

EXHIBIT NO. _____ (KRK-1ET)
DOCKET NO. _____
2001 PSE RATE CASE
WITNESS: KARL R. KARZMAR

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY, INC.

Respondent.

DIRECT TESTIMONY OF KARL R. KARZMAR
ON BEHALF OF PUGET SOUND ENERGY, INC.

NOVEMBER 26, 2001

1 **PUGET SOUND ENERGY, INC.**

2 **DIRECT TESTIMONY OF KARL R. KARZMAR**

3
4 **Q: Please state your name, business address, and present position with Puget Sound Energy.**

5 A: My name is Karl R. Karzmar and I am the Manager of Revenue Requirements at
6 Puget Sound Energy. My business address is 411 108th Avenue NE, Bellevue,
7 Washington 98009-9734.

8 **Q: What topics will you be covering in your testimony?**

9 A: In this portion of my testimony, I will present the calculation of rate base, working
10 capital, conversion factor and the overall revenue requirement for the electric
11 results of operations. I will also explain some of the various adjustments to the
12 results of operations for the current test period and, after taking into account these
13 adjustments, present the revenue requirement. The requested revenues to the
14 Company from retail customers is \$1,516,457,647 for the test year with the
15 proposed rate increase. The rates proposed in Mr. Heidell's testimony reflect that
16 revenue requirement. The adjusted test year revenues are \$1,288,235,372, as
17 shown on Exhibit KRK-E3, Summary page, before deduction of the residential
18 and farm exchange credit shown as a separate item on Schedules 7, 307, 8, 11, 10,
19 12, 29, 35, 56, 59 and 194 (the "Residential Exchange Schedules").

20
21 Based upon the adjusted test year revenues of \$1,288,235,372 before
22 deduction of the residential and farm exchange credit shown as a separate item on
23 the Residential Exchange Schedules, the total requested revenue change to the
24 Company in dollars is \$228,222,275.

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

26 A: Please see Exhibit KRK-E2.

1 Q: **Please explain your Exhibit KRK-E3.**

2 A: The first page of this exhibit, Summary page, presents the unadjusted rate base for
3 the Company as of June 30, 2001 calculated on an Average-of-the-Monthly-
4 Averages basis. The rest of the exhibit is composed of two sections.

5 Pages E3-A through E3-D present a summary schedule of all the pro forma
6 and restating adjustments. The first column of numbers, on page E3-A, is the
7 unadjusted net operating income for the year ended June 30, 2001 and the
8 unadjusted rate base for the same period. Each column to the right of the first
9 column represents a pro forma or restating adjustment to net operating income or
10 rate base. Each of these adjustments has a supporting schedule, which is
11 referenced by the page number shown in each column title.

12 Pages 2.01 through 2.27 are the supporting schedules for each of the
13 adjustments shown on the summary schedule.

14 The last column, shown on page E3-D of the summary schedule,
15 summarizes all of the adjustments and is the adjusted test year results used to
16 calculate the revenue deficiency.

17 Q: **Please describe each adjustment, explain why it is necessary, and identify the**
18 **effect on operating income or rate base.**

19 A: I will explain the adjustments generally in the order as they are shown on the
20 summary schedule.

21 **General Revenues**

22 This is a restating and pro forma adjustment, as shown on Exhibit
23 KRK-E3, page E3-A, column 2.01, which removes from operating revenues all
24 rate schedules that are a direct pass through of specifically identified costs or
25 credits to specifically identified customers, such as municipal taxes, the
26 conservation rider, and residential exchange. A pro forma adjustment has been

1 included that reflects the revenue that would have been collected during the test
2 year if the approved tariffs had been implemented at the beginning of the test
3 period. This adjustment includes the effect of the settlement related to index
4 customers (Rate Schedule 48 and certain special contracts) as well as the January
5 1, 2001 rate change. This adjustment also pro forms revenue to a level, which
6 would have occurred, had the temperatures during the test year been average, or
7 normal. Mr. William A. Gaines has provided the actual and temperature adjusted
8 Generated, Purchased and Interchanged (GPI) megawatts for the test period. The
9 difference between the actual GPI and temperature adjusted GPI is adjusted for
10 system losses and then totaled into winter and summer load. To determine the
11 impact on revenues, the winter and summer totals are priced based on the seasonal
12 end block residential rate. Pro forma adjustments have also been made to reflect
13 known changes in revenue to be expected within the rate year.

14 Net operating income is decreased by \$145,269,602 as a result of this
15 adjustment.

16 **Power Costs**

17 This schedule, shown on Exhibit KRK-E3, page E3-A, column 2.02,
18 adjusts the test year power cost to reflect the power cost resources that will be
19 used during the rate year. The calculation is explained in Mr. W.A. Gaines'
20 testimony, and is shown in Exhibit WAG-1.

21 Net operating income is increased by \$1,139,126,295 by this adjustment.

22 **Q: Will you be proposing a power cost tracker in this case?**

23 A: Yes. I will describe the accounting related to the power cost tracker that is
24 discussed in detail in Mr. James A. Heidell's testimony.

25 The elements and the appropriate accounting for each element follow:
26

1 **Deferral and Scope of Power Costs So Deferred**

2 The Company will set power cost rates based on a forecasted amount and
3 defer the difference between actual tracked variable power costs and such rates.
4 The deferral will be recorded on a monthly basis in FERC Account 182.3, Other
5 regulatory assets or Account 254, Other regulatory credits depending on whether
6 the month end balance is a debit or credit respectively.

7 **Recovery Through a Tariff Rider**

8 The net amount of the forecasted variable power costs for the following
9 month along with the deferred balance at the end of the prior month, would be
10 recovered from customers through a rider, Schedule 123, and amortized over the
11 following month. Amounts deferred would be amortized to FERC Account
12 407.3, Regulatory debits or 407.4, Regulatory credits as they are recovered by the
13 Company from the customer. The rider would be reviewed and adjusted each
14 month based on the prior months deferral balance and projected variable power
15 costs for the next month. Exhibit JAH-2 reflects the calculation in the
16 determination of the monthly power cost rate.

17 **Interest Accrual**

18 The Company proposes to accrue interest on any deferred balance (debit or
19 credit) at the interest rate applicable to customer deposits. Any interest accrued
20 will be recorded in the FERC Account established for the deferral though
21 separately identifiable by "order number" on the Company's accounting system.

22 **Reporting**

23 The Company will submit a report to the Commission within thirty days
24 after the end of each month showing the rates for the following month. The
25 Company will provide work papers showing the activity in its deferred power cost
26

1 accounts and calculations of the per-unit charge using account balances and
2 forecasted volumes.

3 **Q: Will you please continue describing the restating and pro forma**
4 **adjustments?**

5 A: Yes.

6 **Sales for resale-Secondary**

7 This adjustment, shown on Exhibit KRK-E3, page E3-A, column 2.03,
8 adjusts the revenue for Sales for Resale/Other Utilities and Wheeling for Others to
9 the levels determined by Mr. W.A. Gaines as shown on his pro forma power cost
10 schedule.

11 Net operating income is decreased \$1,121,750,845 by this adjustment.

12 **Federal Income Taxes**

13 This schedule adjusts actual Federal Tax expense to the restated level
14 based on the test year for this case. As our normal tax year ends December 31st,
15 this adjustment recalculates the test year using expenses and tax adjustments for
16 the twelve months ended June 30, 2001 and removes the current tax year
17 estimates from the test period.

18 The effect of this adjustment, shown on Exhibit KRK-E3, page E3-A,
19 column 2.04, is to increase net operating income by \$172,069.

20 **Tax Benefit of Pro Forma Interest**

21 This pro forma adjustment, shown on Exhibit KRK-E3, page E3-A,
22 column 2.05, uses a rate base method for calculating the tax benefit of pro forma
23 interest. As adopted by this Commission in prior rate cases, the customers receive
24 the tax benefit associated with the interest on debt used to support rate base and
25 construction work in progress that has associated tax deductible interest. Interest
26

1 related to the 1997 Conservation Trust has been restated to reflect the
2 extinguishment of the Trust.

3 The effect of this adjustment is to decrease net operating income by
4 \$11,137,590.

5 **SFAS 106**

6 The purpose of this pro forma adjustment, shown on Exhibit KRK-E3,
7 page E3-B, column 2.13, is to reflect the ten percent increase in other post
8 employment benefit expense, other than pensions, that is expected in the rate year.
9 This adjustment will be updated during the course of the proceeding.

10 The effect of this adjustment is to reduce net operating income by \$66,169.

11 **Montana Energy Tax**

12 This restating adjustment, shown on Exhibit KRK-E3, page E3-C, column
13 2.15, adjusts the test year amount of this tax to the amount that would be incurred
14 based on the power cost adjustment.

15 The effect of this adjustment is to decrease net operating income by
16 \$123,049.

17 **SFAS 133**

18 This restating adjustment, shown on Exhibit KRK-E3, page E3-C, column
19 2.16, removes the effect of SFAS 133 which represents gains or losses recognized
20 which have not been realized for financial reporting purposes.

21 The effect of this adjustment is to decrease net operating income by
22 \$23,534,337.

23 **Production Adjustment**

24 This pro forma adjustment, shown on Exhibit KRK-E3, page E3-C,
25 column 2.21, decreases production related rate base and certain production
26

1 expenses by the same production factor which was used by Energy Supply
2 Planning for calculating power costs.

3 Net operating income is increased by \$1,171,560 and rate base is
4 decreased by \$23,461,839 as the result of this adjustment.

5 **Montana Corporate License Tax**

6 This pro forma adjustment, shown on Exhibit KRK-E3, page E3-D,
7 column 2.22, adjusts this tax to the current taxable income computed in the pro
8 forma income tax adjustment. This Corporate License Tax is based upon Federal
9 taxable income.

10 The effect of this adjustment is to decrease net operating income by
11 \$426,541.

12 **Working Capital**

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

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

22 This total working capital is then allocated between nonoperating working
23 capital and operating working capital using the method consistent with previous
24 rate cases. The resulting operating working capital represents the shareholder's
25 average investment which is required to provide utility service but which would
26 otherwise not earn a return.

1 This pro forma adjustment, shown on Exhibit KRK-E3, page 4.01,
2 increases rate base by \$47,176,662.

3 **Cost of Capital**

4 This schedule, shown on Exhibit KRK-E3, page 4.02, reflects the
5 projected capital structure for the Company during the rate year and the associated
6 costs for each capital category. The capital structure and costs are presented in the
7 testimony of Mr. D.E. Gaines' and Dr. Hadaway. The rate of return is 10.47%.

8 **Conversion Factor**

9 The conversion factor, shown on Exhibit KRK-E3, page 4.03, is used to
10 adjust the net operating income deficiency by revenue sensitive items and Federal
11 income tax to determine the total revenue requirement. The revenue sensitive
12 items are the Washington State utility tax, Washington WUTC filing fee and bad
13 debts. The conversion factor used in the revenue requirement calculation, taking
14 into consideration the adjustments discussed earlier, is 62.09019%.

15 **Allocation Methods**

16 Common Utility Plant is that portion of utility operating plant that is used
17 for providing more than one commodity, i.e., electricity and gas to customers.
18 Thus, common plant includes costs associated with land, structures, and
19 equipment which are not charged specifically to electric or gas operations because
20 the assets are used jointly by both departments. The Company allocates its
21 common utility plant in determining rate base by using the four-factor allocation
22 method as authorized in the merger stipulation. Components of the four-factor
23 allocator include the number of customers, direct labor charged to O & M,
24 Transmission and Distribution O & M, and net classified plant (excluding general
25 plant).
26

1 Common operating costs are those costs that are incurred on behalf of both
2 electricity and gas customers. The Company incurs common costs related to:
3 Customer Accounts Expenses; Customer Service Expenses; Administrative and
4 General Expense; Depreciation/Amortization; Taxes Other Than FIT; and FIT.
5 The most appropriate allocation method is applied consistently to each type of
6 common cost. Allocation methods used include: (1) twelve month customer
7 average; (2) joint meter reading customers; (3) non-production plant; (4) four
8 factor allocator; (5) direct labor; (6) current tax.

9 For purposes of calculating the working capital allowance, the Company
10 applies the most appropriate of the allocation methods to each common balance
11 sheet accounts.

12 Allocation methods used and the calculations thereof are shown on Exhibit
13 KRK-E3, page 4.04.

14 **General Rate Increase**

15 This schedule, shown on Exhibit KRK-E3, page 4.05, is a summary of pro
16 forma and restated rate base and net operating income. Based on \$2,662,676,447
17 invested in rate base and \$136,999,433 of net operating income, before deduction
18 of the residential and farm exchange credit shown separately on Residential
19 Exchange Schedules, the Company would have a retail revenue deficiency of
20 \$228,222,275.

21 **Q: Does this conclude this portion of your testimony?**

22 A: Yes.

23
24
25 [BA013250002]
26

EXHIBIT NO. _____ (KRK-E2)
DOCKET NO. _____
2001 PSE RATE CASE
WITNESS: KARL R. KARZMAR

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.

Respondent.

**PROFESSIONAL QUALIFICATIONS OF KARL R. KARZMAR
ON BEHALF OF PUGET SOUND ENERGY, INC.**

1 **PUGET SOUND ENERGY, INC.**

2 **PROFESSIONAL QUALIFICATIONS OF KARL R. KARZMAR**

3
4 **Q: Please state your name, business address, and occupation.**

5 A: My name is Karl R. Karzmar. My business address is 411 108th Ave N.E.,
6 OBC-03W, Bellevue, WA 98004-5515. I am employed as Manager, Revenue
7 Requirements of Puget Sound Energy ("the Company").

8 **Q: What are your qualifications?**

9 A: I have more than twenty-five years inter-disciplinary utility experience in financial
10 management and reporting, including extensive regulatory accounting study and
11 experience. Special study included completion of the Stone & Webster Utility
12 Management Development Course.

13 **Q: What is your educational background?**

14 A: BA Accounting / Business, University of Washington, Seattle, WA.

15 **Q: Have you testified previously before the Commission?**

16 A: Yes. I have provided testimony and or testified on behalf of the Company in six
17 previous general rate filings: Combined Causes U-82-22/37, Cause No. U-83-27,
18 Cause No. U-84-60, Docket No., UG-920840, Docket No. UG-931405 and
19 Docket No. UG-950278. I also testified before this Commission in Docket
20 No. UE-991409.

21 **Q: What are your responsibilities in your present position?**

22 A: I am responsible for evaluating the financial statements of Puget Sound Energy in
23 order to prepare internal and WUTC compliance reports and revenue requirements
24 determination.

EXHIBIT NO. _____ (KRK-E3)
DOCKET NO. _____
2001 PSE RATE CASE
WITNESS: KARL R. KARZMAR

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
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Complainant,

v.

PUGET SOUND ENERGY, INC.

Respondent.

**EXHIBIT TO DIRECT TESTIMONY OF KARL R. KARZMAR
ON BEHALF OF PUGET SOUND ENERGY, INC.**

EXHIBIT NO. _____ (KRK-E4)
DOCKET NO. _____
2001 PSE RATE CASE
WITNESS: KARL R. KARZMAR

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

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PUGET SOUND ENERGY, INC.

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**EXHIBIT TO DIRECT TESTIMONY OF KARL R. KARZMAR
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