BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Petitioner,	Docket No. UE-031725
vs.	Volume III
PUGET SOUND ENERGY, INC., Respondent.	Pages 249 to 446

PORTIONS DESIGNATED CONFIDENTIAL

A hearing in the above matter was held on February 24, 2004, from 10:00 a.m to 5:25 p.m., at 1300 South Evergreen Park Drive Southwest, Room 206, Olympia, Washington, before Administrative Law Judge DENNIS MOSS and Chairwoman MARILYN SHOWALTER and Commissioner RICHARD HEMSTAD and Commissioner PATRICK J. OSHIE.

The parties were present as follows:

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P R O C E E D I N G S

JUDGE MOSS: Good morning, everyone. I think, Mr. ffitch, you will want to enter your appearance this morning.

MR. FFITCH: Thank you, Your Honor, good morning, Simon ffitch, Assistant Attorney General for the Office of Public Counsel.

JUDGE MOSS: I believe that's our only new appearance today.

When we left off yesterday we had Mr. Gaines on the stand, and he remains on the stand and, of course, remains under oath, and Mr. Cedarbaum was focusing his attention on some confidential matters and was going to try to get through all that in a set, and so we will do that this morning.

I just want to make a comment for the benefit of those who are on the bridge line monitoring this proceeding, whomever they may be, that we anticipated in this proceeding because there is a large volume of confidential information, much of which concerns pending or potential prospective transactions and so forth that's sensitive, commercially sensitive, that it would be necessary to go into confidential session from time to time. And so when we do that, we ask that those who are in the hearing room who have not signed the necessary document under the protective order in this proceeding, that they leave the room, and we also mute the send function of the teleconference bridge line so that those who are monitoring remotely are unable to hear us. And, of course, we have that bridge line available for monitoring at other times in the hearing, and it will be turned back on when we move out of our confidential session, so I will be turning that off now.

MR. CEDARBAUM: Actually, Your Honor, I believe that I can complete all of my questions in a non-confidential setting.

JUDGE MOSS: Having said all that, Mr. Cedarbaum has just informed me that --

MR. CEDARBAUM: You were too fast on the draw.

JUDGE MOSS: -- he thinks he can complete his cross-examination without reference to the sensitive materials in such a way that we compromise your confidentiality, and so just note my speech for future reference, and we'll ask Mr. Cedarbaum to proceed with the microphones left on.

MR. CEDARBAUM: Thank you, Your Honor, I didn't want to interrupt, you were too quick on the button there.

Whereupon,

WILLIAM A. GAINES,

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

C R O S S - E X A M I N A T I O N

BY MR. CEDARBAUM:

Q. Mr. Gaines, I don't think this next question involves any confidential information to be divulged, but I did want to ask you some clarifying questions on Exhibit 91C, and turning to page 2 of that document, and the purpose of my questions is just to clarify generally what's in the columns that are listed on the middle of that page 2. And is it correct that the column that's labeled power value increase refers to the value of selling power to the secondary markets?

A. Yes, that's right. I believe that's the value of that portion of Tenaska generation that would be sold in the secondary market.

Q. And then the second column that's labeled cost of gas increase, that refers to the increase in the cost of gas to serve the company's retail load?

A. No, I don't believe so. I believe that's the increase in the cost of gas associated with the power that's sold in the first column.

Q. And then finally the third column is just the net of the first two columns?

A. Yes.

Q. And looking at page 9 of the same exhibit, which is an E-mail from Mr. Elsea to you and some others of June 8th, 2000, are the column descriptions that you just gave for page 2 basically the same for page 9?

A. Yes, they are.

Q. I have a few lines of questions for you back in your rebuttal testimony, and I'm done with Exhibit 91C, and I would like if you could turn to page 14 of that testimony, which is Exhibit 45.

CHAIRWOMAN SHOWALTER: What page was that?

MR. CEDARBAUM: I'm sorry, page 14 of Exhibit 45.

BY MR. CEDARBAUM:

Q. Do you have that?

A. I have it, yes.

Q. I'm looking at the sentence that begins at line 25 that says that many states moved rapidly toward retail restructuring, and similar legislative efforts were being explored in Washington state at the time, referring to the mid 1990's. Do you see that?

A. I do.

Q. Is it correct that one of the legislative efforts in Washington state involved a bill sponsored by Senator Bill Finkbeiner called the Electric Customer Choice Act; do you recall that?

A. Yes, that's one of the initiatives that we had in mind here.

Q. Would you accept subject to check that in a letter dated October 17th, 1997, the company commented on that bill, and with respect to the mitigation of stranded costs, the company stated:

Utilities as always should seek to mitigate power supply costs, and legislation should provide avenues, for example financing mechanisms to perform buyouts/buydowns, to enhance a utility's ability to perform such mitigation.

Would you accept that subject to check?

MR. GLASS: Could Mr. Gaines review the letter to answer the question?

JUDGE MOSS: That can be provided to him.

MR. CEDARBAUM: Your Honor, I only have one copy. If Mr. Glass would like me to make a second copy, I can do that.

JUDGE MOSS: Maybe if you just have a question or two, you can hand him the document and do

that from where you stand.
BY MR. CEDARBAUM:
Q. Mr. Gaines, I'm handing you a letter dated October 17, 1997, which is the letter I was just discussing with you, and you can go ahead and review it, but what I was referring to was on page 3 of the letter under the item transition cost number 3, and the quote that I gave you is highlighted there, so take your time.
A. (Reading.)
Q. And I would just ask you to accept that subject to your check.
A. Well, this is the first time I have seen this letter, but the words are there as you quoted them, yes.
Q. Thank you.
MR. GLASS: Your Honor, I would suggest on this that seeing how this is the first time Mr. Gaines has seen this in some time that it might just be most efficient to make that an actual exhibit so the Commission can read the context of the letter.
JUDGE MOSS: Did you have an interest in making that an exhibit, Mr. Cedarbaum?
MR. CEDARBAUM: I can do that, that's fine.
JUDGE MOSS: All right, well, why don't we just do that, and that will give us a more complete record. Let me give that a number.

MR. CEDARBAUM: I will need a chance off the record to make copies, but I can do that.

JUDGE MOSS: Sure, we can do that later today.

We're going to mark that as 99, and it's correspondence from PSE to is it directed to Senator Finkbeiner?

MR. CEDARBAUM: Yes, it is.

JUDGE MOSS: And it's dated?

MR. CEDARBAUM: October 17th, 1997.

JUDGE MOSS: All right, we'll mark that again as 99, and you will make copies for us later.

By the way I should mention while I'm on this page of the exhibit list, we had handed out this morning a new Exhibit 98 from ICNU that has been distributed to the Bench, that will also be used when Mr. Van Cleve does his cross-examination, or it's proposed for use then.

BY MR. CEDARBAUM:

Q. Mr. Gaines, I would like you to flip the page in your rebuttal to page 15, and at lines 13 you refer to Schedule 48; do you see that?

A. Yes, I do.

Q. Is it correct that Schedule 48 customers were not granted retail access, but they remain on the company's -- as part of the company's retail load under tariff?

A. That's right. I wasn't involved in the original development of Schedule 48 but enjoyed administrating it for several years. The industrial customers got what was the economic equivalent of open access through Schedule 48, but the service continued to be provided by the company.

Q. So you're saying they received a market based rate.

A. Yes.

Q. Is that right?

A. That's correct.

Q. But they also continued to pay what were called PURPA transition cost fees as well; is that right?

A. I don't have a good recollection of that. That may have occurred for some early periods.

Q. Well, let me just ask you then to accept subject to check that under Schedule 48, Table 1, there's a schedule of power cost transition charges beginning in June for June 1st, 1998, and then there's a schedule for '99 and then 2000 and beyond.

A. I will accept that subject to check, yes.

Q. And the PURPA transition charges are defined in the tariff to be the difference between the market based price and the company's embedded cost of service?

A. I don't have a recollection of how those were computed.

Q. Would you accept that subject to your check?

A. I would.

Q. The last subject I have for you, and you're welcome to refer to your direct testimony if you would like but I'm not sure it's worth all the shuffling of papers, but at page 7 of that testimony, which is Exhibit 11, you state at line 2:

At the time the 2000 to 2001 least cost plan was filed as documented in that plan, it appeared that the most reasonable way to provide customers with least cost reliable electric power would be through PSE's expanded participation and reliance upon the wholesale power markets and via reduction in PSE's dependence upon long-term fixed cost generating resources.

Do you have that generally in mind?

A. I don't have the testimony in front of me, but yes, I have it generally in mind.

Q. If I could have you turn to Exhibit 86, which purports to be the pages from the company's 2000 annual report to shareholders.

A. All right, I have that.

Q. If you could turn to the second page of the exhibit, which is the page number 3 of the annual report, in the column on the right, the first full paragraph, about in the middle of that paragraph, it states:

> Our strategy of covering our core
> electric loads with our long-term
> embedded cost electric resources
> protected us from having a net adverse
> exposure to these markets.

Referring back to the power crisis. And then it says:

> We intend to continue this strategy
> going forward to help insulate the
> company and our core electric customers
> from these markets.

Do you see that?

A. I do.

Q. Thank you.

MR. CEDARBAUM: Your Honor, I would offer for admission Exhibit 86.

JUDGE MOSS: I think we actually already have that in the record, but there's no objection, and it will be admitted.

MR. CEDARBAUM: All right, great.

That completes my questioning of Mr. Gaines, thank you.

JUDGE MOSS: Thank you, Mr. Cedarbaum.

Mr. Van Cleve, you had indicated that you had some cross-examination for Mr. Gaines.

MR. VAN CLEVE: Yes, Your Honor, thank you.

C R O S S - E X A M I N A T I O N

BY MR. VAN CLEVE:

Q. Mr. Gaines, I would like you to refer to Exhibit 210, which was a redirect exhibit of Ms. Ryan's. I think we can work through the questions on this with you because this is a company data response to ICNU Request 6.15, and it indicates that you were the witness on that. And also --

A. Mr. Van Cleve, is this the single page you passed around earlier this morning?

Q. No, no, this is actually you will need -- this is a redirect Exhibit 210, which is the calculation of the NYMEX volumes.

A. Yes, what I have here as 210 is the company's response to ICNU Data Request 6.15.

Q. And you were the witness on that?
A. Yes.
Q. We think that there is an error in the calculation in this data response.
A. We think you might be right.
Q. And we think that we have attempted to correct it here. It appears that the -- if you look at your exhibit on the first line, if you take the total contracts 13,332 and multiply that by 10,000 MMBtu and then you divide the notional value, the $19.29 Billion, that would produce an effective NYMEX price of $144 in MMBtu. So we think we have identified the error that -- in the notional value column that it assumed that the 10,000 MMBtu was per day instead of per month, so the notional value column is overstated by approximately a factor of 30. And we on exhibit, what's marked as Exhibit 98, have recalculated what the notional value is. Would you agree subject to check that our recalculation is correct?
A. I will agree to that subject to check, yes.
Q. Do you recall testimony from yesterday to the effect that the national gas market was approximately 60 BCF per day?
A. I recall it. I don't know that for certain to be the case.

Q. Assuming that that is the case, if we look at some of the out months, for instance February of 2005 where the volume is .51 BCF per day, would you agree that that would represent only about approximately 1% of the national market?

A. I would agree with the mathematics, yes.

MR. VAN CLEVE: Your Honor, we would offer Exhibit 98.

JUDGE MOSS: There's no objection, it will be admitted as marked.

BY MR. VAN CLEVE:

Q. Mr. Gaines, could you please refer to Exhibit 244C.

JUDGE MOSS: And this is one of Mr. Schoenbeck's exhibits?

MR. VAN CLEVE: Yes, it is.

JUDGE MOSS: Okay, just for future reference, we have such a volume of material in this case, it would be helpful if when you're identifying an exhibit that's for some other witness, let us know the witness so we can get the right volume.

MR. VAN CLEVE: Your Honor, we have considerably shortened our cross-examination questions for Mr. Gaines as a result of the discussions with Ms. Ryan yesterday, and I think I could move through it rather quickly if we could go into confidential session so I can get right to the numbers that I would like to discuss with Mr. Gaines.

JUDGE MOSS: All right, I think that's an appropriate suggestion then, let's do that.

So I will ask that those present in the hearing room who have not signed the confidentiality agreement under the protective order, if they could step out into the hall, we'll send somebody out, Mr. Van Cleve indicates that he will he fairly brief, and at this point I will be turning off the conference bridge line send function.

(Confidential session.)

JUDGE MOSS: All right, we're returning to non-confidential session, Mr. Van Cleve having completed his questions on the confidential exhibits.

So you wanted to move some exhibits?

MR. VAN CLEVE: Yes, Your Honor, I would like to move for admission of Exhibits 78, 80, 92, 93C, and 95C. I will just point out that 92, 93C, and 95C I did not have any questions about.

JUDGE MOSS: All right, any objection to the admission of any of those?

There's no objection, so those exhibits will be admitted.

Does that complete your cross-examination?

MR. VAN CLEVE: Yes, it does, Your Honor.

JUDGE MOSS: All right.

Just to be sure that I have a clear record, my notes indicate that you are not offering 79, 81, 94, 96C, or 97.

MR. VAN CLEVE: That is correct.

JUDGE MOSS: All right, thank you.

MR. VAN CLEVE: Your Honor, I think Exhibit 80 should be designated HC.

JUDGE MOSS: Thank you.

All right, Mr. Brookhyser, do you have questions for this witness?

MR. BROOKHYSER: I do.
JUDGE MOSS: All right.

C R O S S - E X A M I N A T I O N

BY MR. BROOKHYSER:
Q. Good morning, Mr. Gaines.
A. Good morning.
Q. In your rebuttal testimony you rebut the proposed disallowances by Staff, Mr. Lazar, and Mr. Schoenbeck related to some of the Tenaska fuel costs; is that correct?
A. Yes, it is.
Q. If despite your rebuttal efforts the Commission were to allow any of those disallowances or grant any of them, would that have any effect on Puget's performance of its obligations under the Tenaska contract?
MR. CEDARBAUM: Your Honor, I will object, I --
CHAIRWOMAN SHOWALTER: Will you use the microphone.
MR. CEDARBAUM: Sorry.
First of all, CCW hasn't presented its own witness, so it's a little difficult to understand where these questions are going, but it seems to me like this

is friendly cross-examination, and so I would object on that basis. We usually don't allow that.

JUDGE MOSS: Well, that's true, we don't allow friendly cross-examination. Of course, I don't know what your position is relative to the company's position, so we're going to have to count on you at this early stage to tell us whether you were trying to elicit friendly cross-examination, Mr. Brookhyser.

MR. BROOKHYSER: No, I would not consider this friendly cross. It is supportive of my client's position. I do not know that it is --

JUDGE MOSS: And what is your client's position with respect to the disallowance as proposed by Staff?

MR. BROOKHYSER: My client's position is that the disallowances should not be allowed, but what I am asking is not a question directly related to the disallowances, it's related to if the disallowances are granted, what is going to be Puget's further performance under its contract. I do not see that as either supportive or in conflict with the company's position, but it does advance my client's position. So it's not friendly in terms of further advancing the company's case.

MR. CEDARBAUM: Your Honor, I guess I don't see a difference between the two at this stage. I mean he's asking this witness what the impact on the company is of the Staff's disallowance and that -- and his client's position I believe is aligned with the company on that.

MR. BROOKHYSER: No, I wasn't asking what the effect on the company is, I'm asking basically what the effect is going to be on my clients. I don't think there's anything in a rate case that prohibits interveners or other parties from having interests that are consistent with the company's.

JUDGE MOSS: Sure, that's true, but if your interest is consistent with the company's and you attempt to cross examine the company's witness, then you are almost by definition eliciting friendly testimony. And so your task in the proceeding would be to cross examine the witnesses who the outcome of their positions would be adverse to your interests.

But we may have some independent interest in hearing this line, so I think Chairwoman Showalter has a comment.

CHAIRWOMAN SHOWALTER: Well, I guess I have a question. It seems to me that if your concern is that should we adopt these recommendations, the company may not perform in a way that is beneficial to your clients, if that is your concern, then I don't think the question would be friendly cross. I'm not sure that's where you're going.

MR. BROOKHYSER: Yes, that I think was exactly --

CHAIRWOMAN SHOWALTER: But that would be an understandable position I think from a given client's point of view that should things turn out one way, the problem may get solved on their backs. Is that essentially what your concern is?

MR. BROOKHYSER: Yes.

CHAIRWOMAN SHOWALTER: Well, it would seem to me then that we should allow the question.

MR. CEDARBAUM: Your Honor, I'm sorry to belabor this, but if I now understand the question, I guess I would add the objection that this calls for speculation. There has been no foundation that Mr. Gaines knows how Mr. Brookhyser's clients may or may not react or be burdened or not, so I haven't heard any foundation for these questions.

MR. BROOKHYSER: Again, I'm not asking about how my clients -- I'm not asking him how my clients are going to react, I'm asking him how Puget may react. It may be that his answer is, I have no idea at this point. I'm simply asking whether he has a position on that or has an answer.

JUDGE MOSS: I think the Bench's ruling on this indicates that you should be allowed to proceed, and you may renew your objection as appropriate, Mr. Cedarbaum.

So we have probably lost the question by now, could you restate it.

CHAIRWOMAN SHOWALTER: Before you do, essentially aren't you asking how would the company implement the Staff and ICNU recommendations should we adopt them?

MR. BROOKHYSER: Yes, or even more narrowly, would the implementation have any effect on their performance of the contract.

CHAIRWOMAN SHOWALTER: All right.

JUDGE MOSS: Do you have the question in mind, Mr. Gaines?

THE WITNESS: I think I have.

JUDGE MOSS: All right, go ahead and give an answer.

A. Well, I think I would give a two part answer. First I would say that, you know, the company takes seriously its contractual obligations to Tenaska, as it does all of its power supply contracts, and would intend to perform. But I would add to that that I really probably couldn't predict at this point in time what the company might need to do to react to economic pressures that might be created by these disallowances. And, you know, you can recall that in the mid and late '90's the company took actions around these PURPA contracts that resulted from the economic pressures that existed at that time and resulted actually in the Tenaska restructuring that we're talking about here now, which was a mutually agreed restructuring.

So just to recap, you know, primarily we would intend to honor our existing contractual obligations, but probably can't predict what we might feel we needed to do if, you know, the economic pressures became different than they are now.

MR. BROOKHYSER: Thank you, those are all the questions that I have.

JUDGE MOSS: Thank you, Mr. Brookhyser.

Let's see, Mr. ffitch, do you have any questions?

MR. FFITCH: Public Counsel has no questions, Your Honor.

JUDGE MOSS: Thank you. So that brings us I believe to questions from the Bench. We have had Mr. Gaines on the stand for a bit more than an hour now, would we want to take a recess or continue ahead.

(Discussion on the Bench.)

JUDGE MOSS: All right, we'll take a ten minute recess until 11:15.

(Recess taken.)

JUDGE MOSS: I believe we are to the point in time of questions from the Bench.

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. Hello, Mr. Gaines.

A. Hello.

Q. My questions fall into four general areas. A, the original finding of imprudence; B, the effects of the accounting order and Puget's operations under that accounting order; and C, looking forward on a going forward basis, what are the appropriate mechanisms to use. D is just cleanup, after I ask my questions I will probably go through the books and ask you various small clarifying questions.

A. Great.

Q. And on A I don't have much to ask, it's really to set the stage. If there had been no intervening regulatory events since the finding of imprudence, do you agree that Puget would have been bound by the amounts allowed under the order that found

imprudence, the 1.2% reduction off of a fixed amount?
A. Yes, and in fact that's what has been done even though there was an intervening regulatory event. Our review of the 19th and 20th supplemental order allowed us to reexamine how that 1.2% disallowance was computed. It was related primarily to the dispatchability of the power plants and is simply a percentage disallowance computed on that basis, and we have applied it to our Tenaska costs in each regulatory proceeding since those orders.
Q. Are you saying then that had there been no subsequent regulatory events, that even under the prudence or imprudence finding, the company could have proceeded to purchase gas or conduct various operations without an intervening regulatory event?
A. Oh, I see, I may have misunderstood your question originally. The thing that really in my view gave rise to this change is the renegotiation of the gas supply contracts. It was really a change in the commercial arrangements that put the company in the position of being a gas supplier, and it turned out of course that the way that that restructuring was done necessitated a regulatory ruling on the accounting for the buyout cost.
Q. And that's my area B, and that's really where

most of my questions are, but I was just trying to get a starting point.

A. Oh, okay.

Q. If all that had happened to date in a regulatory sense was the original finding of imprudence and the 1.2% reduction, then do you agree that the company would be responsible for the costs as outlined at that time?

A. Well, I'm not sure I understand. The original contract here was a set price per megawatt hour, and so the company pays so many dollars per megawatt hour for each megawatt hour produced by the power plant and then applies this 1.2% disallowance of so-called net contract costs. And so absent any regulatory event since 1992, we presumably would have continued to do just that.

Q. All right. Well, then I would like to move to area B.

A. Mm-hm.

Q. Which is the accounting order and what its effects are, and I think my questions revolve around asking whether there is a distinction that's relevant to this case between expectations and promises. Do you agree that the expectation at the time was that the company would save money for the rate payers?

A. Definitely. I mean that was the basis for entering into this transaction in the first place, that there was an expectation that there would be significant savings from the gas cost restructuring.

Q. And then I think maybe the nub of this issue, maybe not, is whether that expectation was in fact a binding promise on behalf of the company, either because that's what it was at the time of the accounting order, or there was an upper constraint set by the imprudence finding. Is that your understanding of the conflict in this case?

A. Well, I believe there are two issues in your question there, at least the way that we view it, and I will take the first one first. Was there a binding promise that the level of savings projected at the end of '97 at the time of the restructure would be realized, and no, there was not. We made clear to the Commission and all of the parties in the accounting proceeding, we made clear to our board and others that our intention at the time of the restructuring was to provide gas to the Tenaska plant in the short-term market.

And generally what was meant is that we would procure spot market gas and apply the sort of near-term hedging and risk management techniques that Ms. Ryan was talking about yesterday, and that is what we have done since the time of the restructure. Now over that six or so year period, we have periodically taken a look at the idea of locking the price in long term for the remainder of the term through 2001 for various reasons, and also for various reasons we have not found opportunities to do that that we felt were economically attractive.

So that's part one, and I think the second part of your question had to do with is there a cap, and that goes back I think to your initial area A of inquiry about the imprudence determinations back in '94 associated with supplemental orders 19 and 20.

Q. Yes, all right, but then I guess maybe it's proceeding on part one of your previous answer, I would like to take ourselves back in time, as difficult as that is, and ask you a few questions about what would have happened had certain events played out differently before you knew what would have happened. And specifically let's go to the legislation, Senator Finkbeiner's legislation was mentioned. If the proponents of that legislation had prevailed and there had come about retail restructuring in which retail customers were free to select their supplier of generation, what would that have meant about your load or at least I guess your certainty of load, and how would you have gone about -- let me stop the question with what would that have done to your load?

A. Well, we believed and were concerned that it might have reduced our load. And I think in, if I could, in answering that question, I would like to provide just a little bit of context for what was happening at that time.

We're in the late '90's, say the end of 1997. There's a lot of uncertainty about whether and how deregulation might proceed across the country and here in the state. The company had at that point in time a power supply portfolio whose costs were almost entirely fixed, not sensitive to market price, not sensitive to gas price. And although we of course did not have formal retail deregulation, we did have at the time of our merger application the industrial customers agitating for access to market, and they were granted that just prior to our merger through Schedule 48.

So we had already transitioned somewhere between 200 and 300 megawatts of our load, about 10% or 15%, to market responsive pricing. So from a risk management point of view now, I've got a fixed price power portfolio that originally was structured to serve 100% of my load needs, but I've got 15% of my sales revenues fluctuating with market. So a part of what I'm trying to do by restructuring the Tenaska contract for example, is not only to reduce costs overall, but to reformat my portfolio in a way that I've got some portion of it responsive to market pricing. It's really a risk management approach.

Q. So in that period before there was restructuring, you wanted to align your portfolio somewhat with your Schedule 48 customers?

A. I was, yes, I was hoping to move towards a situation where I had fixed price supplies to serve my fixed price loads and market responsive supplies to serve my market responsive loads.

Q. All right. Now had you locked in long-term Tenaska prices at the time of the accounting order, and had there been restructuring legislation along the lines of Senator Finkbeiner's bill, would that have given rise to stranded cost issues or not?

A. We were concerned that it could, because energy prices had been declining for, you know, several years leading up to this period, customers were agitating to leave embedded cost service, not only of the retail distribution utilities, but even the Bonneville customers were agitating to leave what at the time was one of the lowest cost hydro suppliers in the country, because market prices were so low. And so we were concerned that if in late '97 we after restructuring locked back in to a fixed price again and energy prices generally and gas prices particularly fell further that we would further exacerbate what was a fairly significant stranded cost problem for the company at that time.

Q. And when was the Schedule 48 entered into, what year?

A. I don't remember precisely, but I think it was in 1996, the year before our merger was finalized.

Q. So that was prior to the accounting order?

A. It was.

Q. And I don't recall whether it is in Schedule 48 itself or it was a surrounding expectation, but wasn't the expectation that at the end of Schedule 48 the customers would not be returning to Puget?

A. I don't recall whether that was the expectation in the original incarnation of Schedule 48; I don't know.

Q. Okay. I'm going to shift now to area C, which is going forward. Is the exercise that we're trying to do here is to find an appropriate benchmark, a mid point around which up or down there's symmetry of risk between the company and the shareholders?

A. Yes, that's one of the things I think that's at issue here yesterday and today is what should be the gas price forecast that's used for setting the base line rate in this forward PCORC period. And there was a lot of testimony and discussion about that yesterday, and the company's proposal and actually its practice in the last several proceedings both on the power side and on the gas side is to use recent historical forward market prices to set that base line. We have done that in the prior PCA, and we have done it in our PGA's as far back as I can recall.

Q. I guess the question I have is the NYMEX is objective in that it is actual trades not affected by the company, but what if the company's own projections through maybe some other analyses, including fundamental analyses, show that the company expects the prices to be lower than the objective forward prices show, is that, I will call it a mid point or this benchmark, does a benchmark that is higher than the company's own analyses show a reasonable line for this mid point?

A. It's an interesting question I think. You know, Ms. Ryan spoke some yesterday about the forecasts that the company has developed and the third party forecasts that it uses from private forecasting services. I think she indicated yesterday that the company's own fundamental analysis model is, you know, still in a fairly early stage of development. And even when developed, it will be a forecast, not a price level at which transactions could actually occur or at which participants in the marketplace, the buyers and the sellers together, settle actual forward prices.

Q. Well, then if we were to set this mid point at something other than prices you could actually go out and execute, how would the company handle that? Supposing we set this mid point at some projection based on a fundamental analysis, how would the company operate under it?

A. Well, we might want to ask Ms. Ryan about that, because she now is responsible for our near term gas supply management and hedging. But the concern I think that the company would have is that, you know, the price level would be biased, we would no longer have a normal distribution around the expected outcome of the PCA, which I think was, you know, the original intent, that we would have a normalized distribution and some sharing bands around that distribution. The concern would be that the mid point, if you will, of our probable power cost distribution would be skewed unfavorably to the company.

Q. But isn't this really trying to decide what's normal?

A. It is.

Q. Well, on that count then, you heard the discussion yesterday of my concern that ten days might not be sufficient, so we asked for more time. Do you have any opinions yourself on how -- what an appropriate benchmark might be assuming the NYMEX model? Obviously you put the ten days in yourself, but at least can you answer my concern that ten days plucked out of September might not be indicative of that mid point?

A. I think it's a good question. We use the ten days because we used it historically, and there was some precedent both in our gas cases and our electric cases for that, but I think it's a good question. I don't think that I have a view about exactly what period should be used to average the NYMEX prices.

Q. All right. Do you have any views on whether gas buying behavior varies seasonally? I think it was my general understanding, and please correct me, that companies tend to get busy in the spring buying forward for the heating season, and then things slack off, and maybe that's a shorter term than we are thinking of in this mid point.

A. Well --

Q. But I guess my concern is whether a period of time in say September is not very useful if most of the buying is going to be in April, for example?

A. Well, I listened to that discussion yesterday with some interest, and I think my response to that would be that the forward market prices at any given time are what they are, and they reflect all of the dynamics that are going on around the market, you know, at that point in time. And it is typical in the forward market prices that there's seasonality, you know, the forward prices in the winter generally are higher than the forward market prices in the summer because of the heating load effects. But it's all sort of in there, if you will, and to try and make adjustments somehow to the forward market prices or to try to choose a period of time to snapshot the prices that somehow are not subject to these effects I think is difficult or maybe not even needed.

Q. All right. Now the answer to this question is probably somewhere in the testimony, but I have lost track of how long this benchmark is going to be good for under the company's proposal.

A. It's going to be good for what we're calling the PCORC period, which is April of this year through March of next year.

Q. And then what is anticipated that will occur in a regulatory sense?

A. Well, I guess it would continue unless we reset it.

Q. And as a general matter, isn't it appropriate to reset this benchmark periodically?

A. I'm a little fuzzy honestly on the fine mechanics of the PCA, and we might have to ask Mr. Story to talk about that. But generally the idea was when the PCA was established in the settlement of our last general rate case that yes, the benchmark would be reset periodically.

Q. And my next question would be, is one year or so the appropriate period, is that a better question for Mr. Story?

A. He will have better answers about what was agreed to in the settlement for the PCA mechanics.

Q. All right, I'm moving to area D and just going to ask you a series of clarifying questions on exhibits. If you could turn first to Exhibit 77, page 79, this is a confidential exhibit, but I think I can ask the question probably without going into confidential session. Have you got page 79?

A. Yes, I have.

Q. I'm looking at the second bullet, and am I correct that probably what's confidential, if anything, about this is the numerical number?

A. Yes.

Q. Okay. So what does this mean, filing gas cost savings?
A. What I believe it means is that at the time that the restructure was done at the end of '97, and based on the forward market gas price quotes that we had at that time, that this number was the expected savings over the 14 year life of this transaction.
Q. And maybe I just don't understand the term internal rate of return very well, but is IRR just the same as a percentage amount savings in operations?
A. It is, but it involves present value math.
Q. Okay.
A. So that over the life on a discounted cash flow basis this would be the number.
Q. All right. And then can you then turn to Exhibit 85, the last page of that exhibit.
A. This is our 1998 annual report?
Q. Yes.
MR. CEDARBAUM: Your Honor, for the record I believe it's 1999.
JUDGE MOSS: Yes, I have it as the 1999 annual report, the one with the interesting picture of a mountain on the front.
That's the one, that's '99.
THE WITNESS: All right, I'm there, thank

you.

BY CHAIRWOMAN SHOWALTER:

Q. All right, in the last page of that exhibit under the first column.

A. Yes.

Q. There's the phrase that under the terms of the order the company is allowed to accrue as an additional asset one half of the carrying cost of the deferred balance. Obviously the term carrying cost is in our order, but can you just explain to me what that means, one half of the carrying cost?

A. I can, and I think I can do it even better if I provide a little context.

Q. Okay.

A. Again, this was a transaction that bought out gas contracts that would have continued for 14 years through the year 2011. And so the company at the time of the restructuring made an estimate of what the savings would be year by year and was attempting through this accounting mechanism to line up the amortization of the buyout cost with the expected savings year by year. And if you look over the entire 14 year life of this transaction, the savings were expected to be much larger in the future years than in the early years.

So with that as background, what's being referred to here in our annual report is that for the first five years of the transaction the company was allowed in accounting to capitalize 50% of the annual carrying cost of the initial buyout payment.

Q. So this is like a house mortgage?

A. Like a reverse mortgage almost for the first five years.

Q. I think I understand, but I will think about it some more.

Could you turn to page 89 of that same Exhibit 77.

A. Yes, I have it.

Q. Oh, I hope I have the right -- I think I might -- just a minute here. I'm sorry, Exhibit 91C.

A. Yes, I have that.

Q. Page 2. Mr. Cedarbaum asked you some questions about this exhibit, but it says that updated, and I realize this is a confidential exhibit, but it says updated power and gas prices come from something called the power cost outlook. Can you tell me what that is?

A. Yes, the company has an internal process for forecasting its earnings on an ongoing basis, we call it the outlook process. So each month there is an update to this forward looking outlook of earnings through the end of the calander year.

And I might say while we are on this exhibit, I had a chance to examine it a little bit during the break, and I think I may have misspoken when I was responding to Mr. Cedarbaum's questions about the gas costs here. I think I --

Q. Why don't you correct your testimony then.

A. I think Mr. Cedarbaum asked me if the gas costs represented all of the gas costs or just the gas costs associated with that portion of generation that is surplus to load needs, and I think the answer to that can actually be found on the next page in the middle where it says it's all of the gas costs. And I just wanted to clean that up, because I think I might have misspoken earlier.

Q. Okay. Also Ms. Ryan testified on this page that this page does not include an option analysis, which was also a factor in the July 2000 RMC meeting. Do you know what the option analysis was?

A. Generally I recall that discussion and --

Q. Just what does it refer to, what is an option analysis?

A. The idea is that as we got into the early months of the West Coast energy price crisis, prices became very volatile. And so when market prices are volatile, the option value of a resource like this rises. Option value is a function in part of volatility, so that not only was the absolute heat rate, the spark spread value of this generator growing, but the option value of it was growing as well because price volatility in the underlying markets was rising.

Q. I see. So its relative value was changing; is that what you mean?

A. It's the value of holding this asset, holding this heat rate, was rising not only in an absolute or intrinsic sense, just spread itself, but on the chance that there might occasionally be price spikes, the value of that was rising as well.

Q. Okay, I think I'm just about done.

You state several places in your testimony that the purpose of the accounting order was to drive Tenaska gas prices toward market, and maybe that's true of the Encogen too, I'm not certain. But as implemented by the company, did the prices go toward market and market prices went up, or did the prices not go to market?

A. Well, the prices did go to market. I mean the underlying gas supply that we're providing to Tenaska has been at market since late '97. In the first year or two of our experience, the market prices that we supplied to the generator were actually lower than our original projection. The West Coast energy price crisis then occurred, and everything went crazy for a couple of years. So we have had the experience of market prices being higher and lower, and we have eight years left to go in this transaction.

CHAIRWOMAN SHOWALTER: All right, I have no further questions, thank you.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

Q. I believe all of the questions I had have been answered either in cross or by the Chair, I have only one clarifying matter. In Chairwoman Showalter's description of the issues, the first one -- the second is the accounting order and the issue of whether it was an expectation or a promise. Assuming the conclusion is that it was not a promise but an expectation, there is of course still the issue of whether the company acted appropriately in the management going forward in I guess purchases. So the issue isn't ended by a determination that it was not a promise but an expectation. I think you would agree to that, wouldn't you?

A. I would agree to that, yes.

COMMISSIONER HEMSTAD: That's all I have.

E X A M I N A T I O N

BY COMMISSIONER OSHIE:

Q. Mr. Gaines, were you a member of the management team that negotiated the restructuring of the Tenaska and Encogen agreements?

A. Yes, I was.

Q. I just want to focus on Tenaska, but it's a legal maybe answer, generally the questions that I have, but the -- I don't recall the exact number for the cost of the restructured agreement to Puget, but I think it was $213 Million; is that right?

A. Yes, it was on that order.

Q. Okay. My question really is how the company reached agreement as to that number. You know, I know you didn't just pull it out of the air and the other party did too, or you didn't throw darts at a dart board, you know, with a group of numbers on it and decide that, but I'm curious as to how that number through the negotiation process became the final number for the cost of the restructuring and was agreed to by the seller?

A. Sure, I could give you just a little bit of the negotiating history around that. The original gas supply to the Tenaska plant was provided by five separate gas suppliers, independent gas suppliers, who were supplying gas to Tenaska. And Tenaska in turn bundled that all up with the capital costs of their plant and sold us power at a fixed escalating rate. So what was done in this transaction was to unwind the five underlying gas supply contracts.

Now each of those five contracts had a fixed and escalating price stream, and those were very rapid escalations, and the prices got very high in the latter periods. And so actually not Puget but Tenaska, who was the counter party to each of these suppliers, went individually and negotiated buyout arrangements with each of those five suppliers based on the known escalating gas prices in the contracts, based on prevailing forward market prices at the time, and based on prevailing interest and discount rates. Tenaska then packaged up those five proposed buyouts and brought to Puget this roughly $213 Million buyout price.

Q. And I assume that Puget's analysis of the Tenaska offer or the Tenaska -- I guess their -- I'm trying to think of what their -- it would be their management offer I guess, assume -- knowing that it was just a bundling of the gas contracts and then offering to you that value, I would assume that you, Puget, conducted the same analysis as Tenaska would have to determine that the offer that was made by Tenaska was reasonable?

A. We did. The analysis that -- the sort of analysis that we did is reflected in this so-called Exhibit B to our original accounting petition, and that Exhibit B is I think in exhibits in a number of places in this proceeding. It showed a significant savings even after recovery of and on the $213 Million buyout price. So that as long as the IRR number in that calculation were positive, positive at all, the customers are better off even after having paid the costs of and the return on the $213 Million buyout.

COMMISSIONER OSHIE: I don't have any further questions, thank you.

E X A M I N A T I O N

BY JUDGE MOSS:

Q. I just have a couple. We talked about the accounting order implementation involving my recollection was the buyout cost was $215 Million, but then the company under the order was allowed to add one half of the carrying cost to the balance, which would in turn be partially offset by the annual amortization amount. And, in fact, during the first few years the regulatory asset grew on the company's books. Now the other half of the carrying costs would have been treated how?

A. It would have been expensed, I believe.

Q. And recovered in rates as an expense?

A. Well, remember that during much of this period the company was in its merger rate stability period. From 1997 through early 2002, the company's rates were set by the merger stipulation, and so the economic or income statement effects during that period were born by the company.

Q. So the expense portion of that, are you saying the expense portion of that was absorbed by the shareholders?

A. Yes.

Q. Now once out of the merger rate plan period, then you had a rate case, and so from that point forward I take it the carrying costs or some portion of them would have been expensed?

A. Well, in the -- yes, in the normalized rate making process and historical test year process that we follow, yes.

Q. And so today we have -- are those fairly steady? They certainly appeared to be fairly -- the carrying cost appeared to be about 8, between $8 and $9 Million a year in the first few years based on the things I have seen in the record. Is that fairly constant over the life?

A. I saw that just this morning for the first five years, and I didn't look at it for all the years, so we might ask Mr. Story about that.

Q. Okay, fine. But whatever it is today, all of it is being expensed?

A. Yes.

Q. Okay. I have just one other brief area. You made reference earlier today in response to a question to the ongoing process of evaluating the virtues of being short, long, or balanced. Now we had some testimony from Ms. Ryan yesterday basically describing the short position as being two years out and earlier, the long position being two years and more or more than two years I should say, and then balance presumably would be some blend of short and long?

A. You're referring now I think to the time frames over which we manage our portfolio.

Q. Yes.

A. Yes.

Q. I'm trying to get some sense of the parameters of what balanced means. I think when you gave your testimony --

A. I see.

Q. -- I wasn't clear on what that meant, what you meant.

A. Well, as I think you know, presently and looking forward the company is deficit in firm power supply, and that occurred because of load growth and because of the expiration of some long-term supply contracts, and so now both in the near term and in the long term the company is deficit on a firm supply basis.

Q. Okay, now --

A. I hope that's responsive.

Q. Well, you're talking about the electric portfolio, I want to focus on the gas.

A. Okay.

Q. The fuel gas portfolio for Tenaska, I think that's the context in which the testimony was given. And the company has the option in terms of that portfolio of fuel of being long, being short, or being balanced. And what my question is, what does it mean, what would it mean to be balanced? I think the company has in fact operated on a short basis.

A. Well, it's a good question, so what does it mean to be balanced. As I mentioned earlier, this resource and others with similar heat rates are marginal resources for the company, if you will. So in our merit order dispatch stack, these are some of the first resources to be displaced and the last resources to be dispatched. And so looking forward, it's difficult to know exactly what it means to be balanced, because we have variable loads, we have variable hydro supply, all of those things. So it's not as simple as just going out and purchasing forward for the next eight years 50,000 MMBtu's per day of gas. Because the amount of gas that's needed by this generator fluctuates with the fluctuation in load, hydro, and economics actually, the market price of replacement power. So it's not actually as simple as what was portrayed in the presentation materials that were in the exhibit yesterday.

JUDGE MOSS: That's all I have.

Anything further from the Bench?

All right, did the Bench's questions cause other counsel who had cross examined Mr. Gaines to have any follow up?

MR. CEDARBAUM: Your Honor, I just have one question. I'm actually not sure it was in response to the Bench's questions, it was just a comment that Mr. Gaines made that I would like to clarify.

R E C R O S S - E X A M I N A T I O N

BY MR. CEDARBAUM:

Q. Mr. Gaines, you had indicated I believe that you thought that all of the risk management committee meeting documents that have been provided in your rebuttal case were all that have been preserved by the company. Do you recall that?

A. I think I was asked if I kept my own personal notes, and I think I indicated that I didn't, and then --

Q. I think you indicated that you didn't have any, that you didn't take any.

A. Mm-hm.

Q. But I thought you also said that you understood that the documents that had been supplied to the parties in this case were all the documents that had been preserved?

A. Yes.

Q. So my question is, were there other documents that were not preserved that you're aware of?

A. No, none that I'm aware of.

MR. CEDARBAUM: Okay, thank you.

JUDGE MOSS: Well, our luncheon recess today is going to need to run until 2:00 and so we can continue on until 12:30. If you think you can finish your redirect fairly promptly, it might be beneficial to proceed. What do you think?

MR. GLASS: We can proceed.

JUDGE MOSS: Do you think you can finish up in 30 minutes?

MR. GLASS: I hope so.

JUDGE MOSS: Okay, why don't we press on until 12:30 then, and we'll break then, and again we will be gone until 2:00.

R E D I R E C T E X A M I N A T I O N

BY MR. GLASS:

Q. Mr. Gaines, the first question I have is a clarification with regard to a question that Chairwoman Showalter asked. She asked if the '92 order imposed a fixed cap or somehow set a fixed amount that would be allowed in rates less a disallowance. Do you agree that there was an actual cap on the costs that could be recovered?

A. No, I don't, I think those orders are fairly clear and speak for themselves, and they talk about a percentage disallowance of net contract costs associated with Tenaska.

Q. What were those excess costs? Mr. Cedarbaum asked you and I believe pointed you specifically to -- let's just get the exhibit in front of you. This is the 19th supplemental order, which I believe has been marked as Staff Cross 82.

JUDGE MOSS: Exhibit 82.

Q. Right, and in particular on page 47 of that order.

CHAIRWOMAN SHOWALTER: What page?

MR. GLASS: Page 47, Conclusion of Law Number 3 at the bottom.

JUDGE MOSS: I think we all have that.

MR. GLASS: Great.

BY MR. GLASS:

Q. Mr. Cedarbaum referred to the middle or to the second line, the excessive costs. Could you explain your understanding of what the excessive costs were?

A. My understanding of the way that this was computed was based on a comparison between the company's avoided costs at that time, its avoided costs under PURPA, and the cost of these particular contracts, that comparison was made subject to some adjustments. And one of the adjustments that was made was one that criticized the company for not adequately accounting for the displaceability of the Tenaska power plant. So that when the comparison is made with that adjustment, the cost of this power was 1.2% higher than the avoided cost, and so that was the basis of the disallowance.

Q. So the disallowance, that 1.2%, was specifically related to the dispatchability value?

A. That's my understanding. And while I probably couldn't point you to it precisely, I think you will find that laced through these two orders.

Q. And just to reiterate a question that was asked, that 1.2% has been applied, or has that 1.2% disallowance been applied since this time in 1994?

A. Yes, consistently.

Q. To the extent that the contract charges have fluctuated over time, no party has ever advocated that there was a cap set in this order in 1994?

A. I have never heard that before, not even at the time of the restructuring in '97.

Q. I would like to move forward to the context of the time that you made the decision to restructure, and I'm looking for the reference to the pie charts exhibit.

A. My Exhibit 31.

Q. Yes, your Exhibit 31, which was corrected a few days ago.

JUDGE MOSS: That would be our Exhibit 58.

MR. GLASS: Correct.

BY MR. GLASS:

Q. Mr. Gaines, could you please explain the significance of the before and after?

A. I can. What we are trying to illustrate here is the nature of or the cost characteristics of the company's power supply portfolio both before and after the restructuring. As I mentioned in my cross-examination earlier today, before the restructuring the company had very little of its supply portfolio responsive to market. It was almost entirely fixed price. About 6% only was responsive to market, as you can see in this exhibit. After the restructuring, we had increased the market responsive component to about 18%, and it just turned out that that corresponded approximately with the amount of industrial load that had gone to market price service.

Q. When you refer to going to market, was that pure reliance on spot markets as you found them, or was that something else?

A. No, as we indicated at the time and has been discussed yesterday and today, our approach to the gas supply management for Tenaska is to procure the physical gas itself primarily in the spot markets and then to do the sort of near-term hedging and risk management that Ms. Ryan was talking about yesterday.

Q. I would like to now shift to Exhibit 95, please, which is ICNU Cross-Ex. 9, specifically page 4.

A. I have it.

Q. Do you recall where this document came from?

A. It looks like one of the exhibits to the Tenaska accounting petition back in late '97.

Q. Can you explain what the two columns, what that information is?

A. I can. I believe this is the expected savings year by year that would result from the restructuring based on the gas price projections at that time. So in other words, this is the allocation of the savings year by year.

Q. So if 2004 is roughly a mid point, what allocation of the savings occurred from '98 to 2004 versus from 2005 to the end?

A. Well, if I just eyeball this, probably less than half the savings were expected to happen in the early years through 2004, more than half in the latter periods.

Q. I believe Mr. Van Cleve asked you for a legal conclusion, and I didn't quite get fast enough to actually bring it up, but he asked you whether you believe that fuel costs have been prudent from '97 or whether this case centers on the prudency of fuel costs from 1997 to the present. Do you recall that question?

A. Generally, yes.

Q. Aren't the relevant time periods in this case the PCORC rate period and the reasonableness of the costs in that period and by reference of the case in the PCA compliance docket the relevant time frames there?

A. Well, I think that's right, those are the only two periods really at issue in this case and that hit customer rates. Those are just two annual periods.

Q. So, for instance, as you have explained, there were short-term gas prices and management in the '97 and '99 periods, do those costs affect in any way the two time periods that are at issue here?

A. None of the gas supply purchasing or hedging that we did in the early years of this transaction have any lingering effect in the PCA period or the PCORC period.

Q. You have provided in your testimony Exhibit 51, which is a time line, and I would like you to refer to the time line as we discuss a few really relevant points in time.

A. All right, I have it.

Q. Sorry, I need to catch up.

Can you please explain what this graph represents?

MR. CEDARBAUM: Your Honor, I will object, this witness was not asked on cross -- this is beyond the scope of redirect. This witness was not asked any questions on this exhibit during cross or anything really about the time sequence or events that he describes on that exhibit. This is beyond the scope.

JUDGE MOSS: Well, I think we have had considerable testimony back and forth concerning the historic setting in which we find ourselves and events that transpired through that period, so in terms of the general objection, I will overrule it.

You may proceed.

BY MR. GLASS:

Q. Mr. Gaines, could you please explain in the context of the time leading up to the decision in 1997 and how that related to the gas prices which are portrayed at the bottom of this exhibit?

A. Well, let me set a little context for this exhibit. This is a retrospective look at the company's gas supply management going all the way back to late 1997, and so we thought it would be helpful to provide an exhibit like this to set in context not only the gas prices but a number of the events that were unfolding in the industry, and so that's the purpose for the exhibit.

And as we march through it, you know, particularly looking at the first page, we can see the gas prices both on NYMEX and in the Pacific Northwest at Sumas were pretty stable and hovering around $2 per MMBtu. And then as we begin to march forward through the exhibit, and the format changes a little so that we have only one year per page going forward, gas prices again particularly in the Northwest low and stable in '96 as a lot of the impetus for retail access and industry restructuring continues to unfold up above. In '97, again relatively flat and stable gas prices.

And it's at the end of '97 here that the Tenaska restructuring was done, and it is at this point as I understand it that some of the parties in this case assert that gas prices should have been locked by the company for Tenaska. And I think what's important in the determination of prudence around gas supply management is this context of what the company knew or could have known at the time. So that's a large part of the purpose for this demonstration.

Q. So in December of 1997, which is at the end of page 3, you were seeing gas prices that were continuing and had for a preceding number of years relatively stable at the $2 to $3 range or the $1 to $2 range?

A. That's correct.

Q. Please explain what happened during the time frame of '98 to '99.

A. Well, as we got into 1998, the gas prices continued low and stable. And as I indicated before, in this year our gas supply costs for Tenaska were actually a little lower than what we had forecast in the initial restructuring petition. And as we move along, similarly in 1999 relatively low and stable gas prices. And it was really not until 2000 in the early months of the West Coast energy price crisis that prices began to escalate both unpredictably and uncontrollably.

Q. Would it be a fair question to ask that at the end of 1999, at the end of -- at the edge, the right-hand edge of that page 5 there, there was no way to anticipate what would occur at the end of 2000?

A. Well, we certainly didn't have an anticipation of that, and I think it's pretty evident that most other market participants didn't either just judging by what happened to even other utilities in this region in terms of the rate impacts and gas fuel costs.

Q. On page 6, the middle of 2000, there have been a number of questions about a set of documents in the June 2000 time frame. Could you place that in the context of this chart?

A. I can. There were a couple things going on here. This was June of 2000, approximately the middle of the time line on this page, and so prices in the gas markets had begun to rise, that was part of the impetus for the retrospective that we did in June. The other part of the retrospective was that the company was continuing its efforts to implement and develop an internal risk management capability, systems, procedures, all those things. And so the combination of those two things drove the interest in a status update and a look back at this point in time.

Q. In just a minute we're going to return to the exhibits, the June 9th I think exhibits that was the hindsight self assessment, but let's continue on finally to through 2001. At the end of 2001, please describe what somebody active in the gas trading markets would have been assuming then about the gas markets?

A. Well, it's pretty clear from this chart that prices were falling during this period, and I think it might be an interesting exercise for all the parties here to hypothetically position themselves in December of 2001, that's what we knew about the gas markets at the time, and ask themselves what the company should have done at that point. Is that a time to lock gas prices? Is that a dip? Do we know? I'm not sure.

Q. I would like to turn now to I believe it was Exhibit 77, which was the risk management documents in June of 2000, June 9th, 2000. And in particular on page 28, I believe Mr. Van Cleve quoted a portion of that paragraph starting, since the transaction.

A. I may not have the right exhibit.

Q. Okay.

A. June 9th of 2000?

Q. Yes, this is page 28. This is ICNU Cross Exhibit 1. This is behind the tab June 9th, 2000.

A. All right, I have it now.

Q. Could you please read the entire sentence into the record, since the transaction, which is I think the third paragraph.

A. It reads:

Since the transaction, PSE should have developed and implemented short, intermediate, and long-term plans for hedging Tenaska gas costs that should have included specific trigger prices, hedge quantities, and hedge durations.

Q. What does the should have mean?

A. It means that that's what a prudent gas manager should do. And, in fact, it's what we did do during this period.

Q. So this should not be read as a conclusion that the company had not done the things mentioned here?

A. Oh, no, no, it's not intended that way at all. It's --

Q. The documents here in this risk management, which is the June 9th period, you briefly mentioned them before, there are actually three separate documents. Could you explain the hindsight review that was going on at this time?

A. Well, as I was mentioning a minute ago, I think there were two drivers for this review. One was the fact that the company was in the middle of implementing and developing its risk management capability, hiring people, developing procedures, installing systems. At the same time, gas market prices had begun to rise in early 2000 in what turned out to be the early periods of the West Coast energy price crisis. And both of those things caused the company to take a pause and a look back not only at the status of its risk management capability, but also to focus in on two particular transactions and gas management situations and do a retrospective of its activities.

Q. Do you think it's a prudent or a reasonable thing to do to continually reassess contract decisions and these types of decisions?

A. It's not something that we do often, but we thought it was a useful exercise at this time.

Q. I would like now to focus on the 12, well, the December 13th, 2001, risk management meeting minutes, which are in the same exhibit, I think we're looking at page 73. In particular, please refer to page 78. There was some discussion yesterday about what the company -- whether the company should hedge long term or short term and what actually the result was. As a member of the risk management committee at that time, what do you recall the decision made or the recommendation and how, what occurred afterwards?

A. Well, my recollection about this is actually not very good. So I do recall that there was some discussion about this and some analysis that was brought by the staff, but I really -- I really don't remember myself how it was acted on.

MR. GLASS: I might -- we -- the company recently reviewed this and revised a data request with regard to this, with regard to this time frame. I would like to make sure that the revised copy is actually in the Commission's record. It happened early Monday morning. And with regard to 6.11, sorry, the old version I believe was admitted as Exhibit 92.

JUDGE MOSS: I have 92 as an ICNU Cross-Exhibit Number 6, PSE response to ICNU Data Request 6.11.

MR. GLASS: Does it say response or revised response?

JUDGE MOSS: Just response.

MR. GLASS: Okay, this is the revised response we have provided to counsel Monday morning. Sorry for the confusion.

JUDGE MOSS: All right, we'll just use it to supplement the existing Exhibit 92 as the updated response.

BY MR. GLASS:

Q. Mr. Gaines, we won't go into great detail on this, but would this refresh your recollection, do you now recall what transpired at that time?

JUDGE MOSS: Haven't we already covered this, Mr. Glass?

MR. GLASS: We can move on.

BY MR. GLASS:

Q. One final question or two. The Chairwoman asked you if there was a normal gas price. For the purposes of setting rates, is there a normal gas price or a normalized gas price that we used in this proceeding?

A. I'm not sure I follow.

Q. The company has used the NYMEX gas prices; is that correct?

A. That's correct.

Q. Okay. And the NYMEX gas prices are based upon market information?

A. That's correct.

Q. Okay. Would it be a correct thing to normalize those forward prices in some manner?

A. Well, I don't think so, and in fact I'm not even sure how you would go about it, because all of the factors that affect the market prices are already factored into the prices, if you will.

MR. GLASS: No further questions.

JUDGE MOSS: Well, are we going to be able to release our witness from the stand?

MR. CEDARBAUM: I just have a short two or three questions.

JUDGE MOSS: Does the Bench?

CHAIRWOMAN SHOWALTER: Go ahead.

JUDGE MOSS: All right, we'll indulge a short two or three questions.

CHAIRWOMAN SHOWALTER: We're getting hungry.

MR. CEDARBAUM: I know what that means.

R E C R O S S - E X A M I N A T I O N

BY MR. CEDARBAUM:

Q. Mr. Gaines, my questions have to do with your understanding of the Staff case. And is your understanding that the Staff's position is that the company should have locked in long-term gas prices when it restructured the Tenaska contract or that the company has not demonstrated that what it did do was a prudent and reasonable thing to do?

A. You know, I can't really tell. They seem to want to use the prices in late '97 as a benchmark of some kind, but I can't really tell.

Q. Well, isn't it correct that the use of those prices is for measuring the amount of the disallowance; is that right?

A. They certainly proposed that, yes.

Q. And so you're not clear then -- let me ask it this way. In the 1994 prudence review case, the Commission went through sort of a two part process. It first determined whether or not the company had been prudent in acquiring Tenaska, it concluded that the company had not been prudent, so it then tried to measure an adjustment to make sure that rate payers were not harmed.

A. Generally, yes.

Q. Is that basically it?

A. Mm-hm.

Q. Is it your understanding that Staff has or has not done a similar kind of thing where it looked at -- it tried to determine whether or not the company had shown that it was prudent, reached a conclusion that the company did not make that showing, and then measured a disallowance based on that conclusion?

A. Well, I really can't tell. There seems to be a lot of discussion about a damage calculation in the Staff's case, but I'm not sure where the foundation for it is.

Q. Isn't it true the foundation for it was the savings, stream of savings that the company showed in its petition to the Commission?

A. I can't tell how that's a demonstration of imprudence.

MR. CEDARBAUM: Thank you, those are all my questions.

JUDGE MOSS: I think we may now be in a position, yes, it appears that we are.

So, Mr. Gaines, we did get you off the stand prior to the luncheon recess.

THE WITNESS: Thank you.

JUDGE MOSS: So that you may enjoy a nice lunch.

And I think after lunch then we'll have Mr. Story; is that right, Mr. Glass?

MR. GLASS: Pardon me?

JUDGE MOSS: We'll have Mr. Story after lunch?

MR. GLASS: Yes.

JUDGE MOSS: All right, very well, we will be in recess until 2:00 this afternoon, see you all then.

(Luncheon recess taken at 12:30 p.m.)

A F T E R N O O N   S E S S I O N

(2:05 p.m.)

JUDGE MOSS: We had earlier in this proceeding the stipulation between PSE and WUTC Staff regarding the weather normalization adjustment. The Commission entered an order approving that. I have marked it as a Bench exhibit for purposes of our record Number 1, and so I will admit that on the Bench's own motion today.

And in addition to that, we have as part of that stipulation the agreement that the testimony of Dr. Yohannes K. G. Mariam would be admitted along with his single exhibit, prefiled direct exhibit, as evidence in support of the stipulation and that cross-examination will be waived. The Bench has no questions for Dr. Mariam, and therefore I will propose that we enter his exhibits by stipulation without requiring him to take the stand.

MR. GLASS: That's fine.

JUDGE MOSS: All right, then Exhibits 321 and 322 will be admitted along with Exhibit 1.

And with that, although Commissioner Hemstad has not joined us, he had another appointment and instructed that if he was not back by 2:00 that we should resume without him and he will join us as soon as he can, so if you would call your next witness, Mr. Glass.

MR. GLASS: Puget Sound Energy would like to call John Story.

JUDGE MOSS: Please raise your right hand.

(Witness John H. Story was sworn in.)

JUDGE MOSS: Thank you, please be seated.

Whereupon,

JOHN H. STORY,

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

D I R E C T   E X A M I N A T I O N

BY MR. GLASS:

Q. Good afternoon, Mr. Story.

A. Good afternoon.

Q. Please state your position.

A. I'm a Director of Cost and Regulation with

PSE.

Q. Did you prepare testimony for this proceeding?

A. I did.

Q. Are your direct testimony and exhibits, Exhibit 211 through 219, prepared by you or under your direction?

A. They were.

Q. Were your rebuttal exhibits, Exhibits 220 through 227, prepared by you or under your direction?

A. They were.

Q. Have you identified any errata in your testimonies?

A. Yes, I have.

Q. And those were filed last week?

A. That's correct.

Q. Are you prepared today to answer questions about your testimony and exhibits?

A. Yes.

MR. GLASS: Your Honor, I would offer Exhibits 221 through 227 into the record at this time.

JUDGE MOSS: What about 211 through 220 or 219?

MR. GLASS: Oh, 211 through 227, excuse me.

JUDGE MOSS: That's quite all right.

MR. GLASS: Going too quickly.

JUDGE MOSS: No problem.

Hearing no objection, those will be admitted as marked.

And the witness is available for cross-examination, Mr. Cedarbaum.

MR. CEDARBAUM: Thank you.

C R O S S - E X A M I N A T I O N

BY MR. CEDARBAUM:

Q. Hello, Mr. Story.

A. Hello.

Q. This morning Judge Moss had a colloquy with Mr. Gaines about carrying costs, and I just wanted to make sure the record was clear from an accountant's perspective on what that is. Is it correct that the carrying costs that were discussed involved interest on the money that the company borrowed in order to restructure the Tenaska contract?

A. Well, they were actually an 8% rate, so it was a rate determined in the order. I don't know if it was the exact cost of borrowing. It was just an 8% rate, and then it was applied to half of the balance.

Q. But the 8% rate was intended to represent the interest on the money the company borrowed to restructure the contract?

A. That's correct.

Q. Okay. And then half of that interest the Commission allowed the company to include in the regulatory asset as well; is that right?

A. That's correct.

Q. And the regulatory asset is a part of rate, the company's rate base?

A. It is now, yes.

Q. And so there may have been some discussion this morning about the carrying costs being expensed. By that what we mean is that the carrying costs are recovered essentially through a rate of return calculation and the revenue department determination; is that right?

A. Since 2002, that's correct.

Q. And when we talk about expensing something with respect to the reg. assets that we're talking about, the amortization of the regulatory asset itself; is that right?

A. That's correct.

Q. Okay. Let me turn to your rebuttal testimony in Exhibit 220. Can you tell me in what FERC account the company books the amortization of the Tenaska regulatory asset?

A. I believe it's account 407.
Q. I am told actually that it's account 555 for purchase power; am I wrong on that?
A. I was just going to double check that. I will accept that subject to check.
Q. Can you tell me in what FERC account the company books the amortization of the Encogen Cabot regulatory asset, or would you accept subject to check account 547 for fuel?
A. I will accept that subject to check.
Q. On page 12 of your rebuttal testimony you reference Financial Accounting Standard Board Statement Number 71.
A. Yes.
Q. If I could have you turn to what's been marked for identification as Exhibit 228; do you have that with you?
A. Yes, I do.
Q. Do you recognize this document as portions of what I will call FAS or FAS 71?
A. Yes, it's the original FASB.
Q. Is it your understanding that these sections of FAS 71 remain in their current form today?
A. No, they don't. Paragraph 9 has been amended by 144.

Q. Is that the only amendment?

A. Well, paragraph 9 was amended by SFAS 144, and then paragraph 10, which isn't here, was also amended, and it amends paragraph 9 also.

Q. Sticking with this exhibit though, paragraph 9, which is on the second page of the exhibit that actually has the page number 3 at the bottom, the subparagraphs 9(a) and 9(b), are they essentially paraphrased by you in your rebuttal testimony at the top of page 12?

A. That's correct.

Q. If you could turn to the first page of the exhibit, paragraph 5, this paragraph has three subsections which set forth other criteria that need to be met in order for FAS 71 to apply; is that right?

A. That's correct.

Q. In looking at subparagraph (c) it says:

In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the enterprise's costs can be charged to and collected from customers. This criterion requires consideration of

anticipated changes in levels of demand
or competition during the recovery
period for any capitalized costs.
Are you familiar with that provision?

A. Yes, I am.

Q. In your opinion, when the company came before the Commission in 1997 to restructure the Tenaska contract and receive permission to book that regulatory asset on its books, did the company meet that criteria in 5(c)?

A. When we received the order it met the criteria, right.

Q. Do you believe the company still meets that criteria?

A. Currently if the Commission were to adopt Staff's proposal, it may not.

Q. I'm asking you whether you think the company under its case meets that criteria?

A. Under the company's case, it does, yes.

Q. Is it correct that the company has maintained the Tenaska regulatory asset on its financial statements continuously since 1997?

A. 1998, correct.

MR. CEDARBAUM: Your Honor, I would move the admission of Exhibit 228.

JUDGE MOSS: It will be admitted as marked.
BY MR. CEDARBAUM:
Q. Mr. Story, would you agree that just from general accounting theory that in order for an asset or an expenditure to be considered for capitalization rather than expensing that there has to be an element of future benefit for that asset?
A. I'm sorry, could you repeat the question again for me?
Q. The question is whether you agree from the general theory of accounting that in order for an expenditure to be considered for capitalization rather than expensing that there has to be an aspect or a characteristic that that expenditure will have future benefits?
A. No, not necessarily.
Q. Let me ask you to turn to page 3 of Exhibit 228, paragraph 58, and this is the page that has actually the page number 24 at the bottom, do you know was paragraph 58 amended by FAS 144?
A. No, it wasn't. These are basis for conclusions, and this is actually the exact example I was talking about where I was thinking an answer would be no, it doesn't have to have a future benefit. Storm damage you can accrue like some utilities can accrue

prior storm damage, but it doesn't create a future benefit. All it is is recovery of those costs.

Q. Let me ask you to look at the first sentence of paragraph 58. It says:

The economic effects cited by most
respondents is the ability of a
regulatory action to create a future
economic benefit, the essence of an
asset.

Do you agree with that statement?

A. Right, that's a future economic benefit to the company. The way I was taking your question, was there a future economic benefit like say to the customer or another party.

Q. Looking at paragraph 66 of the exhibit, which is on the page numbered 26 at the bottom, do you know if paragraph 66 has been amended by FAS 144?

A. I'm having a little problem with the word amended. These are reasons for conclusions, and they don't get amended. You may have a change in a future SFAS pronouncement that may change the reasoning, and it may impact this type of reasoning, but these normally do not get amended because they were the reasons at the time.

Q. I guess I was picking up on either my word or your word, one of us or both of us used that word before, so I was trying to use it again. But I guess the question is, did FAS 144 have an impact or change this reason, what did you call it, a reason for discussion, a basis for a conclusion, I'm sorry, did it change that at all?

A. I believe it could, yes. The changes that they put into 144 basically say that a commission can create an asset, but they can also do away with an asset by their actions. If a cost isn't recovered in a future regulatory proceeding, then you may have to write off the underlying asset. But then 144 also changed how you can put an asset back on the books. I think 66 could have been changed.

Q. Can you point me to the specific language in paragraph 66 that you believe was changed by FAS 144?

A. I'm not saying that the language was changed, I'm saying the reasoning may have changed.

> But regardless of the actions of the regulator, if the market for the enterprise regulated services or products will not support a price based on costs, enterprises rates are at least partially controlled by the market. In that case the cause and effect

relationship, the cost and revenues that
is the basis for the accounting required
by the statement can not be assumed to
exist.

So if you were to change the underlying costs that the company can recover on a regulatory asset, in my mind you would fall under 144, and you may have to write off the underlying asset.

CHAIRWOMAN SHOWALTER: I'm just going to interject, we're talking about accounting items, it's very hard for us to follow, can you just be sure that you each speak fairly slowly and clearly and project your voices and not go over things too rapidly.

THE WITNESS: It's exciting stuff.

BY MR. CEDARBAUM:

Q. Looking at paragraph 66, the beginning of the second sentence says, regardless of the actions of the regulator, is it correct that FAS 71 as it may have been impacted by FAS 144 would still lead to the conclusion that there could be actions outside of actions taken by a regulator that could affect the ability of the company to maintain a regulatory asset on its books?

A. The way I would interpret that statement is that if the market were to change, like if you were to lose customers and you hadn't rechanged, you hadn't reset your rates, it may not take action. I mean you don't have to write off the asset because you're not recovering the cost just because you don't have the revenues coming in. But if the market were to change and it was to get built into rates, then the underlying costs could be written off.

MR. CEDARBAUM: Okay, thank you, Mr. Story, those are all my questions.

JUDGE MOSS: Mr. Van Cleve?

MR. VAN CLEVE: No questions, Your Honor.

JUDGE MOSS: Mr. Brookhyser?

MR. BROOKHYSER: No questions.

JUDGE MOSS: Mr. ffitch?

MR. FFITCH: No questions.

JUDGE MOSS: Questions from the Bench?

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. Do we have copies of FAS 71 and FAS 144 in this record?

A. We have a partial 71 that Staff just put in 228. We do have a full copy of 71, and we can provide a full copy of 144 if you would like.

Q. Going first to 228, is the first two pages of 228 the relevant portions of FAS 71?

A. No, there's about 24 paragraphs in SFAS 71 give or take a couple of paragraphs. Paragraph 9 and 10 are kind of important. Paragraph 9 has been amended by -- it's been amended by SFAS 90, 92, 121, and 144. I would say the major amendment came in 144. It added a paragraph to the end of paragraph 9 and then also amended paragraph 10, which refers to paragraph 9.

Q. I think I'm having trouble with what is a standard and what is a reason for a conclusion. Can you explain to me what is here in Exhibit 228?

A. Exhibit 228 is the first two pages. The first two pages are a part of the standard. The standard actually gives the guidelines that the accounting profession has to follow as far as handling a certain type of item. In this case it's dealing with regulation.

Q. All right. But then with respect to paragraph 9, that's a standard, but you say it was amended by standards 92, 121, and 144?

A. And 90 also.

Q. And 90?

A. Right. As accounting has progressed, they do come out with new standards that may amend the way you treated accounting items in the past. And what they would normally do is they put out a new standard, and then they tell you what it supersedes or amends. And they will mark the old standard so that you can understand that it's no longer the way it's written, you have to go to a new standard to read the update.

Q. But at what point in time was paragraph 9 here in effect, and when was it superseded?

A. Paragraph 9 became effective in 1982 when SFAS 71 became effective. And SFAS 144, I don't have a date on that one, but I believe it was just recently. And I can read you the amendments on paragraph 9 if you would like.

Q. No, I would rather get a written copy.

A. Okay.

Q. Thank you.

A. The way you have to read these standards is you will, when you get a new standard 71 which we can provide, paragraph 9 will have a line beside it. And at the beginning of that paragraph or SFAS 71, they will tell you every paragraph that's been amended or superseded. And then you have to go to the new standard, and at the back of the new standard it will tell you what's changed in each of those paragraphs of the standards that you're looking at, so we will provide a 71 and a 144.

Q. Okay, I would like to make that a Bench request, something that makes it evident what changed in this standard as time went on.

A. Okay.

Q. And then just continuing on the next two pages beginning with paragraph 55, those are reasons supporting the standards?

A. Yes. Generally what the Accounting Standards Board will do is they will have a writeup at the back of a pronouncement or a new standard talking about the process they went through in deciding why they're going to go with a certain standard, and that's what these are.

Q. All right. So in these amendments that you're going to provide, are they accompanied by additional reasons for why they were, why the standards were revised?

A. Yes, but it may not address a certain paragraph within the old standard. It's just the new reasoning as to why they're amending an accounting pronouncement.

Q. Can you provide those as well in this Bench request?

A. Yes, they're part of the standard.

Q. Thank you.

JUDGE MOSS: And this will be Bench Request

Number 2, Mr. Glass, and we'll reserve Exhibit Number 3.

BY CHAIRWOMAN SHOWALTER:

Q. There was one other question that I believe Mr. Gaines said I should ask you, which is about how the benchmark is changed from time to time, and I believe he explained that in this proceeding the benchmark is established for the period ending March 2005?

A. That's correct.

Q. What happens after that? Is there some kind of automatic mechanism, or that does the benchmark remain unless the company comes in and asks that it be changed?

A. A particular cost would remain the same until it's changed for setting the rate. With the natural gas, that happens to be one of the variable costs within the PCA, so the actual cost that we incur during the PCA period is run through the PCA. And unless we're in one of the bands, you know, sharing bands, that cost gets passed through. If we happen to be in the first $20 Million of the band, the company would eat the difference between what's built into rates and what the new cost is, receive a benefit if the cost were lower. As far as the changing of the PCA rate, there's two ways to do that. We can do it through a PCORC mechanism like we're in right now, or we can do it in a general rate case.

Q. I'm trying to determine the default. Let's say we accept the company's proposal and adopt the NYMEX benchmark.

A. Mm-hm.

Q. And now it is March 2005.

A. Yes.

Q. And neither the company nor anyone else has come in to us. First of all, is that possible under the order setting up the PCA mechanism, and if it is, what happens in April of '05?

A. The rates would still be set using the NYMEX set in this rate proceeding, and it would just go forward until it was changed either through a new PCORC case or a general rate case. There is no mechanism to change it other than those two methods.

Q. And if the parties other than the company feel that the current benchmark, the then current benchmark is inappropriate, is not in the appropriate mid point, is the burden then on those parties to come forward and propose a new benchmark?

A. Well, I suppose they could, but there's a couple of things built into the PCA where if the companies come in and ask for a rate increase and it's more than 5% during the PCA periods, then we have to file a general rate case within three months of the final order that would give us over 5% of a rate change between the start of the PCA and whenever that happens. And then there's an additional provision that says if we have a PCORC case after three years and we would have to come in for a general rate case. So there are some provisions to come in and change those rates.

If the individual or a party felt that the rate was inappropriate, they could bring it up in a compliance filing. That wouldn't change the rate, but it could bring the company in for -- it wouldn't -- I mean there's no real mechanism I know of other than for them to suggest that that rate be changed in a proceeding, and the Commission could most probably order the company to come in and have it changed.

It's -- but that's only one component of the PCA. You've got to remember too it's all of the other costs are changing. What we're trying to do is come up with a rate that will give the company its recovery of power costs. One component like any rate may be out of line, but something else will be changing so that you hopefully in the future you recover your costs. I mean we're not trying to recover the costs exactly, we're trying to set a rate that will recover our costs over time.

The other safeguard within the PCA is that if you get a credit balance, the customer will get a benefit of a credit balance also. You know, it goes both ways, the bands. So like right now the company has eaten, not eaten but absorbed about $40 Million worth of power costs. It could go the other way.

CHAIRWOMAN SHOWALTER: Thank you.

COMMISSIONER OSHIE: I don't have any questions of Mr. Story.

JUDGE MOSS: All right, Mr. Story, it looks like you may be on the stand briefly, but I do have a couple of questions.

E X A M I N A T I O N

BY JUDGE MOSS:

Q. I was just actually looking through your testimony, I thought I recalled reading in your testimony that you were involved in the restructuring; is that correct?

A. No, I was involved in the PRAM proceedings, the merger, and I was actually in a different position during the restructures.

Q. I see. But you have or you should have a good familiarity with the accounting treatment of this regulatory asset.

A. I do.

Q. For most of its life.

A. Yes.

Q. Okay, good, because that's what most of my questions relate to. I think for ease of reference, and it may be elsewhere in the record we could look as well, but, and maybe your counsel will have to provide you with a copy of this, I'm actually looking at one of Mr. Elgin's exhibits, it's marked in our record as 283, and it was his KLE-3C for the benefit of those who are using that system. This is PSE's petition for the accounting order.

A. I have that.

Q. Do you have that?

A. Yes, I do.

Q. Good. And I would like then for you to turn in the exhibit that I have here it's the upper right-hand corner page number 6, and it says at the bottom, petition for accounting order - 5. Are you on that page?

A. Yes.

Q. Okay. And I'm looking specifically at paragraph 12, and that paragraph talks about, well, it says:

To achieve the targeted savings, the

company requires an accounting order
that obtains the desired effect for rate
making purposes and satisfies the
company's financial reporting and
accounting needs.

And so, it didn't say this but I will add it in, and so:

It is proposed that the order authorize
the company to do the following for
accounting and rate making purposes.

And (a) is:

Capitalize for recovery and rates the
purchase price paid by the company for
the gas supply contract.

Now that was, that's the $215 Million buyout costs?

A. That's correct.

Q. That's what that's talking about. And then it says:

Defer amortization of the purchase price
for five years.

So I think this goes to a point I asked Mr. Gaines about. I was speaking with him in terms of there having been some offset between carrying costs and amortization over the first five years, and it appears to me that I had that wrong, and perhaps my question therefore was -- threw him off, but there was amortization, but it was actually added to the balance of the regulatory asset rather than expensed?

A. Right, you're talking about the interest, it was capitalized, that's correct.

Q. And that was a debt rate of interest, and that's the $8 Million per year we see there added in for the first five years?

A. That's correct.

Q. Okay. And then at (c) actually relates back to that, that's a reference to earn a return at a debt rate, that's when you're talking about carrying costs, that's what you're talking about?

A. Yes.

Q. Okay. And the debt rate I believe you said was 8%?

A. For this calculation, yes.

Q. Correct. And on one half, only on one half of the deferred balance?

A. Yes.

Q. Okay. And then in paragraph (d), and I'm sorry to walk you through this step by step, I just want to make sure I understand it all, step (d) there, the company was to commence amortization of the deferred balance including the accumulated debt return from those early years and the capitalized purchase price, so now we're up to say what, $239, $250 Million, something like that; do you recall?

A. It would be close, it would be about $8 Million a year, so you would have another $40 Million.

Q. So you're looking at $255 Million?

A. In that range.

Q. In that range. And so that's at year six. And the basis for that, the commence the amortization, the basis for that is the pro rata allocation of power cost savings as set forth in Exhibit H for the remaining years. Now are you familiar with Exhibit H?

A. Yes.

Q. It's not part of this, what was Exhibit H?

A. Exhibit H calculated the difference between, and this is from memory so I would like to subject to check my own self, but they calculated the difference between the old contract rate and the market rate that was projected in the '97 order. They got a stream of savings that were basically the difference between those two rates, and then it took this amortization and shaped it into that savings so that proportionately you would have the cost of the purchase, the restructure, put into years that have more or less savings, and you would have some savings coming through in each of the years.

Q. So you would have higher amortization in the out years to reflect the projected greater savings in the out years?

A. That's correct.

Q. And less amortization in the early years to reflect the fact that in those early years the savings would not be as great?

A. That's correct.

JUDGE MOSS: That's basically how that worked. And rather than belabor the point and stretch our memories too far, I'm going to make Bench Request Number 3 that the Bench be provided with and the record be provided with Exhibit H to the petition.

(Bench Request 3 to be Exhibit Number 4.)

BY JUDGE MOSS:

Q. Now that paragraph (d) goes on to say:

> The unamortized balance will be included for rate making purposes for recovery in any future proceedings.

When it says included for rate making purposes, that means as part of rate base I take it?

A. That's correct.

Q. And so on that unamortized balance, the company earns a return?

A. Its authorized rate of return.

Q. Authorized rate of return, okay.

A. Right.

Q. What does that last sentence of paragraph (d) mean?

Interest cost in excess of the amounts in item (c) would be considered for recovery by the Commission in future proceedings.

What does that mean?

A. Not having been involved in the case, I'm not sure, but I would interpret that to mean that the second half of the interest might have been taken up for consideration instead of -- even though it had been expensed as an additional item to be included. That has never occurred.

Q. Okay, well, that sounds a little different from what Mr. Gaines said, which was that the shareholders would have absorbed that, so I'm going to ask as Bench Request Number 4 that the company clarify that point, whether the shareholders absorbed the other half of that interest. Indeed the question can be put quite directly, what does that sentence mean that I was just asking about, because it's now somewhat confused in my mind.

A. I think we're saying the same thing, Mr. Gaines and myself. The shareholder did take that cost, it's just that it could have been considered in future rate proceedings. It never has been, we have never brought that cost in, so it's -- but we can provide clarification on the sentence.

Q. Just maybe clarify it a little bit for me, I would appreciate that.

All right, paragraph (e) says that the company needs to flow through for tax purposes the straight line tax amortization of the purpose price. I don't have any trouble with that one.

(F) says defer power costs savings of $3 Million in 1998, $5 Million in 1999, and so on and so forth, I won't read them all into the record. How would that be reflected in the books in accounting for this asset? If you're deferring the power cost savings, where does that show up?

A. I'm sorry, I don't know the interpretation of that sentence either. We can clarify that.

Q. Okay, and we'll just role this into that same Bench request. I want a clarification of how the company accounted for these deferred power cost savings, whether they're in some fashion added back in as part of the regulatory asset or treated in some other fashion, I don't know.

But then (g), and I'm concerned you're not going to be able to answer this one either, Mr. Story, but then the company says it will flow back the power cost savings in (f), doing the math quickly, it looks like about $40 Million, for accounting and rate making purposes as follows, $17 Million in 2003, $16 Million in 2004, and $8 Million in 2005, and I have a couple of questions. Well, I guess the basic, the overall question is how are these commitments being met in the context of the company's PCORC filing? I haven't seen those numbers, and I would like to know how those are being handled. Basically is the company living up to these commitments and how?

A. This is the -- we will have to provide clarification on that. I think what the difference is here -- well, I won't even speculate. I believe this was the original petition, and that's not the way the final accounting came about in the petition, you know, in the settlement, but we'll provide clarification.

Q. Well, now I am confused, because this is the company's petition, and the Commission approved that petition on the basis as an open meeting item and entered an order in that proceeding with respect to that matter and basically approved the company's petition or granted the company's petition so --

CHAIRWOMAN SHOWALTER: Allowed.

Q. Allowed, thank you. In fact, I'm looking at that if you have -- I think actually I'm looking at a portion of the order, perhaps not.

CHAIRWOMAN SHOWALTER: What exhibit are you on?

JUDGE MOSS: Right now I am on Exhibit 283.

BY JUDGE MOSS:

Q. But we also have, well, I guess it's actually part of that same exhibit it looks like, yeah, part of 283 is the Commission's memorandum order. This is page 19 of the exhibit. This is in the Matter of Petition of Puget Sound Energy for an Order Regarding the Accounting Treatment for the Purchase of the Gas Sales Contract, Docket Number UE-971619. And so the Commission approved the accounting petition, and I am looking at page 23 of the exhibit, which is page 5 of the order, the second ordering paragraph, with one caveat that I will state in a moment, basically restates what is in paragraph 12 of the accounting petition or paraphrases it. And the caveat is, and I was going to ask you about this too, this ordering paragraph says about midway to a little more than midway through, it says:

And commence amortization of the

deferred balance including the debt return and capitalized purchase price in the first year based on, et cetera and so forth.

Shouldn't that say sixth year?

A. That's where I'm having a little bit of a confusion here. I can go back to the work papers on the Tenaska, which I'm sorry is not part of the record, the work papers have been provided to others. And the amortization on Tenaska actually started in year 1, that's why I think the accounting changed between the petition and what was ordered.

Q. Well, and the order does say in the first year.

A. Right, and we did amortize $1,952,000 in the first year, $3,863,000 in the second year. So not having been part of the process for '97, I think it would be best if I just clarify that.

Q. I understand. And again, I think what the company did appears to be consistent with what the order says first year, but of course the petition itself said -- well, and I think the order said somewhere that it approves the petition except as otherwise stated here, so maybe that was one of those otherwise stated. I wasn't around at that time either, so I'm operating in the dark, which is why I have these questions.

JUDGE MOSS: All right, so the general question is how the company has in fact followed this, and if there are deviations from it such as, from the petition, such as we just discussed, then please explain those as well. And I, you know, a narrative response may be supplemented by a table or something like that is the sort of thing I'm looking for, something written in plain English.

(Discussion on the Bench.)

JUDGE MOSS: You know, excuse me, Mr. Story, Mr. Glass, we haven't been setting time frames for the response to these Bench requests, and I know we have a fairly short turn around in our briefing schedule in this proceeding, so can you give me some sense of when you might be able to provide responses to these, could this be done by the end of the week?

MR. GLASS: Certainly.

JUDGE MOSS: I would appreciate that.

CHAIRWOMAN SHOWALTER: And in connection with that last request, just draw your attention to the Staff memo at the open meeting on page 3, item c, the Staff recommendation is that amortization begin in the first year. So apparently the Commission adopted the Staff recommendation. What went on prior to that, I don't know.

MR. CEDARBAUM: Your Honor, Commissioners, I will just note for the record that Mr. Schooley is a Staff witness in this case, and he will be on the stand, and perhaps he can be helpful on these subjects.

JUDGE MOSS: And perhaps if I don't get back to my notes he will be mindful of it and someone will draw him out on this subject so that I can better understand all of this. I do appreciate the comment.

And I think with that, Mr. Story, that completes my questions as well. If there's nothing further from the Bench, we always give counsel an opportunity to jump in one more time before we go to any redirect.

MR. CEDARBAUM: No questions.

MR. VAN CLEVE: No questions.

JUDGE MOSS: Fine, then do we have any redirect?

MR. GLASS: No redirect.

JUDGE MOSS: No redirect, all right, very well.

Mr. Story, we appreciate your help with our case and your testimony today, and you may step down subject to being recalled if needed.

And we never do use the term rest your case, but I do believe that completes your witness list, Mr. Glass?

MR. GLASS: Excuse me, Your Honor, yes, we have no further witnesses to call.

JUDGE MOSS: All right, then just briefly off the record during the lunch recess I mentioned to Mr. Van Cleve and Mr. Schoenbeck that I had him listed next, so if he's ready to go.

MR. VAN CLEVE: He is, Your Honor.

JUDGE MOSS: All right.

Please raise your right hand.

(Witness Donald W. Schoenbeck was sworn in.)

JUDGE MOSS: Thank you, please be seated.

Whereupon,

DONALD W. SCHOENBECK,

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

D I R E C T   E X A M I N A T I O N

BY MR. VAN CLEVE:

Q. Mr. Schoenbeck, do you have in front of you what's been marked as Exhibit 231C through 246?

A. Yes, I do.

Q. And are these documents your direct testimony and exhibits in this proceeding?

A. Yes, they are.

Q. Are they true and correct to the best of your knowledge?

A. Yes, they are.

Q. Do you have any changes or modifications to these exhibits?

A. Not at this time, no.

MR. VAN CLEVE: Your Honor, we would move for the admission of Exhibits 231C through 246.

JUDGE MOSS: Hearing no objection, those will be admitted as marked.

MR. VAN CLEVE: And Mr. Schoenbeck is available for cross-examination.

JUDGE MOSS: Now I'm thinking that we'll go directly to PSE on this, noting however that while Staff and Public Counsel and CCW may be positionally aligned with ICNU, there are also some differences, and so I just want to ask if any of you have any intention of cross examining Mr. Schoenbeck.

MR. CEDARBAUM: I did not off the bat, something might come up.

JUDGE MOSS: Well, clarifying question or something like that, but I meant going in.

MR. BROOKHYSER: Yes, I did have one

question.

JUDGE MOSS: One question, all right, then we'll probably get away with that.

Would you prefer to have the one question from CCW prior to your cross-examination, or would you prefer to go first?

MR. GLASS: That's fine. I would note that we are also, as Mr. Cedarbaum was this morning, sensitive to friendly cross-examination, so.

JUDGE MOSS: Mr. Brookhyser is apparently friendly to everyone, or perhaps hostile to everyone.

MR. BROOKHYSER: Hostile, I like the idea.

MR. GLASS: I would be happy to have Mr. Brookhyser go ahead.

JUDGE MOSS: All right, Mr. Brookhyser, you may ask your one question.

MR. BROOKHYSER: Thank you.

C R O S S - E X A M I N A T I O N

BY MR. BROOKHYSER:

Q. Mr. Schoenbeck, you're proposing an adjustment related to the regulatory asset growing out of the Tenaska buyout; is that correct?

A. Yes, I am.

Q. And in making that recommendation, do you intend any recommendation or do you intend that your recommendation have any implication regarding how Puget manages or fulfills its obligations under that contract?

A. No, I do not. I do not intend that the implementation of my recommendation would cause Puget to abrogate that contract.

MR. BROOKHYSER: That's all I have, thank you, Your Honor.

JUDGE MOSS: Okay, thank you, Mr. Brookhyser.

And, Mr. Van Cleve, you have been silent, so I assume you have nothing. Oh, this is your witness.

MR. VAN CLEVE: This is my witness.

JUDGE MOSS: Just being overly polite. Sometimes accused of being in this case foolish.

All right, Mr. Glass.

MR. GLASS: Thank you, Your Honor.

C R O S S - E X A M I N A T I O N

BY MR. GLASS:

Q. Good afternoon, Mr. Schoenbeck.

A. Good afternoon, Mr. Glass.

Q. Please, by my count there are three issues outstanding between ICNU and Puget Sound Energy at this time, the winter capacity cost, the Tenaska fuel, and the gas pricing in the PCORC time period. Do you agree

with that list of three?
A. Actually, since the testimony was prepared I did review the rebuttal testimony with respect to the winter capacity option issue, and I would be willing to support the joint Staff and company position in that matter, therefore I think we're really down to just a significant two issue rate case at this point in time between the company and us.
Q. Two is better than three. Let's go to the two then. On pages 26 to 31 of your testimony, which is marked as Exhibit 231, you outlined your proposal for a rather significant disallowance of the fuel cost for Tenaska. At the top of page 27, you recite that 2.1% disallowance.
A. Is it 1.2%?
Q. Let's get to page 27. At line 10 on page 27 of your testimony, the last bit of that quote there is a statement or is a copy of something out of the 19th supplemental order; is that correct?
A. Yes, that's correct, and I thought you had said 2.1, and that's why I just corrected it to be 1.2 for the Tenaska contract.
Q. Okay, 1.2%. Do you actually -- in your testimony, do you state that the Commission imposed a fixed price cap in that order?

A. No, I don't believe I stated that specifically at all. I obviously think there were expectations with regard to the reformation of that contract, but I have not stated in my testimony that there was a fixed price cap. However, I think that is one reasonable interpretation to take out of the process, that given the fact that the contract was a must-take contract at a constant price, it would -- could naturally be considered as a fixed price cap.

Q. Would you agree that in the 19th supplemental order in the definition of the remedy and in the 20th supplemental order that the Commission defined the remedy to be 1.2% times -- defined the disallowance to be, excuse me, to be 1.2% times the net contract charges for Tenaska?

A. Yes, I do agree with that, and I guess what I was trying to say is at that time that determination was made it was a fixed price contract. So if the fixed price contract was $83.7 a megawatt hour and you took 1.2% of that, you would end up with a fixed price contract of $82 a kilowatt hour or however the math would work out, and it would still be a fixed price for that contract.

Q. The Commission did not, however, set the fixed price in the 19th or 20th supplemental orders?

A. No, it set a percentage of 1.2%.
Q. Very good. I would like to switch to gas pricing. Your testimony is that PSE's forecasted gas prices based upon the NYMEX market based indexes should not be used as the base power or the base power cost in this proceeding?
A. That's exactly right.
Q. And in lieu of the market based gas price forecast, you suggest that the company should use a fundamentals based forecast?
A. Yes, it gets even a little bit more specific than that. You're looking for a fundamental forecast that does not take into account near-term or short-term nuances. So put another way, in a fundamentals forecast you could take into account, if it's a short range forecast, very recent fundamental information such as supply and demand and withdrawal. What I was looking for is a fundamental forecast that did not take into account short-term information. Obviously I was familiar with the CEC model, and it was also publicly available, so I thought in selecting such a model that it would be readily available, it would be transparent, it would be done by a third independent party.
Q. A point of definition before we continue. You said short term and near term, do you agree or will

you for the sake of continuing in this examination agree with Ms. Ryan's testimony yesterday that the near term at least as far as the company is concerned is within the next two years?

A. Well, we can use that definition. But again, in my mind I think in response to some of the data requests to you I noted how there can be a very recent like a cold snap event in the nation and on the East Coast, and it can result in an upward tic in the NYMEX gas price for each of the 30 months of the NYMEX strip. And what I was trying to say in that data request, that that type of a near-term event has actually kind of long-term implications on the NYMEX strip, so that's the exact type of short-term or near-term event that I was trying to avoid in determining a base gas price forecast.

Q. I would appreciate it if you, that was far more answer than the simple question of the definition of the near term, this will go a little bit more quickly if you answer the question.

So you would agree that the definition of short term for use of our discussion today will be within the two year period?

A. Well, if you want to define it, what I said, if you want to define short term as being two years, I will be willing to accept that in my answers to you.

Q. As you just mentioned, you recommend a model that basically does not take into effect fluctuations in the short-term market that would depart from a long-term fundamentals based model; is that correct?

A. Yes.

Q. And the model that you suggest the company should use is the North American Regional Gas Model published by the California Energy Commission?

A. Yes, and again because it is a -- I think it's a unique model for the circumstances we have before us in this case, and also the results of it are free. It's made by an independent party that publishes the results to anyone who wants to review them.

Q. Please refer to Exhibit 259, which is PSE Cross-examination Exhibit 13.

JUDGE MOSS: 253, I'm sorry, you said 259, didn't you?

MR. GLASS: 259, yes.

JUDGE MOSS: I'm sorry, 259.

THE WITNESS: I'm sorry, Mr. Glass, what was the number then?

MR. GLASS: That was 259, and that was PSE Cross-Ex. 13. Specifically this is the December 2003 California Energy Commission report.

THE WITNESS: Yes, I have it.

MR. GLASS: Great.

BY MR. GLASS:

Q. Have you been provided with a copy of this report prior to today?

A. I obtained a copy for myself prior to today, yes.

Q. Okay. And this is a document or several chapters of a document published by the California Energy Commission entitled Electricity and Natural Gas Assessment Report, and it is a commission report on December 2003; is that correct?

A. Yes, that's correct.

Q. This commission, this report, you would agree, wouldn't you, that this report presents the results of a natural gas, the NARG model results for 2003 wouldn't you?

A. For 2003, no, I would not. Are you talking does this report produce a gas price forecasted from the North American model for the year 2003? Did I misinterpret your question?

Q. I will take that question.

A. No, it does not.

Q. Okay. You indicated in your testimony that on line 3 and 4 on page 19 of your testimony that you used the NARG model results that were used for the CEC's December 2003 publication; is that correct?

A. I'm sorry, I'm really sorry, could you give that reference again?

Q. Your testimony, page 19, line 3 and 4.

A. From the NARG model results used for this publication, that's correct, I see it now.

Q. So just to make clear here, the results that you used in preparation of your testimony are the same numbers that were used to produce this commission report that was from December 2003?

A. To be clear, there is a NARG model run that was used as a portion of the results reported in this report.

Q. Continuing on that same line 4, you propose a $3.60, well, I guess it's the next line, the Sumas price projection of $3.61?

A. Yes, that's correct.

Q. Please turn now to Exhibit 252, which is PSE Cross-Ex. 6.

A. Okay, I have it now.

Q. This is ICNU's response to PSE's Data Request Number 9; do you agree?

A. Yes, I do.

Q. Did you prepare this?

A. Yes, I did.

Q. In the response you were asked to describe how you came up with the $3.61 figure, and I would like to summarize roughly three steps and see if I've got it accurately portrayed. The NARG model prices are annual values as stated in 2000 dollars; is that correct?

A. Real dollars.

Q. Real dollars. And you converted those NARG values, those NARG model values to nominal dollars using the CEC's GNP deflator; is that correct?

A. Which is the same deflator they used in the December report, right.

Q. And then you weighted between 2004 and 2005 75% in 2004, which is nine months, and then three months of 2005 to account for the PCORC rate year; is that correct?

A. That's exactly correct.

Q. And you indicated in your response the NARG prices were from a run date in April of 2003; is that correct?

A. Yes, that the gas price projection that was used in the report that was published in December, but the workshops and the consultation effort that went into developing those prices actually started in January of 2003.

Q. So they started in January, and then the run results were in April of 2003?
A. That's correct.
Q. I would like to turn to yet another exhibit, Exhibit 258, please.
A. I'm sorry, I don't have those numbers, so can you give me your corresponding cross number?
Q. Sure, it's PSE Cross-Ex. 12. And while you're getting there, I will explain what the cover page states, Natural Gas Market Assessment. This is another report by the California Energy Commission, it's a staff report from August of 2003.
A. Yes, I have this as well.
Q. Very good. Have you been previously given a copy of this?
A. Actually the first time I saw this one was when it was provided by you.
Q. Okay. Please turn to chapter 2, page 5, I guess this is page 11 of 60.
A. Yes, I have it in front of me.
Q. Great. Please direct your attention to the NARG model assessment methodology.
A. I'm sorry, I may be looking at the wrong page. Are you talking about the numbers up at the top left or bottom?

Q. Yes, the top left is page 11 of 60.
A. Okay, sorry, I'm on page 17.
Okay, excuse me, now so it's page 11 of 60, it's also page 5 of the report.
Q. Okay, that first paragraph under there reads on the second sentence:

> The general equilibrium model predicts quantities and prices of natural gas needed to balance supply and demand throughout North America over a 45 year forecast horizon in 5 year increments.

A. Uh-huh.
Q. Is that accurate?
A. Well, that's what this report says.
Q. And --
A. The NARG model, the way it was done for the April run actually produced annual results.
Q. But the NARG forecast works in five year increments, doesn't it?
A. Well, it's a supply and demand model. You can run Aurora in hourly increments, you can run it in typical week increments, you can run it in hourly increments or monthly increments, annual increments. The NARG model for the results that were produced in April were run in annual increments.

Q. Annual increments, and so to obtain monthly figures, you would interpolate?

A. You would have to shape them.

Q. Okay. One minute, please.

I would like you to look at page 26. Let me get there and I will tell you what --

A. I'm sorry, are you referring to the top again or the bottom?

Q. I think the top.

A. Okay, yes, I have it.

Q. Excuse me, I need to find the correct page here.

MR. GLASS: Your Honor, I would ask for one minute to find exactly where I need to be.

JUDGE MOSS: Just take your time, find your place.

BY MR. GLASS:

Q. Okay, I figured it out, it's on page 17 of 60 on the top, which is 11 at the bottom, and please direct your attention to the modeling assumptions and data sources. Are you familiar with the general vintage of the historical data upon which the NARG model is based?

A. I guess can you be more specific on the general vintage, are you talking in terms of some of these publications or --

Q. Yes.

A. Well, they're stated here. For example, the Canadian natural gas demand data was based on 2001 data.

Q. Correct. And the annual energy outlook which is roughly in the middle of the page is based upon a 2002 report out of the EIA; is that correct?

A. That's exactly right.

Q. And you would accept subject to check that that is based, that 2002 report is actually based upon 2001 data?

A. Well, if you could provide me something with that, I could accept that subject to check.

Q. Okay.

A. But again, that's, you know, the vintage of the data of -- I don't believe is that significant when you're trying to do what -- I was selecting a model that does not take into account short-term implications, and this would also go with respect to short-term differences in load. I think actually in looking at this report for cross-examination I thought this was actually a critical paragraph that really summarizes what I was looking for and why I chose this model, and it's on page 30 of 60, at the bottom it's page numbers 24. And that's what I think really cuts to the chase on this issue is I was interested in a model that did not take into account the short-term fluctuations, as I believe the NYMEX price series does.

Q. So if you're trying to find a model that does not reflect fluctuations within the next two year period, which is the short-term period, you would actually seek to have a price set without regard to the actual prices that would occur within the next two years?

A. Well, that's why to call two years a short term in the gas industry is I think a little bit extended. I would never refer to two years personally as a short-term period of time. But certainly I think if you start at the other end, I think it would be, you know, a tragedy if this Commission were to update the NYMEX price series right now in the month of February for rates to go in effect on April 1st. Because while I would say that the NYMEX prices for April 1st are a good predictor of what the market price is, I do not believe that's the correct normalized value that should be used for setting the base cost in a PCA, just as PSE has recognized in their own long-term forecasts that the near-term years 2004 and 2005 are high. Prices were lower in 2003, they're predicting them to be lower in 2006, 2007, 2008. So using the NYMEX price in this proceeding has too much near-term market pressures that are not reflected in a base fundamental approach.

Q. Well, that may be true, but doesn't the company if it has to go out and buy gas, isn't it subject to those near-term market pressures?

A. It absolutely is, but there again that's what I think is the critical difference is what I'm trying to testify to is what should be a normalized price of gas, not is what is what I call the next year or the next month price of gas. Because that differential, that risk of the next month's price being either above or below the normalized price should then be flowed through the PCA mechanism and apportionately shared between rate payers and shareholders.

That's why I think the very simple analogy is the 40 water years. This case before you today does not rely on a single water year, they have used 40 different hydro conditions to determine how much generation will be used on a normalized basis for the next month, for the month of April. Well, undoubtedly the forward price of electricity in the forward near-term reports can give you a much better estimation of what the actual power generation will be from the hydro facilities rather than the 40 year, than the average of the 40 year runs. I was trying to do a comparable thing for the gas price, what is a normalized gas price that does not take into account near-term risk that should be shared through the PCA mechanism.

Q. Near-term risk and also near-term real prices that the company will experience?

A. Yes, that's right, because what would happen if we take into account those real-term prices? If we said we will set rates, that was my omniscient example in my testimony where if we set rates knowing precisely what every cost was going to be next month, that would absolutely make meaningless the risk sharing mechanism that was negotiated between the parties in the last rate case where the first $20 million fluctuation in power cost is absorbed by the company, and then there's three more brackets with different risk sharing percentages. If we set the base power cost price based on the exact cost that would be incurred by the company in this period, they would capture all the benefit, and the rate payers would have no -- the rate payers would not benefit from the PCA mechanism.

Q. Conversely if the rate is set at a model's base price significantly less than what the company will actually be able to go out and buy power for, that will be on the company's side of the ledger?

A. That's correct, that's why I think this is a very critical issue that the Commission get this gas price right.

Q. So you would find the CEC NARG model produced based on this 2001 and 2002 data to be a more accurate reflection of the power cost price than the actual forward prices?

A. Did you mean to say gas price or power price?

Q. Gas price, you're right.

A. I thought in putting this testimony together it was the best price available at the time, and I still believe that, because it's in the believable range. When you look at, you know, potential long-term offers on a cogeneration development, you hear certain gas price values, you know, for sustainable long-term values. And I think it also, the $3.61 also is in that range of reasonableness for me just as a price of $4.35 at Sumas for long-term is not within that zone of reasonableness.

Q. I believe you just testified that the best price available, that you believe the California NARG model is the best price available. I would like you to turn to page 26, which is the page or two right after, this is page 32 of 60 in the same CEC report under the heading long-term versus short-term forecasts.

A. Yes.

Q. The first paragraph says:

Providing an annual average price does
not provide insight into the volatility
of the day-to-day market for seasonal
market price. Four factors are not
included in this analysis, weather,
hydro electricity availability, seasonal
demand swings, and changes in economic
parameters. This is a limitation of
long-term analysis describing in this
report.

A. I'm sorry, are you reading the same paragraph I noted earlier? I think I was on the wrong page again. What page at the top?

Q. Page 32 of 60.

A. Okay.

Q. And under the heading long-term versus short-term.

A. Oh, well, yes, and what I was trying to point out before when I said the current passage, for me, it's basically the same paragraph at page 24 where it says the prices in the base forecast, it's basically saying the exact same thing, you know, that --

Q. Right.

A. -- showing long-term prices does not capture the seasonal price variability that occurs in the market. But in my mind it's the base case forecast assumes average weather conditions and availability of hydro in the WCC region, and it does not include the short-term consequences of temperature extremes, droughts, abundant hydro or financial difficulties within the natural gas industry. And also add to that list in my mind it would not include short-term injections or withdrawals from storage that I do not believe should be taken into account in the base gas price forecast, as I believe are absolutely taken into account in the NYMEX gas strip.

Q. I would like to refer still to the same paragraph in the August report, page 32 of 60, first paragraph under long-term versus short-term forecast. It continues:

> Staff has research underway to incorporate these factors into future assessments.

A. Yes, that's what it says.

Q. Continuing in the next paragraph, the last two sentences are:

> These effects can result in higher prices over fluctuating time frames. Quantifying these factors requires comprehensive analysis of short-term

market fundamentals.
Is that correct?
A. Yes, that's correct.
Q. I would like to refer you to then the December 2003 CEC report, which is Exhibit 259.
A. I'm sorry, is that 13?
Q. Yes, I'm sorry, that's 13.
A. Yes, I have it.
Q. Please direct your attention to the last paragraph on page 101.
A. 101 at the bottom?
Q. Yes, 101 at the bottom.
A. Close enough, I have it.
CHAIRWOMAN SHOWALTER: Can you wait for a minute. Page 41 of the exhibit.
COMMISSIONER HEMSTAD: I think it would help the record if you would, the page references would be to the pages of the exhibit so we're not jumping back and forth.
MR. GLASS: I understand. This will be page 41 of 59.
THE WITNESS: Yes, I have it in front of me.
BY MR. GLASS:
Q. The last paragraph reads:
The long-term analysis is based on an

annual average natural gas supply and demand conditions and does not, as we have discussed before, reflect the influences of seasonal and spot market behavior. In order to capture these current market conditions, experience in the power generation sectors, electricity generation simulations and price assessment incorporate NYMEX price information for the early years in this analysis.

And then it goes on to describe figure 4.11, which is actually a revision of the August data.

A. No, this actually uses the April data.

Q. Well --

A. For the NARG report.

Q. Did the April, well, did either the April or the August data include NYMEX for the short term?

A. The NARG is a natural gas fundamentals model. What they did to produce this forecast, the decline in the prices from 2004, 2005, and 2006, or excuse me, only going through 2005, are reflective of the NYMEX strip at the time the report was produced. For the years 2006 through 2007, that's the NARG reports, that's exactly why I wrote my testimony the way I did. I wrote my testimony to say the NARG run that was used as the basis for this report. While they published the NARG results in this graph for the year 2006 on, they actually had produced a forecast for the year 2003 on. That's why I answered earlier the NARG results for 2003 were not in this report, but they are for the year 2006 going forward.

Q. You would agree, however, that figure 4.11 has been -- includes NYMEX prices in that first year?

A. Yes, it absolutely does, more than one year.

Q. So in other words, when the California Energy Commission issued its report in December, it chose to include data with this NYMEX near-term market information in its report?

A. Yes, that's exactly right. But again, you know, I think I have been pretty clear on why I wanted to use the NARG results for the year 2004 and 2005, because it does not have these short-term swings in them.

Q. You're not aware of any proceeding in which the use of the CEC gas price forecast was proposed or advocated for use by the Commission?

A. We're talking about the WUTC Commission?

Q. Yes.

A. I am not aware.

Q. Okay, Exhibit 254, Cross-Ex. 8.

JUDGE MOSS: While Mr. Schoenbeck is looking for that would be a good moment for us to take a recess, so we'll take 15 minutes and return at 3:50 p.m.

(Recess taken.)

JUDGE MOSS: While we're settling in here, I will make sure that I'm clear on Bench Request 4. One of the pieces of information that I want to be sure is in your response to Bench Request Number 4, Mr. Glass, is the amount of recovery of and on the Tenaska and Encogen regulatory assets that are included in this PCORC filing.

(Bench Request 4 to be Exhibit Number 5.)

All right, then let's resume our cross-examination of Mr. Schoenbeck by Mr. Glass.

MR. GLASS: Thank you, Your Honor.

BY MR. GLASS:

Q. We are currently at Exhibit 254, PSE CX-8.

A. Yes, I am.

Q. Okay. This is your response to our data request confirming that you're not aware of this Commission ever using the CEC gas forecast; is that correct?

A. Yes, that's correct, I'm not even sure it's ever been proposed before.

Q. Continuing to PSE Cross-Ex. 10, which is Exhibit 256, there you were asked if any other utility or utility commission has used the CEC model to calculate rates for an electric utility, and you cite a few dockets there, and you suggest that PG&E may or has used the CEC benchmark for gas; is that correct?

A. That's correct.

Q. Okay, very good. And the last exhibit I will go to is Exhibit 261, which is PSE Cross-Ex. 15.

A. Yes, I have that.

Q. Okay. This document purports to be Pacific Gas & Electric Company's 2004 Energy Resource Recovery Account. Do you confirm that that's what it says?

A. Yes, that's the August version, and as I noted in my response to Exhibit Number 256, I was anticipating a February 13th filing for the CEC benchmark gas value would be used, and, in fact, that filing was made on February 17th, and it did indeed use the CEC value.

Q. Is that filing for the same period as this 2004 Energy Resource Recovery Account?

A. Yes, it absolutely is. It's just marked -- I believe it's just simply marked updated, but it's for the same application number, it's application 03-08-004, it's dated February 17th, 2004, and it's entitled 2004

Energy Resource Recovery Account Update Volume 1 Forecast.

Q. Referring to PSE Cross-Ex. 15 again on page 29 of 30.

JUDGE MOSS: Exhibit 261?

MR. GLASS: Same exhibit, yes.

A. Yes, I see that.

BY MR. GLASS:

Q. In the middle paragraph that begins:

PG&E used current forward market prices for energy and natural gas to simulate the economic dispatch of PG&E's resources.

Will you read the sentence that begins natural gas?

A. Natural, on line 14?

Q. Correct.

A. It says:

Natural gas prices are calculated based on the June 23rd, 2003, closing prices for NYMEX gas futures contracts plus broker quotes received on June 23rd, 2003, for basis differences to PG&E's city gate delivery.

MR. GLASS: At this time, Your Honor, I would like to move to have Exhibits 252, 254, 256, 258, 259, and 261 moved into the record, please.

JUDGE MOSS: All right, let me go over that with you, 252, 254, 256, 259, 261.

MR. GLASS: Yes, 258 was missing.

JUDGE MOSS: Do you wish to offer 258?

MR. GLASS: Please.

JUDGE MOSS: All right, is there an objection to any of those exhibits?

Hearing no objection, those will be admitted.

Are you electing not to offer the remaining exhibits designated for this witness?

MR. GLASS: That is correct.

JUDGE MOSS: So we will list as not offered Numbers 259, 250, 251, 253, 255, 257, and I had previously marked as not offered 247 and 248 because they duplicate numbers 82 and 83.

Does that complete your cross-examination?

MR. GLASS: At this time, yes.

JUDGE MOSS: All right, do we have questions from the Bench?

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. First, Mr. Schoenbeck, I missed the very beginning of the cross-examination here when Mr. Glass identified three issues, it had turned out you have reached some agreement in your own mind on one of them and there were two left.

A. Right.

Q. What were the three, and what are the two?

A. Well, the three was the cost associated with the Tenaska contract, second one was what would be the appropriate normalized gas price series to use for setting the base rights, and the third had to do with the cost associated with meeting the test year winter peak, and it was with regard to this latter issue or the third that having reviewed the rebuttal testimony of PSE that I agree with the value. Basically it was they decreased the cost associated, their rejected cost of meeting that peak, by somewhere in the range of $8 to $10 Million.

Q. All right, so the remaining two are the cost of Tenaska and what forecast is used to determine base gas rates?

A. Right.

Q. Now turning to the first one, cost of Tenaska, I thought you testified that a must-take contract at a constant price "could be considered as a fixed price cap". That's what I wrote down.

A. That's correct.

Q. And so my question to you is today on the stand what is your view of what we should do with respect to what we could consider? We can consider it, should we turn it into a fixed price cap?

A. My testimony addresses three possibilities directly on what could be done. I guess subsequently sitting through this hearing I guess I have come up with a fourth. But the three were take the original contract, discount it for the 1.2%, and consider that a price cap that you would use for both base cost purchases and PCA purchases. The second approach would be to take, you know, basically the Exhibit B analysis, which would hold PSE's feet to the fire that the cost savings they had projected should be used to determine rates. The third one which I addressed was just the notion that in looking at it from what we know today, this regulatory asset that was created basically has no value, so write it off, and that's the one I chose among those three. I believe there potentially could be a fourth now as well, and that would be using a, if you will, I hate to use the word, but using a normalized Tenaska cost based on such as the Exhibit B revenue stream.

Q. When you refer to Exhibit B, what exhibit are you talking about in our record?

A. I believe it's my Exhibit 244.

MR. VAN CLEVE: I think it's page 1 of 244C, Your Honor.

A. Yes, that's correct. So what you would do would be to impute a price of Tenaska using the projected or expected prices at that time, which would -- which is reflected on the last line if you look at the first column, the values that -- $1.73 for example. So for the rate year if you go over to 2004, 2005, you would be looking at a price of gas of approximately $1.92 to $1.98 versus the $4.35 that's currently reflected in their base filing. But what you would then do is use the PCA mechanism to reflect what the actual costs end up being for Tenaska.

So in other words, just like we have argued so much over what would be a reasonable normalized cost to use for gas, you could do the same thing with respect to Tenaska to at least get a little bit of sharing then between the company shareholders and the company rate payers. Because under the current circumstance, what's happened is while there was this perceived benefit, it's basically gone away with the net present value of the transaction being zero. But this would allow a mechanism under which the actual cost of Tenaska would be flowed through the PCA and go through the shareholder-rate payer savings bands.

Q. All right. So I have written down four options. On number two, well, I have number two, is that essentially changing or transforming the expectation that was present at the time of the accounting order into a binding promise?

A. Right. In the nuance there between two and four is that under number two you would hold their feet to the fire for both the base cost determination and for the PCA adjustment, so they would net out.

Q. Well, actually I was just at this moment still on number two trying to understand it.

A. Okay, sorry.

Q. Which we would transform the expectation at the time of the accounting order into its own cap?

A. That's correct.

Q. All right. But then was number four taking that expectation and making it the mid point around which risk is shared?

A. Yeah, you know, I use that as an approach. Basically what you would have to do, I used that as an example but that would be the notion, you would come up with a normalized gas price, and maybe it's $3.61 instead of the $1.90 or the $4.35, but then you would use that, and you would use that over the long term of that contract.

What triggered this thought was your discussion with Mr. Gaines when it was basically, well, let's wait to see how we performed at the end of the contract after the year 2011. But what would happen at that point? I don't know what incentive there would be or contentious argument over who had benefited to what extent between shareholders and rate payers. But if you could come up with a bench gas mark right now today as part of this hearing and say we'll allow you to manage around that, and to the extent you can beat that benchmark through the PCA bands, those savings would accrue to shareholders. And if you would be above that band, those additional costs would be born again between shareholders and rate payers. So it's the notion of giving them an incentive to truly manage under that contract when there would be something at risk or something for their reward.

Q. But I just want to make sure I understand what your idea is under option four.

A. Mm-hm.

Q. What I'm understanding you to say, which might not be accurate, is that for Tenaska gas prices we use the expected gas prices at the time the accounting order was approved and fluctuate the risk around that line; is that what you're saying?

A. No, but -- don't focus on the value as much as the idea. I gave as the value say the $1.93 for what the accounting order said, but that would basically give virtually a significant amount of the benefit that would then flow to the rate payers. So what I was thinking to come up with a solid value, a solid gas value, whether it's $3.50, $3.60, $3.70, but it's certainly not $4.35, and set that price constant for each year through 2011. So then to the extent Puget can beat that price in their actual acquiring of gas for Tenaska, they would basically get a benefit from that. And to the extent they could not, those costs would be, again my mind is it's going through the PCA mechanism would be -- fall in within the bands of whatever, whatever the band was for that year, whatever the -- it would be shared between rate payers and shareholders.

Q. Do you agree that this concept that you're now articulating as distinct from using NYMEX or the CEC forecast would require us or would be premised on this idea that at the time of the accounting order there was more than an expectation, or at least if there was no more than an expectation we are now going to transform it into something more than an expectation, i.e., a promise of delivery?

A. Well, in a way.

Q. Either an absolute promise or a promise around which there is a little bit of sharing?

A. In a way. In my view what the accounting order said is, I think you're right, there was an expectation, but then there was the quote in there that talked in terms of however their management of gas would have to be prudent for the remaining time. You know, obviously we have raised some concerns in our testimony with regard to that gas management. But it's a tough, tough issue, but what I was trying to get at was the price used just for Tenaska. So we would -- you would still have the argument on what price should be used for all of their gas fired resources, but it's to focus on a base value for Tenaska, put it in there, and then keep it set through the year 2011 even though we get to continue to have arguments over what would be the appropriate gas value for all of their gas fired resources for the next ten years.

Q. All right. Now just switching gears a little bit, if we, if the Commission takes a different tack and determines that there was no promise, there was an expectation, but the only managerial expectation was that the company would buy gas prudently as opportunities arise.

A. Mm-hm.

Q. Under that scenario, do you think that the company's purchasing patterns were imprudent?

A. Well, you know, trying not to use hindsight, which is, you know, always difficult to do, having gone through many RMC documents, the ones that have been made available to us by the company, in my mind there is I believe a critical series starting actually with the December 13th RMC, December 13th, 2001, RMC meeting documents and minutes when that was the last time they talked in terms of potentially going long for Tenaska throughout the remainder of the contract.

You know, there's fractured information, there's very limited information in the minutes. Even though they're talking in terms of tens of millions of dollars of decisions, if not hundreds of millions of dollars in the case of Tenaska, the only summary you see is one or two sentences in the meeting minutes, so it doesn't tell you much what went on. But trying to glean from the documents I had seen, what it looked like to me they said we've got a market price, we think it's a good market price, however we think the market is going to go down further. That's why there was a discussion with regard to getting a price that's 10% below the market because of their expectations. And then that may or may not have been a recommendation, but there's at least a discussion on that.

In the subsequent, the next two meetings after that December meeting, there was again fundamentals report talking in terms of bearish circumstances with the expectation the price may go down again. And then comes the March RMC meeting report where then they -- wherein there's kind of a big whoops, you know, the market has turned around, things are bullish, and since then they absolutely have had no opportunity to consider any type of a long transaction for dealing with Tenaska.

The other part of the RMC documents that when you go back even further, when you go back into the sketchy notes that are provided from 1999 and somewhat in the year 2000 as well, certainly what you see time and time again is managing gas cost around a budget. We have a budget, how are we deviating from that budget. And in my thought from reviewing those documents, it was a very, very short sighted view of managing their fuel supply at that time during that era. So I believe that there fundamentally was fault with their management of the Tenaska contract up until at least that whole series that ends in, you know, March 2002.

Q. Well, I wanted to ask you a little bit about the approach that was reflected in the December 13th minutes, the idea was prices would probably go down, and so let's have our target be current prices minus 10%. Is that your understanding?

A. That was my understanding.

Q. All right. I would like you to compare that situation with what the company could be faced with if we adopt your recommendation if the CEC prices are below what the company concurrently buy for.

A. Mm-hm.

Q. Isn't the instruction more or less wait until they get to those prices or go below them before you buy; is that a fair characterization?

A. Not quite I don't believe. And again, it's because of the what you're seeing in the near-term prices versus what I believe the goal of this proceeding should be. And then again is, in my mind, again we're talking in terms of what the prices are today versus what they should be for a base normalized rate making determination.

When you think in terms of like the integrating the NYMEX prices or the short-term into the long-term forecast, that's basically exactly where the company itself is today with respect to their analysis, how they evaluated, you know, the acquisition of Frederickson. They incorporated the near-term price expectations with long-term forecasts, so you have that same kind of hockey stick approach where the prices decline and then they start going up.

So where are we here today when they're asking for a Sumas price in the range of $4.35 for the current rate year when their least cost planning documents say our prices continue to drop after that all the way down to $3.70 in the year 2008. So you have this problem that you got in -- that you discussed a little bit with Mr. Gaines and Mr. Story, you know, what happens next year. If you base the price of gas on $4.50 or if you think the PGT -- or should the, heaven forbid, the PGT pipeline blows up and gas prices become $11 at Sumas, you should not set a base price for gas at $11. You should set it at what would be a reasonable normalized value.

Q. But you're flipping over into what's wrong with the company's proposal. I'm trying to stick to how things would operate under your proposal. So assuming that we adopt your recommendation and take the CEC forecast, exactly what is the company supposed to do?

What happens if the prices don't fall, don't fall close to the forecast levels? This may be a problem with any benchmark, not just yours.

A. I think we have to keep on trying to remember there's a critical aspect here, and that's the PCA mechanism, and I think either Mr. Story or Mr. Gaines testified how they have achieved their cap of risk under that mechanism to the $40 Million level. So basically if that would stay that way and it would not go down over the next several years, what would happen is the difference between the gas price that we reflected based on the CEC forecast of $3.65 or $3.61 versus their actual prices would be recorded as a deferred power cost. But what happens if things turn around, you get an abundant hydro year, you get low prices, you're not giving the company a windfall from having artificially used a gas price that's far above a reasonable level. And that's what our concern is, and that's why we have brought this issue to you.

Q. But your assumption is that the CEC forecast is more durable and more reasonable for a benchmark over a period of one year or more years; is that correct?

A. Well, that's what I said earlier, I think there's something just in my gut saying that a price of $3.61, ignoring your short-term expectations, is a reasonable price for gas at Sumas. If PSE can decide the appropriateness of acquiring Frederickson is based on something akin to $3.70 gas in the year 2008, I think a price of about $3.61, $3.65 in the year 2004 is reasonable.

Q. I want to ask you about whatever index or forecast or mid point we pick, does it make sense to assume it will endure for year after year?

A. It may not endure for year after year, but I definitely agree with what Mr. Story had to say, that's why you want a normalized value, because that normalized value is set, and it is not changed until either the company would seek relief through the PCORC PCA mechanisms or they submit a general rate case. Similarly customers could not seek relief unless they brought a complaint proceeding against you. So yes, it's set once, and under the existing mechanisms for the base case it can only be altered basically under another PCORC rate case or under a general rate case.

Q. All right. Going back for a minute to the 1999, 2002 period when I asked you about prudence, do you agree that Puget's future load in that period was uncertain in part due to Schedule 48 and perhaps also the possibility of restructuring legislation?

A. Well, Schedule 48 gave the customers a market pricing, it did not give them market access. I think there's a big difference there. They were still captive customers of the utility during that Schedule 48 period with all the CTC charges.

With regard to retail direct access, it's hard to go back that far in time, but frankly I never thought that would be much of a risk for Northwest utilities. When you saw the EEI type reports during that time when they showed the potential for stranded costs on an aggregate base, not on just a 4QF project basis but on an aggregate basis, what they generally did was compare the production related cost to the market value of energy at that time. And generally with respect to most of the states in the Northwest, the production related component of the retail rate was at or below market.

Q. I think the, I don't want to go too far back into Schedule 48, but the sentence that I did remember from it said that the company is not responsible for power resources for a customer following the term of the service agreement.

A. Right. But during '99 and 2000 they were still under the term of the agreement.

Q. Well, I know that, but the company is looking forward, isn't it, in terms of what its load may be?

You're saying --

A. Yes.

Q. -- that the end of the agreement was too far away --

A. Right.

Q. -- for it to be particularly concerned about it?

A. Right, it's looking at the risk of the load, and it's also looking at the potential loss to their resources. I think Mr. Gaines referenced that how they had had a series of contracts expire or withdrawals of hydro capability, that type of thing, but it's both loads and resources.

Q. All right. Shifting a little bit, if we are, if we do adopt a NYMEX approach, what in your view would be the best NYMEX approach in terms of ten day periods or one month periods, that sort of thing? And I recognize that's not your recommendation.

A. What you're going to see is, when you go out several months in the NYMEX and even in the near term of NYMEX, you will see very volatile prices where sometimes they will change 10, 30 cents from one day to the next in the near term of the NYMEX strip. And that's what I was trying to say earlier is you also see those same prices dampened all the way down to the bottom of the strip. So I'm not sure if there is a good period, but I would certainly make it much further away under my basis than much closer.

And again, why I'm saying that is I believe that the gas price should not absolutely reflect near-term expectations. So in other words, I would not say use a NYMEX strip for February or January or December to determine the gas price that should be used for April. I would go back extremely far, but then that gets you right into the robustness of the market.

And in my mind when you look at the response to ICNU 6.15 and you see a market that's half a BCF per day, you have to really realize that is nothing in the gas industry. When you talk in terms of a national index, a half a BCF per day of gas usage is the equivalent of about one half the capacity of the Northwest pipeline at the Sumas import point into the United States. So if you looked at a Pennwell map and you see gas pipelines going up and down every state in the union, a significant number of pipelines going up and down every state in the union, you represent -- you understand that a half of a BCF of a market is just a drop in the bucket. So I would never set rates on so ill liquid of a market.

Q. Well, supposing it took NYMEX prices for

January 1 through October 30 of 2003, forward prices for the period April 2004 through March 2005, so you had all of those transactions.

A. Right.

Q. Well, let me start, is that better than ten days in September?

A. It may be. It's hard to say sitting here today if it is. It would certainly address my concern about being further away from the immediate period. But then I would again want to look at the volumes that are being transacted, and that's what you see in the NYMEX, and that's what I said in my testimony. NYMEX is always great for the next month or the next quarter, and as I say that's a robust market. But when you see an order of magnitude drop off from one month to the next to the next month, that's just then the standard deviation, if you will, of the expected value just starts exponentially increasing because the NYMEX price 30 months out or 29 months out from today is just going to have that much greater variability associated with it than obviously the price the next week. So that's why I really have a fundamental problem with trying to apply NYMEX as a base gas cost.

Q. All right. Shifting back to the CEC model, is the one that you are recommending one that was created in April 2003?

A. The model itself was first published in 1989, and it still to this day is a Fortran program, but there have been improvements to it since 1989. The data, the fundamental data in this forecast is basically a vintage primarily in the year 2002.

Q. But you have a recommendation of $3.61; is that correct?

A. Yes, based on the output for that model for Sumas.

Q. And was that number produced in a run in April 2003?

A. Yes, it was.

Q. Do you have any concern that that run is too old, or do you think that when a forecast is on fundamentals it's not going to vary much say from this year, last year, to April 2004?

A. It could, but I would hope it would not be dramatic. If it would be dramatic, you would need to see the reason why it produced a wildly varying result. It's a tough issue, it's just simply a tough issue. Because what I'm saying is you should have a reasonable long-term expectation price that doesn't take into account these near-term fluctuations.

Q. Do you have --

A. So you can -- you have a tension between how recent is the model result.

Q. Do you have any comparable results for years prior to April 2003 for April 2002, 2001, 2000, so that we could see how much that forecast varies year to year?

A. I have actually talked about that with Mr. Popoff, I have not done any back casting of the results from the CEC model, so the answer is no, I haven't done that.

Q. I have one question on the you talked about averaging water years and that you -- I understood you to say that you were doing something similar in the forecast model.

A. Mm-hm.

Q. And it struck me that water years is a natural event, and global warming aside, we (a) have no control over the water and we do figure that it does average out over time, and it struck me that markets being manmade events affected by all kinds of things but including regulatory issues or issues that can be altered, I didn't know if 40 years of markets, if that, or even something analogous to it, is valid in the same way.

A. Well, I think what I was trying to get to, it's the notion that the gas model uses normalized temperatures and normalized hydro conditions. That's what I was really trying to get to. As opposed to doing the same thing with the normalized hydro condition where you -- where there is this variability about near-term immediate circumstances just with water as there is with temperature as there is with, and particularly for gas, injection withdrawal from storage. Those all have real time consequences on market prices. What I'm trying to say, let's use a result that tries to normalize all of those variables out to create kind of a base value.

Q. And I understand the desire to normalize the short-term variables out, but unlike water and temperature, it would seem to me that in the market areas there could be big events like another pipeline or restructuring or a war, I don't know, but there's various things that can't be gotten out of a long-term market forecast and also can't be predicted.

A. Well --

Q. Or expected.

A. An explosion of a pipeline can not be predicted, but the addition of a pipeline can be and is used in the model, just like within -- maybe another way to try this is let's look at the Aurora model. The Aurora model used in this proceeding is a fundamentals electricity model. It produces expected market prices based on gas as an input taking into account what it believes are the resources available to meet that load and all the transmission constraints. That's what I'm trying to do with regard to the gas in this case.

Where PSE instead of using an Aurora run to come up with the expected market price for their deficit energy, they could have just gone to a forward electricity strip, right. They could have gone to a 12 month strip at Mid-C to determine the market electricity price to use in this rate case. But instead they tried to use a fundamentals approach to come up with what would the market price say based on this assumption with respect to resources, this assumption with respect to loads, and this assumption with respect to temperatures. And I guess that's all I was really trying to do with regard to the gas side of the equation as well.

Q. So you're saying that the CEC forecast is as useful in a gas case as an Aurora model would be in an electricity case?

A. Absolutely.

Q. And by the way, if we're going on your tack, are there other forecasts other than the CEC model that would also be an option, and if so, why did you select CEC?

A. I tried to -- there -- many consulting firms have gas models and many that are fundamental gas models, and many consultants will provide those models to you at a certain fee, at a subscription charge. And that's why I simply chose the CEC model because it was in the public domain, it had been in the public domain for many years, and it's free.

CHAIRWOMAN SHOWALTER: Thank you.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

Q. Chairwoman Showalter's last question was a question I was going to ask you about other models. You say there are many other models, but they are then proprietary?

A. That's exactly right.

Q. If the CEC model is free, why isn't that used?

A. Well, I personally believe for several consulting firms, particularly back in the late '80's, early '90's, that in fact was their fundamentals model. I think several consulting firms, particularly within California, started, you know, making nuances to it, changing the data, and using that as their proprietary model. It's a good question. I don't know why other people don't use it more.

Q. Well, could it be that there are criticisms of it as a fundamental model that --

A. Well --

Q. -- or are the others simply trying to carve out a proprietary market?

A. It's probably both where what you have, what you have to understand about the CEC of course is they don't regulate, they're not the CPUC, so they don't go through and regulate annual rate charges. They're just purely a planning function, so they're always interested in looking at the costs associated with acquiring long-term generation, the cost associated with conservation renewables, the cost associated with transmission or the cost benefits of transmission projects. So they're looking at it on a little bit of a longer term, so it doesn't have -- it has incorporated some of those short-term deficiencies Mr. Glass was pointing out, but in my view this is precisely the type of thing we need for this case, and that's why I thought it was appropriate.

Q. Well, if the CEC model were not available, what would you have done in view of a recommendation?

A. Well, I was very intrigued, I was very intrigued with their -- with the -- what PSE does for their risk management meetings now with their fundamentals reports. Certainly given the very abbreviated time frame we had, we did not ask many record requisitions or data requests with respect to their K3000 system or their what we thought was possibly a more mature fundamentals model than what they have stated in this case. So that would have obviously been a natural second best if time would have been available is to investigate the proprietary software that PSE uses for their fundamental gas forecast, to see the inputs they use in that model, to see the logic, and see if that would be a reasonable thing to use for rate making purposes. That would have been the natural tendency if there would have been sufficient time for this proceeding, to explore the use of that model.

Q. When you talk about using a constant price for the remaining term of the contract, nominal dollars as a constant price or not?

A. Well, I would be willing to discuss an inflation adjustment, but in my mind I was thinking in terms of a nominal dollar constant.

COMMISSIONER HEMSTAD: That's all I have.

E X A M I N A T I O N

COMMISSIONER OSHIE:

Q. Mr. Schoenbeck, under your -- you discussed the fourth option in your discussion with Chairwoman Showalter, and I guess one of the issues that I don't believe was addressed, and maybe I missed it, was what your proposal would be under your fourth option with regard to the regulatory asset.

A. It would stay on the books.

Q. That wouldn't be -- are you -- would you consider any adjustment of the amount of the regulatory asset to reflect the historical performance of the utility with regard to the Tenaska contract, for example?

A. I don't believe so. Certainly that had a great deal to do with our primary recommendation that the historical performance, and particularly the 2003, 4, 5 performance, vis a vis the expectations or promises at that time, but I would have the regulatory asset stay as it is.

Q. It wasn't clear to me, I'm just staying -- I want to move to your option two or what you consider to be your second option in your testimony, which was the elimination of the regulatory asset, and it wasn't clear to me from your testimony, and I think you touched on it a bit in your testimony earlier, as to the reason why you believe the regulatory asset, at least in your initial testimony, should be written off, and meaning -- I guess what I'm -- it wasn't clear whether you were -- you believe that essentially, as I think Chairwoman Showalter had initially discussed with you, whether there was a contract made with the Commission, if you will, that was a promise that the benefits that were reflected in their initial petition would be, you know, could be attained throughout to the life of the agreement, or that they had not managed properly the acquisition of the gas resource with Tenaska even if it were looked at as just an opportunity for gain.

A. It's primarily the latter, how they have managed the resource, there's no longer a value associated with the asset.

Q. And would you -- how would you take into consideration moving forward with the asset? Essentially what you're arguing then is that based on past performance, the asset should be written off completely?

A. Yes.

Q. And that moving forward, how would the utility's management of Tenaska be reflected then in rates?

A. Basically as it has been done to date, it just would be reflected as market purchases of gas. The gas they acquired for Tenaska would be flowed through to rates at whatever they acquired it at.

Q. And if the company didn't change their market purchase strategy for Tenaska, would you be arguing that going forward those purchases would be imprudent, or are they only imprudent because of the regulatory asset?

A. No, I think they were missed opportunities with regard to the managing today, just what I was trying to say earlier. In going forward, I think that's what I keep on going back to this pre PCA world versus post PCA world, we're now in a PCA. What I'm willing to say is with the writeoff of the regulatory asset, they try to manage their cost to the extent they can, and those either risks or rewards would be flowed through the PCA mechanism.

COMMISSIONER OSHIE: I don't have any further questions, thank you.

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. I have one more. Supposing we adopt your $3.61 marker, if prices, if gas were available at that price through 2011 and the company bought gas at that price through 2011, is that first of all permitted under the PCA?

A. I don't see why it would not be permitted under the PCA.

Q. And is that -- would that be prudent, and by that I mean is that per se prudent under the PCA, or is there another analysis at some other time as to whether that would be prudent?

A. Well, in my mind, if you talk in terms of entering into a long-term contract, there should be one prudency review associated with that, and that should occur as soon as possible to when that contract was executed. So if they would say we have an opportunity to buy gas at $3.61 for the next ten years, there's one prudency review on it, and then that's it. It would be deemed prudent at that fixed price for the remaining life of the contract.

Q. But in other words, you're not -- you wouldn't say today that it would be prudent if they do that once it hits $3.61? Would you -- are you saying that you would have to look at that time were gas prices coming down and that sort of thing?

A. Yeah, what I think -- what I was trying to say is a prudency review should be done with the best information that's available on why the decision was made, and the best information that's available is as close as you can get to have the review occur almost simultaneously with the decision making process that executes that transaction. That's what I was trying to get to.

As opposed to now where you're trying to put together this mosaic where you're looking at one or two sentences that describe or summarize actions from five years ago. It's much more difficult to determine an appropriate prudency review under that much of a time lapse. So I think the prudency review would have to occur as close as possible to when that contract was executed whether it be -- because who knows, maybe five years from now $3.61 isn't a good price.

Q. Although I think under my scenario this is the first time it got there. In other words, I was assuming a scenario in which it was above $3.61, and at the point it reaches $3.61, clearly it must have been coming down, so then the question would be is it going to go down even further I suppose.

CHAIRWOMAN SHOWALTER: All right, thank you.

E X A M I N A T I O N

BY JUDGE MOSS:

Q. Just a couple of quick points, Mr. Schoenbeck. Does anyone in the Pacific Northwest region do a gas forecast along the lines of the CEC?

A. Well, the Northwest Power Planning Council would be another regulatory agency that frankly I don't know. I know they have done gas price forecasts in the past. I do not know if they still focus on that type of thing or not, so I'm really not sure.

Q. Okay. The other question I have for you concerns your prefiled testimony, Exhibit 231C in our proceeding. I'm looking at pages 29 and 30, and I just want to understand how you get from one figure to another or what the difference between the two is. On page 29 at line 16, you testified that if Puget had been able to achieve the gas prices the company assumed at the time of the buyout, $1.93 per MMBtu, then the overall revenue requirement currently proposed by Puget would have been (Stricken - Confidential number), then you explain a little bit about the basis of that.

CHAIRWOMAN SHOWALTER: I think you might be giving confidential numbers.

JUDGE MOSS: You're quite right, I apologize for that, I did just state a confidential number in the record, so I will ask that that be marked as confidential in the transcript, and it should be treated as confidential having not been waived by the company.

BY JUDGE MOSS:

Q. However, having made that notation, I note that on the next page 30 in non-confidential testimony, you say:

In other words or better, a third
approach would be to impute the gas cost
savings used in the reformation
analysis, in other words, the gas price
used for Tenaska in this proceeding
would be $1.93 per MMBtu. This would
reduce the revenue requirement by $29
Million.

So is one looking historically and one looking forward, or what's the --

A. No the --

Q. Let's not use the figure.

A. The value on page 29 is predicated on a I guess confidential gas price that PSE is using at Sumas. The $29 Million figure on line 12 of page 30 is based on the CEC output of the $3.61. So as the price of the gas is lower, then I would assume the difference between the CEC price and the $1.93 is a smaller value.

Q. I see.

A. Than between the PSE number and the $1.93.

Q. Okay, I see the difference now.

JUDGE MOSS: That's all I had, I just wanted to clarify that point in my mind.

I guess, Mr. Glass, you might have some follow-up questions, and then we have an opportunity for redirect, so it looks like we're pushing the 5:00 hour, so in terms of your thoughts about redirect, how much?

MR. GLASS: Five minutes.

JUDGE MOSS: I'm sorry, not redirect, but follow-up questions.

And then redirect, Mr. Van Cleve?

MR. VAN CLEVE: Probably five minutes.

CHAIRWOMAN SHOWALTER: All right, we're holding you to it.

JUDGE MOSS: And the other point is that we do need to discuss before we leave today our own hearing management issues, because we have the question of what we're going to do about Mr. Lazar's unavailability, the fact that we have at this juncture you have estimated approximately four hours of cross-examination for Staff's witnesses, what is your realistic estimate today?

MR. GLASS: Less than that.

JUDGE MOSS: Half?

MR. GLASS: Yes.

JUDGE MOSS: All right, so we're probably looking at two more hours of cross-examination for

Staff's witnesses, and then Mr. Lazar is our only other witness. As I understand, he's still unavailable tomorrow?

MR. FFITCH: As we advised previously, he is available for a telephone appearance. I have conferred with counsel for the company, however, and we have had a discussion about the possibility that they might waive cross-examination on their part. We haven't sort of finalized that discussion yet, but -- and, of course, I don't know if anybody else is interested in examining Mr. Lazar, but he is available for speaking by or cross-examination by telephone tomorrow at a time -- he's got some flexibility if we can schedule that today or, you know, tomorrow morning, he can be made available, so. But as I say, it may be that there's not a need for that if we can confer some more with the company and no one else has questions for him, so.

JUDGE MOSS: Well, there may be some questions from the Bench. I don't know definitively that that's the case. I would suspect it is the case. We don't have a definitive answer from PSE regarding whether they might wish to cross examine him. And I will say that I think I am clear in my own mind that appearance by telephone is not something that we are prepared to do.

MR. GLASS: Your Honor, I would say that the company is comfortable with waiving cross-examination of Mr. Lazar.

CHAIRWOMAN SHOWALTER: Just I know that this came up recently, when did you become aware that Mr. Lazar couldn't be here?

MR. FFITCH: Last week as we were looking ahead to the pre-hearing conference or the date of the virtual pre-hearing conference, I discussed with him, he drew to my attention the fact that he had a conflict and asked about the hearing schedule and the witness schedule. And so I -- he had to travel for another commitment this week, and I conferred with counsel for the other parties, and we took our best estimate at which part of the week would be better to have him be available. And given the fact that there were ten witnesses and that the hearing was scheduled for at least four days this week, we determined that his other commitment fit better in the front part of the week, and so we -- he took the first part of the week to be out of town, so.

CHAIRWOMAN SHOWALTER: And when were those arrangements made that he would appear in the later part of the week and not the earlier part of the week and had another commitment?

MR. FFITCH: I can check my notes here, but probably I believe it might have been Wednesday or Thursday of last week that there was an E-mail exchange between counsel, and then on Thursday, I believe it was on Thursday I advised the Bench. Again, I better check my notes, my E-mail notes, but.

JUDGE MOSS: Your E-mail to me was on Thursday afternoon at approximately 1:30 and said that you had informed counsel the previous week that Mr. Lazar would not be available.

MR. FFITCH: Well, it may have been the previous week.

JUDGE MOSS: That's just my recollection.

MR. FFITCH: And I, you know, I apologize. Again, I'm not sure there's a problem, perhaps it appears there may be. We certainly made a reasonable effort to predict when it would be -- he would be appearing and the length of the hearing, as we do in many hearings that come before the Commission. You try to schedule when your witnesses can be here. Many witnesses come from out of town and can only be here for one day, and you have to figure when and try to slot them in. In this case he had another commitment, and we tried to work, figured that the latter part of the week would be more likely for his appearance, and it appears that we are getting to his time slot a lot more quickly, so I apologize for our poor estimate.

(Discussion on the Bench.)

JUDGE MOSS: All right, what we will do is we're going to finish Mr. Schoenbeck this evening based on the commitments of counsel. We will resume our proceedings tomorrow afternoon at 1:30 with the first Staff witness.

Will that be Mr. Elgin, I assume?

MR. CEDARBAUM: No, Your Honor, the Staff lineup, I think I e-mailed this to you on Thursday or Friday.

JUDGE MOSS: You did actually, and I think I -- well, no, I don't have anything different, tell me what it is.

MR. CEDARBAUM: It's Mr. McIntosh, Mr. Schooley, Mr. Elgin, Mr. Russell.

JUDGE MOSS: All right, I had one out of order, sorry. All right, so we'll start then with Mr. McIntosh on Wednesday at 1:30, and we'll figure out what to do about Mr. Lazar. We'll see how things go on Wednesday and figure out what our cross-examination needs are and figure out what we're going to do in terms of timing his appearance tomorrow.

MR. FFITCH: Thank you, Your Honor. I will just say that the more advanced notice I can give him if the Bench's pleasure is to have him on the telephone tomorrow, that --

JUDGE MOSS: No, no, we don't want him on the telephone.

CHAIRWOMAN SHOWALTER: It's not a possibility.

MR. FFITCH: I understand.

COMMISSIONER HEMSTAD: I think that he should anticipate being here on Thursday.

MR. FFITCH: Well, that we can -- we had always offered that he could be available Thursday morning for live testimony, so we would be happy to make him available on Thursday.

JUDGE MOSS: I will just say in general for everyone's benefit that in the future when this sort of thing comes up, it is always best to coordinate with the Bench with respect to the scheduling of witnesses and not simply among yourselves, because we have our own scheduling issues as well, and I sometimes have information that you all do not that can be useful in informing those sorts of decisions, so just for future reference so we can all benefit.

So let's proceed with follow-up questions by Mr. Glass, five minutes or less.

MR. CEDARBAUM: Your Honor, excuse me, I did have a couple of, less than five minutes, perhaps a minute and a half or two minutes of questions for Mr. Schoenbeck.

JUDGE MOSS: We will give you 120 seconds by the clock, Mr. Cedarbaum. Let's let Mr. Glass go first though since he did question the witness before.

R E C R O S S - E X A M I N A T I O N

BY MR. GLASS:

Q. Mr. Schoenbeck, I believe you just testified that your gut tells you that a reasonable price during the PCORC time period would you $3.61; is that true?

A. Not during the time period. I'm talking in terms of for a fundamental gas price, not -- I'm trying to make the distinction again between a fundamental result versus what I think the actual gas prices may be for that period.

Q. You are advocating the use of a $3.61 --

A. For a base --

Q. -- price --

A. For a base price.

Q. -- during the PCORC rate period?

A. That's correct.

Q. Okay. Can we buy gas at $3.61 today?

A. No, you can not.

Q. Do you anticipate we will be able to buy gas at $3.61 on April 1st?

A. I would say it would be very doubtful. But again, that is the point is it should not be the next year or the next month gas price, it should be a base gas price.

Q. If under your Tenaska scenarios or even under your gas pricing scenario there is established this fundamental price of $3.61 as I think was just discussed, that would likely lead to the opinion that or lead to the strategy that the company would fix as much as it possibly could or hedge as close to that price as possible; isn't that true?

A. Not necessarily at all, because of the -- because of again the PCA mechanism and what would be going on there. Because you would have to look at the potential market fundamentals to decide if you could either gain or lose from fixing the prices at $3.61. Certainly if you fixed the price at $3.61, then you would be at the break even. There would be no deviation in that cost item between your base power rate and your PCA rate.

Q. Right. If the company could get to $3.61, it would be worthwhile locking in or hedging at that price so there wouldn't be any greater exposure on a going forward basis; isn't that correct?

A. That's correct.

Q. Okay. Do you think that Puget Sound Energy has the credit to lock in its volumes of gas from 2004 through 2011 at a price of $3.61 or even a price close to that?

A. If PSE has the credit to lock in that price, and I guess could you reword the question?

Q. Does PSE have the credit sufficient to lock that volume, to hedge or fix in long-term contracts that volume of gas at that price?

A. You say that volume of gas, you're talking in terms of 50,000 MMBtu per day?

Q. Yes.

A. I haven't done that analysis, it's an interesting question. If in fact you could get the price of $3.61 today, you might be able to do it. I haven't looked at that.

Q. Under your scenarios in which the price is established at $3.61, if as you suggested there is a pipeline burst and the price goes up to $11, under your suggested analysis the company would be at risk for the price differential between $3.61 and $11; isn't that true?

A. Yes, just as they're at the reward situation right now if they would get the Commission to put in a price of $3.35, or excuse me, $4.35, and then their forecast is right and the prices would go down to $3.86 or $3.78 or $3.70 or $3.72, they would get that reward, so it goes both ways.

Q. One final question, your testimony was that the regulatory asset no longer has any value; is that correct?

A. That's correct.

Q. Okay. In order to make that statement, don't you need to presume that you know the outcome of the next seven years of gas prices?

A. Yes, you have to take that into account, that's correct.

MR. GLASS: No further questions.

JUDGE MOSS: All right, Mr. Cedarbaum, let's have your two minutes.

MR. CEDARBAUM: Thank you, Your Honor.

C R O S S - E X A M I N A T I O N

BY MR. CEDARBAUM:

Q. Mr. Schoenbeck, my questions concern the fourth alternative that you gave this afternoon, and that's the one where we set a normalized gas price and then run it through the PCA; is that right?

A. That's correct.

Q. Okay. I believe that there was testimony from one of the company's witnesses which -- well, let me back up. In the PCA there are sharing bands around the base line, and then there's a $40 Million cap above and below the base line; is that your understanding?

A. Yes, I think there's a time limit on the cap.

Q. All right.

A. An expiration date on the cap.

Q. Right. If you look at exhibit, I don't think you need to do this, but for the record Exhibit 17 has the PCA settlement, and on page 2 it says that there's an overall cap for the period July 1st, 2002, through June 30th, 2006, of the $40 Million band cap. And if we go above that cap with respect to costs or benefits, rate payers pay or receive 99%, and the company pays or receives 1%?

A. That's correct.

Q. Do you have an opinion as to whether or not we would be into that, above the cap, under your fourth alternative where we set a normalized cost of gas for Tenaska and run it through the PCA?

A. Are you taking as a -- I think someone said in the hearing that they were at 43, that cap was at $43 today, so to the extent you would use a value less than their market purchases of Tenaska, that would go to increase that amount, that capped amount, which would then have to be shared 99% to rate payers, 1% to shareholders.

Q. Of those costs?

A. Of those costs.

Q. Right. In your proposal you also indicated in response to Commissioner Oshie that under this alternative the company -- the reg. assets would stay on -- could also stay on the books?

A. Yes, the value of the -- I may have been a little too quick in responding to that question, but in my mind it kind of -- the value of the reg. asset would be connected to the normalized gas price you would use. In my response when I said the whole reg. asset would stay on the books, I was thinking if you would get something closer to what the price had been assumed when the reg. asset was created vis-a-vis the $4.35 price. At that range then again the reg. asset has little value, at $1.93 it has maximum value.

Q. So you weren't talking about the unamortized balance today of the regulatory asset?

A. Actually I was.

Q. Well, I guess my bottom line question to try to cut this shorter is, can you explain why this alternative four is fair in your opinion if we have the reg. asset remain on the books and the company is already above the cap and then your proposal would just put the company farther above the cap but rate payers have to pay 99% of those additional costs?

A. Well, there's a lot of things going on here. First of all, they are at the cap today, and the cap goes through the year 2006. Just as there can be upward pressures that have created the cap to be achieved within a two year period, those same types of things could potentially occur to make the cap go down given market prices, where market prices are, where surplus hydro is. But in addition, it's the determination of the cap, I guess I'm thinking beyond 2006, once you get beyond 2006 and the cap is not there. I was really focusing much more on the sharing bands that would be 2007, 2008, through 2011.

MR. CEDARBAUM: Okay, thank you.

JUDGE MOSS: Thank you, Mr. Cedarbaum.

Mr. Van Cleve, any redirect?

MR. VAN CLEVE: Yes, Your Honor, a couple of questions.

R E D I R E C T E X A M I N A T I O N

BY MR. VAN CLEVE:

Q. Mr. Schoenbeck, if you could refer to page 17 of your testimony, which is Exhibit 231, and you were asked a number of questions about the CEC forecast, and the suggestion was made that it might not be valid because it was based on data from April of 2003 or maybe from 2002. And on page 17 is there a, without disclosing any confidential information, is there results of a fundamental forecast from Puget Sound Energy depicted?

A. Those would be the three dashed lines, the two standard deviations about the middle dashed line.

Q. And in the, on that page, the table above the chart, the column labeled RMC median, did that come from the December 2003 risk management committee meeting?

A. Yes, it did.

Q. And if you look down at the bottom of that column RMC median where it says average, does the number there in your mind tend to validate the number that you're proposing from the CEC forecast?

A. They're relatively close without speaking the values.

Q. And in contrast, how would you say that the NYMEX cost or prices proposed by the company in this case compare to that median forecast from the December

2003 risk management committee meeting?

A. Well, that's really the whole purpose of the chart. The solid line on the chart that's labeled 09-03 forecast is actually the company's NYMEX derived forecast with their Sumas basis adjustment, so it's substantially above the median.

Q. Next I would like to refer you to a ICNU cross-exhibit which was number 12, and it's been identified as Exhibit 97C.

JUDGE MOSS: Is that one of Mr. Gaines's?

MR. VAN CLEVE: Yes, it is.

A. Yes, I have it.

BY MR. VAN CLEVE:

Q. And can you tell me where the data in this exhibit came from?

A. The data was cut and pasted from the third supplemental response to a Staff data request which was number 58 in this proceeding.

Q. And were you the person that did the cutting and pasting?

A. Yes, I was.

Q. And can you just describe in general terms what the data represents here?

A. It's the -- it's a -- there's three different sources of data. There is actual prices for the cost of

Tenaska through the November 2003 value, so the -- that value that's shown is still an actual value on a dollar per MMBtu basis. The subsequent value in December is a forecasted value representative of the September NYMEX analysis done by Puget with their basis adjustment. And the NYMEX prices track through the year 2005. Then commencing in 2006 you have the company's least cost gas prices that were used, the average prices used in evaluating the Frederickson plant and showing the cost effectiveness of that plant. The bottom row on the chart is a simple average of the 11 months shown. May is missing because this was in response to a Tenaska issue, so Tenaska does not run in May, so no May prices were reported. So you can see the annual average or the simple average of the 11 months for the years. In particular you go from 2003, 4, 5, and then once they hit into the least cost plan fundamentals type of forecast what those prices are.

Q. So when you look at the average --

MR. GLASS: Your Honor, at this point I'm going to have to object. This exhibit was not brought in through Mr. Gaines. This is brand new information that is not currently in the record, and that would be a new exhibit coming in through redirect.

JUDGE MOSS: Well, that's not unheard of, but are you saying this isn't part of the record?

MR. GLASS: Correct.

MR. VAN CLEVE: Your Honor, I would offer this into the record. As Mr. Schoenbeck has testified, it's based on data provided by the company, and he's merely explaining what it means. In his answers to the questions during cross-examination, he made numerous references to the expectation that the company thought that gas prices was going to go down in the future, and this tends to support it, and it is based on the company's own data.

JUDGE MOSS: I think I will overrule the objection, and we'll admit this. It's been previously marked and identified as 97, so we'll just leave it with that number even though that was identified for Mr. Gaines.

So go ahead.

BY MR. VAN CLEVE:

Q. Mr. Schoenbeck, would you agree that this does indicate that the company forecast that gas prices will decline from the NYMEX prices that it has proposed in this case?

A. That's what it shows.

Q. And is there anything else you would like to point out about this exhibit?

A. No, I would not.

MR. VAN CLEVE: That's all I have, Your Honor.

JUDGE MOSS: Scared me with that last one, Mr. Van Cleve.

All right, I think maybe we did manage to complete our examination of Mr. Schoenbeck today and --

Was there something, Mr. -- no.

So we thank you very much for your testimony, and we release you from the stand. We'll make you subject to recall as we have everyone else in case we have a further question for you at some point.

THE WITNESS: Thank you.

JUDGE MOSS: Thank you very much.

Again, we will resume tomorrow at 1:30.

MR. BROOKHYSER: Judge, one matter, I will not be present tomorrow, I waive my right to cross-examination.

JUDGE MOSS: All right, thank you very much for letting us know.

All right, we'll see you then.

(Hearing adjourned at 5:25 p.m.)