page E3-D, column 2.28, removes amortization of the Company's Low Income Program. Such costs are recovered through a rider outside of general rates.

The effect of this adjustment is to increase net operating income by $3,801,853.

**Regulatory Assets**

This proforma adjustment, shown on Exhibit No.___ (JHS-E3), page E3-D, column 2.29, adjusts the regulatory assets (Tenaska, Cabot, and BEP), net of deferred federal income taxes to their projected rate year AMA balances.

The effect of this adjustment is to decrease ratebase by $~~45,394,988~~ 46,237,863.

**Production Adjustment**

This proforma adjustment, shown on Exhibit No.___ (JHS-E3), page E3-D, column 2.30, decreases production related ratebase and certain production expenses by the same production factor which was used by Energy Supply Planning for calculating power costs. The production factor used in this calculation is the ratio of the test period normalized delivered load to the rate year delivered load which is 98.719%. This equates to the 1.281% reduction applied to these various power related costs.

Net operating income is increased by $~~578,628~~ <u>564,399</u> and ratebase is decreased by $~~10,215,426~~ <u>10,173,212</u> as the result of this adjustment.

**<u>Working Capital</u>**

The purpose of this calculation is to provide a return for the funds the shareholder has invested in the Company, for utility purposes, over and above the investment in plant and other specifically identified ratebase items already earning a rate of return.

The first part of this adjustment calculates the total average invested capital that has been utilized during the test year. From the average invested capital, the operating investment, which is already earning a return, is deducted. A second deduction is made for nonoperating assets and plant not in service. The result is total working capital provided by the shareholder.

This total working capital is then allocated between nonoperating working capital and operating working capital using the method consistent with previous rate cases. The resulting operating working capital represents the shareholder's average investment which is required to provide utility service but which would

This schedule, shown on Exhibit No.___ (JHS-E3), page 4.05, is a summary of proforma and restated ratebase and net operating income. Based on $~~2,658,121,651~~ 2,660,067,846 invested in ratebase and $~~191,820,286~~ 191,241,809 of net operating income, before deduction of the residential and farm exchange credit shown separately on Residential Exchange Schedules, the Company would have a retail revenue deficiency of $~~81,600,769~~ 82,819,884 before allocation of $~~154,338~~ 157,790 to wholesale customers.

## III. ADJUSTMENTS TO THE POWER COST BASELINE RATE

**Q. Please define the term Power Cost Baseline Rate.**

A. In PSE's last general rate case, the Commission approved the parties' Settlement Stipulation for Electric and Common Issues ("Settlement Stipulation"). *See* Docket Nos. UE-011570 and UG-011571, Twelfth Supplemental Order (June 20, 2002) ("Twelfth Supplemental Order"). Among other things, the Twelfth Supplemental Order authorized the use of a Power Cost Adjustment (PCA) Mechanism as a method for adjusting PSE's power costs. The Commission subsequently approved substitution of certain revised exhibit pages to the PCA Mechanism in its Fifteenth Supplemental Order, Docket Nos. UE-011570 and UG-011571, (May 13, 2003) ("Fifteenth Supplemental Order"). A copy of the approved Settlement Terms for the Power Cost Adjustment Mechanism, Exhibit A to Settlement Stipulation, as revised, is provided in Exhibit No.___ (JHS-5).

The PCA Mechanism sets forth an annual accounting process for a sharing of costs and benefits between PSE and its customers over four graduated levels (so-