

**EXHIBIT NO. \_\_\_(DDW-1T)  
DOCKET NO. UE-04\_\_\_\_  
2004 PSE PCA 2 COMPLIANCE  
WITNESS: DURGA D. WAITE**

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**In the Matter of the Petition of  
PUGET SOUND ENERGY, INC.  
For Approval of its 2004 Power Cost Adjustment  
Mechanism Report**

**Docket No. UE-04\_\_\_\_**

**PREFILED DIRECT TESTIMONY OF  
DURGA D. WAITE (NONCONFIDENTIAL)  
ON BEHALF OF PUGET SOUND ENERGY, INC.**

**AUGUST 31, 2004**

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**PUGET SOUND ENERGY, INC.**

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**PREFILED DIRECT TESTIMONY OF DURGA WAITE**

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1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED DIRECT TESTIMONY OF DURGA D. WAITE**

3 **I. INTRODUCTION**

4 **Q. Please state your name, business address and present position.**

5 A. My name is Durga Doraisamy Waite. My business address is 10885 N.E. Fourth  
6 Street, P.O. Box 97034, Bellevue, Washington 98009-9734. I am the Director of  
7 Investor Relations for Puget Energy, Inc. ("Puget Energy" or "the Company").

8 **Q. What is your educational and professional experience?**

9 A. Exhibit No. \_\_\_(DDW-2) describes my educational and professional experience.

10 **Q. What are your duties as Director of Investor Relations for Puget Energy?**

11 A. I am the Company's primary liaison with the investment community. I am  
12 responsible for ensuring regular, effective and prompt communication of all  
13 information having an effect on the Company's debt and equity securities to those  
14 holding and evaluating those securities. This includes: maintaining a regular  
15 program of disclosure in addition to the management of investor/Company  
16 relationships through daily contact with individual shareholders, bondholders,  
17 brokers, analysts, institutional investors and bond rating agencies.

18 **Q. Please summarize your testimony.**

19 A. Applicable accounting rules required the Company to recognize a reduction in  
20 earnings for PCA Period 2 related to the benchmark methodology for calculating

1 future Tenaska disallowances established in Orders Nos. 14 and 15 in Docket  
2 No. UE-031725, PSE's power cost only rate case ("PCORC"). However, PSE will  
3 be able to reverse the earnings reduction it recognized if the Commission  
4 determines in this proceeding that the Tenaska benchmark disallowance for future  
5 PCA periods should not be applied to the 10 plus months of the PCA Period 2 that  
6 had already passed by the time the Commission issued Order No. 14 in the  
7 PCORC case on May 13, 2004.

8 PSE would welcome such a determination because of the reaction of institutional  
9 investors to the recent Tenaska orders. In the eyes of these investors, the recent  
10 Tenaska Orders have increased the complexity of the Company as an investment  
11 proposition, reduced earnings visibility and increased regulatory risk.

12 **II. PSE HAS RECOGNIZED A REDUCTION IN EARNINGS**  
13 **FOR PCA PERIOD 2 FOR ACCOUNTING PURPOSES, BUT**  
14 **COULD REVERSE THAT REDUCTION IF THE COMMISSION**  
15 **GRANTS PSE'S PETITION**

16 **Q. Why did the Company recognize a reduction in earnings for PCA Period 2**  
17 **when PCORC Order No. 15 left open the question of whether any**  
18 **disallowance would be imposed?**

19 A. The Company felt it had to recognize a reduction in earnings of \$10.8 million  
20 pretax or \$0.07 per diluted share for the first 10 plus months of the PCA 2 Period.  
21 For the Company to recognize earnings for a regulatory asset it has to be "highly  
22 likely" that the revenues will be recoverable.

23 The Tenaska Orders left open the question as to how the recovery of the return on

1 Tenaska would be dealt with during PCA Period 2 up to the time the Commission  
2 issued Order No. 14. However, cost information that the Company had available  
3 to it at the time of the Tenaska Orders indicated that if the Commission were to  
4 use the methodology adopted in Order No. 14, a portion of the return on Tenaska  
5 would be disallowed for PCA Period 2 under the methodology established for  
6 PCA periods beginning in May 2004 (basically the last month of PCA Period 2  
7 and beyond).

8 As described in Ms. Luscier's testimony, Exhibit No. \_\_\_(BAL-1T), financial  
9 recognition of this potential disallowance was appropriate under applicable  
10 accounting standards since the Company could not state with a high level of  
11 confidence, in advance of the PCA Period 2 compliance Order, that the  
12 Commission would *not* apply the benchmark methodology established for future  
13 PCA periods to PCA Period 2.

14 **Q. Does this mean it is a foregone conclusion that the Commission should**  
15 **disallow the \$10.8 million in this PCA Period 2 compliance filing?**

16 A. No. If the Commission orders in this proceeding that the Company can recover  
17 its full return on Tenaska for PCA Period 2 prior to the May 24, 2004  
18 implementation of PCORC Order No. 14, then the Company would reverse the  
19 earnings reduction already recognized for this period. Conversely, if the  
20 Commission were to order that the Company is not to recover any of the return on  
21 the Tenaska investment during PCA Period 2, there would be an additional  
22 \$10.8 million pretax write-off associated with this period.

1           **III. THE TENASKA DISALLOWANCES HAVE RESULTED IN**  
2           **SIGNIFICANT INVESTOR CONCERNS REGARDING**  
3           **PUGET ENERGY**

4   **Q. How have investors reacted to PCORC Orders No. 14 and 15?**

5   A. Some investors have indicated that the Tenaska Orders reduce Puget Energy's  
6       earnings visibility, making it more challenging for them to project the Company's  
7       earnings not just for the current year but, for future periods through the term of  
8       the contract which expires in 2011. Typical of this sentiment is the Merrill Lynch  
9       report on Puget Energy "At Least Its Over With" (dated June 16, 2004), which is  
10      provided with my testimony as Exhibit No. \_\_\_\_ (DDW-3).

11       As illustrated by the excerpt quoted below, some investors are concerned that  
12       PSE's other state regulatory filings will receive unfavorable regulatory treatment  
13       as well, and question whether PSE will be given a fair chance to earn its  
14       authorized rate of return:

15               On the regulatory front progress has been slow as the Company  
16               and its investors continue to be penalized by regulators for  
17               decisions made by previous management as much as 13 years ago.  
18               We believe that with regulatory uncertainty and little room for  
19               dividend growth in the next 18 months, near-term appreciation  
20               potential seems limited. Primary risks surrounding the stock  
21               include adverse regulatory rate case developments and rising third-  
22               party energy prices. While the PCA mechanism should allow the  
23               Company to pass most of these costs to the customer, the  
24               mechanism must be renewed in 2006, creating more regulatory risk  
25               that it will be changed at some point in the future.

26       Ragen Mackenzie report on "Highlights of the 2004 Investment Conference"  
27       (dated May 20, 2004) copy provided as Exhibit No. \_\_\_\_ (DDW-4).

1 **Q. Has the valuation of the Company been reduced as a result of the impact of**  
2 **the Tenaska Orders on PSE's earnings?**

3 A. Yes. Some investors reduced their valuation of the Company by reducing their  
4 target stock price, indicating that the Company is worth less as a result of PCORC  
5 Orders 14 and 15. See the Power Insights research note on Puget Energy titled  
6 "No Reconsideration of Bad Order- Lowering Price Target" (dated June 14,  
7 2004), copy provided as Exhibit No. \_\_\_\_ (DDW-5).

8 **Q. Did the Tenaska Orders have an adverse impact on the Company's credit**  
9 **ratings?**

10 A. No. However, the investment community looks for positive outcomes from  
11 current and future proceedings such as PCA Period 2 compliance proceeding to  
12 demonstrate the fact that PSE is in fact beyond the Tenaska disallowances other  
13 than the methodology adopted for sharing the future recovery of the return on the  
14 investment. See Moody's Investor Services report on Puget Sound Energy, Inc.  
15 (dated July 7, 2004), copy provided as Exhibit No. \_\_\_\_ (DDW-6).

16 **Q. How would a decision in this proceeding to forego imposing any additional**  
17 **disallowances on PSE for the PCA 2 Period prior to Order No. 14 be received**  
18 **by investors?**

19 A. I believe such a decision would let investors know that historical Tenaska issues  
20 are now truly behind us. As stated by one of the analysts covering PSE:

21 Following the 2Q04 earnings release and conference call, we  
22 continue to remain lukewarm to prospects of any near-term

1 appreciation in Puget Energy's stock price. While the Company  
2 has some marginal ability to increase its bottom line through  
3 effective cost control, an appreciable upside to earnings would  
4 have to come in the form of regulatory relief (which is not  
5 expected before 1Q05) or better weather (which continues to get  
6 worse in 3Q04 for the utility in our opinion). Getting the Tenaska  
7 issue behind the Company is a positive in our view and allows the  
8 Company to establish good relationships with regulators going  
9 forward.

10 Ragen Mackenzie report on Puget Energy (dated August 18, 2004), copy provided  
11 as Exhibit No. \_\_\_\_ (DDW-7).

12 **Q. Does this conclude your testimony?**

13 **A.** Yes, it does.