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BEFORE THE WASHINGTON  
UTILITIES AND TRANSPORTATION COMMISSION

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WASHINGTON UTILITIES AND	)	
TRANSPORTATION COMMISSION	)	UT-031725
	)	Volume V
	)	Pages 570-600
v.	)	
	)	
PUGET SOUND ENERGY, INC.	)	

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A hearing in the above-entitled matter was held at 9:34 a.m. on Thursday, February 26, 2004, at 1300 South Evergreen Park Drive, Southwest, Olympia, Washington, before Administrative Law Judge DENNIS MOSS, Chairwoman MARILYN SHOWALTER, Commissioner RICHARD HEMSTAD and Commissioner PATRICK OSHIE.

The parties present were as follows:

PUGET SOUND ENERGY, by Todd Glass and Lisa Hardie, Attorneys at Law, Heller Ehrman White & McAuliffe, LLP, 701 Fifth Avenue, Suite 6100, Seattle, Washington 98104.

INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES and MICROSOFT, by Bradley Van Cleve, Attorney at Law, Davison Van Cleve, 1000 S.W. Broadway, Suite 2460, Portland, Oregon 97205.

Barbara L. Nelson, CCR  
Court Reporter

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1                   COMMISSION STAFF, by Robert L.  
2 Cedarbaum, Assistant Attorney General, 1400 S.  
3 Evergreen Park Drive, S.W., P.O. Box 40128, Olympia,  
4 Washington, 98504-1028.

5                   PUBLIC COUNSEL, by Simon ffitch,  
6 Assistant Attorney General, 900 Fourth Avenue, Suite  
7 2000, Seattle, Washington, 98164.

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1           JUDGE MOSS:  Let's be on the record.  I have  
2 distributed, as I try to do each day, an updated  
3 exhibit list.  We have fairly well filled it in as  
4 we've gone along, and so you may notice that I have  
5 reserved some space at the end.  Now, on page 14 of  
6 14, if we have any additional exhibits today, we'll  
7 number those in that sequence so as to avoid  
8 confusion in our record.  Not that there will  
9 necessarily be any today, just for information.

10           We are convened today for the limited  
11 purpose of a hearing -- I'll characterize it as  
12 rebuttal testimony, supplemental rebuttal testimony  
13 in connection with what we have referred to as Mr.  
14 Schoenbeck Alternative Four.  That was an alternative  
15 remedy that was proposed during Mr. Schoenbeck's  
16 cross-examination and specifically in connection with  
17 his responses to some questions from the bench.

18           And so we allowed for an opportunity for  
19 parties who are adverse to that idea to present some  
20 additional testimony today.  It seems appropriate to  
21 me, subject to comments from counsel, that we would  
22 hear first from the Company's witness, and I believe  
23 that would be Mr. Gaines.

24           MR. GLASS:  Your Honor, one preliminary  
25 matter that I'd like to bring to your attention.  On

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1 your exhibit list this morning --

2 JUDGE MOSS: Yes.

3 MR. GLASS: -- Exhibit 262 is not actually  
4 listed. That was the February 17th PG&E amendment to  
5 application that was admitted yesterday. In  
6 conversation with counsel from ICNU this morning,  
7 they've requested that we submit an entire copy of  
8 that application in lieu of the excerpts that we  
9 filed yesterday. We're amenable to that, and we'll  
10 provide that tomorrow.

11 JUDGE MOSS: All right. Thank you for  
12 bringing that to my attention.

13 MR. GLASS: With respect to today's hearing,  
14 I believe that the rules of the Commission provide  
15 that the party bearing the burden of proof falls last  
16 in order, so I would prefer and the Company would  
17 prefer to have Mr. Gaines go last.

18 JUDGE MOSS: All right. I have no  
19 difficulty with that proposal. I will -- we can  
20 proceed that way. I don't have a problem with that.  
21 I just will simply note that this is now a proposal  
22 by ICNU, and the other parties, to the extent they're  
23 putting on a witness, I'm presuming are putting that  
24 witness on because they have some objection, if you  
25 will, or criticism that they wish to put into the

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1 record, so in that sense you are all aligned on  
2 rebuttal in terms of burden. Staff had indicated it  
3 had a desire to put on a witness in connection with  
4 this.

5 MR. CEDARBAUM: That's correct.

6 JUDGE MOSS: All right. Well, why don't we  
7 proceed with that, then. Mr. Lott, I believe.

8 MR. CEDARBAUM: Yes, the Staff witness on  
9 this issue is Mr. Lott. If he could please come  
10 forward.

11 Whereupon,

12 MERTON R. LOTT,  
13 having been first duly sworn by Judge Moss, was  
14 called as a witness herein and was examined and  
15 testified as follows:

16 JUDGE MOSS: Thank you. Please be seated.

17 MR. CEDARBAUM: Your Honor, just one point  
18 for the record. Mr. Lott has not -- did not prefile  
19 testimony in this case, so I would like permission to  
20 ask some preliminary questions to get his  
21 qualifications on the record. And also, he will be  
22 discussing the PCA mechanism in the context of Mr.  
23 Schoenbeck's Alternative Four, and it may be helpful  
24 to the bench if you have before you Exhibit 17, which  
25 is the PCA settlement. And it just describes how the

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1 PCA mechanism is set up.

2 JUDGE MOSS: Seventeen would be one of Mr.

3 Gaines' --

4 MR. CEDARBAUM: One of Mr. Gaines' direct

5 exhibits.

6

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

8 BY MR. CEDARBAUM:

9 Q. If I could please ask you to state your full  
10 name?

11 A. My name is Merton Robert Lott.

12 Q. And who are you employed by, Mr. Lott?

13 A. Washington Utilities and Transportation

14 Commission.

15 Q. What is your position with the Commission?

16 A. I guess I'm the energy industry coordinator.

17 Q. How long have you been employed with the

18 Commission?

19 A. Almost 30 years.

20 Q. And have you testified on a number of

21 occasions for this Commission, either in contested

22 proceedings, such as this one, or in open meeting

23 situations?

24 A. Many times.

25 Q. Were you also involved in the settlement in

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1 the company's last general rate case?

2 A. Yes, I was.

3 Q. And were you one of the primary architects  
4 of the PCA settlement that resulted from that case,  
5 as well?

6 A. Yes, I was.

7 Q. So you're quite familiar with how that  
8 mechanism works and with the underlying intentions of  
9 that mechanism?

10 A. I hope so.

11 Q. You're here to testify in response to Mr.  
12 Schoenbeck's Fourth Alternative that he provided on  
13 the stand, I believe on Tuesday. Can you just  
14 briefly describe, as a preliminary matter, your  
15 understanding of his alternative?

16 A. I can only describe what -- and I thank the  
17 company, by the way, for providing me a copy of a  
18 rough draft of the transcript from that day, and I  
19 was able to go back and review the transcript.

20 Mr. Schoenbeck started off with this  
21 Proposal Number Four, which was to start with what he  
22 referred to as the Schedule B, which I believe is the  
23 gas cost, which I believe are the gas costs that Mr.  
24 Elgin is using, or close to it, that came from the  
25 expected values in the buyout of the Tenaska

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1 contract.

2 He then proposed that that be used as the  
3 baseline of costs in the PCORC and in general rate  
4 cases going forward, and that the PCA then be used to  
5 share fluctuations, so if the actual gas cost was  
6 above that, then the difference would be shared using  
7 the PCA formula, and if the costs were below that  
8 baseline, you would then be below that.

9 In discussion, Mr. Schoenbeck then said that  
10 that was a concept and not that the \$1.93 was the  
11 important value. I mean, he used the \$1.93, was his  
12 example, I believe, but he was saying that number was  
13 not the exact concept, but at some gas level you  
14 could start, use that number, and use -- pick a  
15 number. I think he referred to a solid gas number.  
16 He gave a range of \$3.40 to \$3.60 as an example, not  
17 as a number to choose. And that was -- he basically  
18 said it would be the same thing.

19 When asked whether his original proposal in  
20 his original testimony of disallowing the regulatory  
21 asset, he indicated that, no, there would be no  
22 disallowance of the regulatory asset utilizing this  
23 method. In other words, the regulatory asset and  
24 amortization would continue to flow.

25 I'm not 100 percent sure that that's what

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1 Mr. Schoenbeck means, because he was modifying his  
2 proposal at the time. Therefore, it's tough to say  
3 whether it would -- whether there couldn't be some  
4 disallowance of the regulatory asset or, you know,  
5 depending on how high of a gas price you chose in the  
6 first place as that baseline to share around. That's  
7 my remembrance through reading it last night, also,  
8 again, of his proposal, Number Four.

9 Q. Before we get to your particular response to  
10 that proposal, can you just explain your  
11 understanding of the intent of the PCA and how that's  
12 important to this proposal?

13 A. Okay. The PCA came about as a settlement,  
14 which included just the PCA and also the adoption of  
15 allowance of this type of proceeding that we're in  
16 today, which is the power cost-only rate case  
17 proceeding or single-issue rate case proceeding.  
18 That settlement did both of those things.

19 And the PCA mechanism as established, from  
20 Staff's intent, anyway, and as discussed many times  
21 in our settlement discussions, was intended to allow  
22 the Company to recover major fluctuations in  
23 short-term power costs. What our attempt was, for  
24 example, is if the stream flow went bad, the Company  
25 would be able to recover the excess cost if it went

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1 over a band that they can manage around. That's why  
2 the bands were set up in the PCA settlement, were  
3 established, was to try to figure out a range that  
4 the Company should be able to manage around and try  
5 to limit their damage if it was extreme.

6 And the same thing on the good side. In  
7 other words, we put something on the plus side if the  
8 Company was able to have good years. That was not  
9 just for stream flow; it was also for fuel cost. It  
10 would also be for secondary sales and secondary  
11 purchase cost. So if the secondary market in  
12 electricity either greatly favored them or greatly  
13 damaged them in a particular year, the PCA mechanism  
14 was intended to pick up these impacts.

15 It was not intended -- and there are many  
16 mechanisms established in the PCA and the design of  
17 the PCA. It was not intended to pass through general  
18 increasing costs that the company was incurring. So  
19 for example, the increased costs of a contract such  
20 as -- and I'll use one that's not an issue in this  
21 proceeding, March Point One. So to accept that March  
22 Point One contract had increasing costs was not  
23 intended to pick up those costs, nor was it intended  
24 as a balancing point to pick up the decreases due to  
25 depreciation on the Colstrip plant or the other major

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1 plants now, the Fredonia, Freddy One, I mean, plant,  
2 Fredonia, any other plant the company owned.

3           So as the costs of these plants went down,  
4 these were offset by the increases in their contract  
5 costs. We were not trying to use the mechanism to  
6 pick up these slow-moving or just general increases.  
7 It was only the major fluctuations due to things that  
8 were outside of the Company's control, things that  
9 they would have a tough time coming in and filing  
10 general rate cases for or power cost-only rate cases.

11           Because of the ECAC and the PCA, we were  
12 very concerned about new resources. We put  
13 limitations in the PCA about how new resources could  
14 flow directly into the PCA and said that if the  
15 company -- back up just one step. The company,  
16 however, was concerned about new resources, and there  
17 came the PCORC, or the power cost only rate cases.  
18 We made the settlement with the company, but allowed  
19 the company to bring in new resources when they had  
20 them, such as Freddy One, so that they could get  
21 these into rates in a very quick time frame.

22           That was the intent of allowing the PCORCs,  
23 was -- the one thing that the company also wanted was  
24 this ability to get new resources into rates with  
25 less regulatory lag. I hope that's enough.

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1 Q. With that background in mind of the PCA, can  
2 you now turn to your specific concerns with respect  
3 to Mr. Schoenbeck's Alternative Four?

4 A. Okay. I'd like to start with the first part  
5 -- the first description of it, as you will read in  
6 the transcript later and you may remember, was this  
7 using the -- I think he referred to it as the  
8 Schedule B or the -- he referred to it as about the  
9 \$1.98, which was the expected buyout prices, what  
10 some people may have termed the promise or the  
11 expected value, whatever you want to refer to it,  
12 but he said you could use that as the baseline.

13 Utilizing that may seem like the ratepayers  
14 would get -- the company would then have to share in  
15 some of the damage above it, because the way the PCA  
16 works is that the company has the dead band of 20  
17 million, and then a sharing band of 50/50 for the  
18 next 20 million. So the company would, out of the  
19 first 40 million, would have to suffer the first \$30  
20 million of additional cost due to increased gas cost.

21 There are a couple reasons, however, that  
22 that creates a problem. Remember, the PCA is a  
23 balanced mechanism. It is intended to be balanced.  
24 You have to start off at a point of neutrality and  
25 you're supposed to have -- you know, the dead band

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1 was set, I believe, at what we called one standard  
2 deviation of stream flow variance. That was the \$20  
3 million. I think I testified to that two years ago.

4 If, however, now you started off at this  
5 \$1.93 number and you would kind of anticipate -- I  
6 mean, Mr. Schoenbeck's long-term viewpoint of gas  
7 cost is substantially above 3.60, the company's  
8 projection of gas cost in this case is 4.35, I  
9 believe. These are substantially above it.

10 Those would drive you well into the top of  
11 -- well into the dead band, above the dead band, and  
12 you would be in a situation where your neutral point  
13 is no longer a neutral point. All of a sudden, you  
14 would start to share from that point, you would  
15 already be halfway or maybe all the way through the  
16 50 percent sharing band, and benefits from the good  
17 hydro year would go mainly to the company, but  
18 disbenefits from a bad hydro year would be  
19 automatically passed on to the ratepayers, because  
20 you were already heavily into these debt bands.

21 That's not even taking into consideration  
22 the \$40 million band put around the first four years,  
23 a band that may be re-asked for, an issue that, just  
24 because we have \$40 million in the first four years  
25 doesn't mean the company might not ask for 40, 50,

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1 60, 100 million dollar band for the next four years  
2 depending on the financial situation and how much  
3 risk should the company take in the next four years.

4 That's not an issue that's been decided,  
5 it's not an issue that's been asked for yet, but I  
6 would assume that ultimately the company may ask for  
7 a new cumulative dead band for another period of  
8 time. And I think the Commission will have to  
9 consider how much risk they want to put the company  
10 at over a period of time.

11 One of the reasons why we, Staff, accepted  
12 this 40 million dead band was to help the company get  
13 to the capital structure that Staff and other  
14 parties, including the company, wanted to get to,  
15 which was the 40 percent equity ratio that they at  
16 that time did not have.

17 But going into the future, you still have to  
18 consider how much risk is out there. So my problem  
19 is -- it's twofold. Number one, you've unbalanced  
20 the PCA by sharing through the PCA, and, number two,  
21 you would have this -- the question about whether  
22 you'd get any benefits to the ratepayers or any of  
23 the disallowance to the ratepayers because of the \$40  
24 million dead band that was there.

25 It just to me is not a method that's -- that

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1 gets there. One of the problems with the proposal is  
2 it's not specific, because he went on, as I said  
3 earlier, he went on to say, Well, \$1.93 is -- that's  
4 only -- I'm only testifying to a concept. So what is  
5 the number? Is it \$1.93 or is it 3.60? I mean, he  
6 proposes 3.40 to 3.50 range.

7           So the indefiniteness of the method and  
8 where you would establish that gas cost in order to  
9 give ratepayers a benefit, make sure the ratepayers  
10 don't pay an unfair cost, I guess is the right way to  
11 say it, it's difficult to say.

12           Ultimately, I mean, he used the band of 3.40  
13 to 3.60. Interesting enough, the 3.60 is Mr.  
14 Schoenbeck's proposed gas cost in this case. Under  
15 that proposal, and coupled with the 3.60 proposal, he  
16 has a disallowance of the regulatory asset. So if  
17 you set the base at the 3.60, you'd be basically  
18 throwing out his -- if you accepted his 3.60 proposal  
19 as a normalization level, then using the 3.60 level  
20 for this -- what did he call it -- firm gas price, or  
21 I can't remember the exact word, but you end up with  
22 his case minus the disallowance of the regulatory  
23 asset. So it doesn't look at all like his original  
24 proposal.

25           This is something I'm not sure where Mr.

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1 Schoenbeck would be. This is why I earlier  
2 indicated, after having talked to Mr. Schoenbeck, and  
3 I'm not sure that he's saying that there would be no  
4 regulatory disallowance. I think he might say,  
5 depending upon where you set that baseline gas cost.  
6 So if you use 4.35, I think he would be saying throw  
7 the regulatory out for sure. If you use 3.60, maybe  
8 -- and I'm not sure, because he didn't say it, but he  
9 might propose some disallowance of the regulatory  
10 asset.

11 But the point is we don't really have any  
12 testimony on this, we have no definite position on  
13 this, and it's -- it doesn't really seem to be  
14 consistent with his own testimony, if you use the  
15 high end of that band, the 3.60 range.

16 Let me just check through and make sure that  
17 I've said everything that I wanted to say. Yes.

18 Q. I guess just -- probably not really a  
19 required question, but just for the record, based on  
20 that reasoning that you've just given, is it the  
21 Staff's position that the Commission not adopt the  
22 Schoenbeck Alternative Four?

23 A. Yes, in fact, I don't think that there is a  
24 specific proposal of Mr. Schoenbeck's.

25 MR. CEDARBAUM: Thank you. Those were all

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1 my questions. The witness is available for any  
2 questions from the bench.

3 JUDGE MOSS: Well, and we need to offer Mr.  
4 Van Cleve an opportunity for cross-examination, as  
5 well.

6 MR. VAN CLEVE: Thank you, Your Honor.

7

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

9 BY MR. VAN CLEVE:

10 Q. Mr. Lott, if we assume that what Mr.  
11 Schoenbeck proposed was, one, a partial write-down of  
12 the regulatory asset and, two, setting a baseline gas  
13 cost around which there would be sharing between the  
14 company and customers, would that kind of framework  
15 be acceptable to you?

16 A. Depends on how it's structured. If you set  
17 a baseline for the gas cost that was below an  
18 anticipated level of the gas -- of what the gas costs  
19 are going to be and, therefore, there would be an  
20 expectation that, unless gas costs drop  
21 substantially, there was going to be, you know, a  
22 loss or a sharing of gas cost, I think the proposal  
23 that utilized the PCA -- there might be some other  
24 method, but just a method that utilized the PCA still  
25 creates the imbalanced PCA problem.

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1           I think that you could create a mechanism  
2 that allowed sharing of those higher gas costs in a  
3 second mechanism or away from it. I mean, I don't  
4 know how many mechanisms you want, but I think you  
5 could do that. But to use the PCA, I think it still  
6 creates this problem of how much -- how much -- if  
7 you're using the right normalized gas cost, that's  
8 exactly what Mr. Schoenbeck's original proposal was  
9 in this case, which was disallow the whole regulatory  
10 asset.

11           Staff was not necessarily saying that the  
12 whole regulatory asset needs to be written off, but  
13 that might be a methodology to get there.

14       Q.    So are you saying that it would improve the  
15 proposal to have the sharing mechanism be outside the  
16 PCA?

17       A.    Right, I mean, the sharing mechanism -- the  
18 PCA -- the two would not -- are not the same thing.  
19 Therefore, I think that there's a problem there.  
20 Unless you're using the actual normalized gas costs  
21 that are appropriate going forward, if you bias that  
22 cost in any fashion in your normalized gas cost, then  
23 in order to give some benefit to the ratepayers for  
24 the expected values that were anticipated at the time  
25 of the buyout, then I don't think the PCA should be

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1 used.

2 Q. Do you think it would be appropriate to  
3 measure the original projected savings from the  
4 buyout and compare that with the -- use the same  
5 Exhibit B analysis to see what the savings would be  
6 with the new baseline gas cost and use that  
7 comparison to determine the amount of the regulatory  
8 asset that should be written down?

9 A. Staff didn't actually go out and write down  
10 the regulatory asset, but I think that's, in essence,  
11 what Staff's two positions, two pieces of testimony  
12 do, yes. They don't go to the regulatory asset, they  
13 go to the gas cost, but --

14 MR. VAN CLEVE: Thank you. That's all I  
15 have.

16 JUDGE MOSS: Questions from the bench?

17 CHAIRWOMAN SHOWALTER: No.

18 COMMISSIONER HEMSTAD: No.

19 JUDGE MOSS: Okay. Mr. Lott, we appreciate  
20 you being here today, and I suspect you had to work  
21 last evening, and we appreciate your efforts there,  
22 as well. So with that, we'll release you from the  
23 stand. I've released all witnesses subject to  
24 recall, and I'll do that, although we don't expect  
25 we'll need you back.

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1 THE WITNESS: Thank you.

2 JUDGE MOSS: Now, Public Counsel had  
3 suggested yesterday that he might have something on  
4 this. Do you?

5 MR. FFITCH: May I have one moment to  
6 confer?

7 JUDGE MOSS: Sure.

8 MR. FFITCH: Thank you. Thank you, Your  
9 Honor. Yes, Public Counsel would like to call Jim  
10 Lazar.

11 JUDGE MOSS: All right.  
12 Whereupon,

13 JIM LAZAR,  
14 having been first duly sworn by Judge Moss, was  
15 called as a witness herein and was examined and  
16 testified as follows:

17 JUDGE MOSS: Thank you. Please be seated.

18 MR. FFITCH: Your Honor, just for the  
19 record, Mr. Lazar's direct testimony has been  
20 previously admitted in this proceeding as Exhibit  
21 271-C. That testimony contains Mr. Lazar's  
22 qualifications.

23

24 DIRECT EXAMINATION

25 BY MR. FFITCH:

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1 Q. Good morning, Mr. Lazar.

2 A. Good morning.

3 Q. You are the consultant for Public Counsel in  
4 this case; is that correct?

5 A. That's correct.

6 Q. And have you had an opportunity to review  
7 Mr. Schoenbeck's fourth option, based on the  
8 transcript of his testimony in this hearing?

9 A. Yes, I listened to a portion of his  
10 cross-examination on the conference bridge and I  
11 reviewed the draft transcript last night.

12 Q. And have you formed an opinion about Mr.  
13 Schoenbeck's proposal?

14 A. Yes, I have.

15 Q. And do you have any concerns or do you see  
16 any problems with the proposal?

17 A. I have a couple of concerns with the  
18 proposal. The first is that the figure of \$3.61 for  
19 gas cost, as I understand it, is a modeling result,  
20 whereas the figures that Staff and my testimony used  
21 were known and measurable gas costs from offers that  
22 the company had and presented to the Commission at  
23 the time of the contract restructuring. Those  
24 figures were, I think, better defined and more solid  
25 than using a modeling result.

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1           My second concern, I think Mr. Lott has  
2 spoken to pretty well, that it consumes a fair amount  
3 of the dead band in the PCA mechanism. I think the  
4 PCA mechanism could be adapted to that. I did a  
5 rough calculation. It looks to me like the  
6 difference between 3.61 and 4.35 eats up about \$8  
7 million of the dead band. It would be possible to  
8 restructure the PCA to accommodate that, but it  
9 wouldn't be something that we have enough information  
10 to do in this proceeding.

11           Finally, the size of the regulatory  
12 disallowance of the regulatory asset is also unclear.  
13 Mr. Schoenbeck has indicated that you would plug 3.61  
14 into -- he calls it Exhibit B. I guess it's Exhibit  
15 244-C, and see how big the regulatory disallowance  
16 would be. One could do that. That hasn't been done,  
17 it hasn't been examined, and it's not an  
18 insignificant rate base disallowance that goes, as I  
19 understand it, part and parcel with that proposal.

20           So you know, it would be possible to examine  
21 this under the normal course of examination, it would  
22 be possible to adapt the PCA mechanism to this  
23 proposal, but without a restructuring of the PCA, it  
24 would severely damage the effectiveness of the PCA in  
25 accomplishing the purposes that the parties brought

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1 to the discussion that led to the creation of it, and  
2 I don't think that this proposal should be adopted  
3 without restructuring the PCA mechanism to adapt to  
4 it.

5 Q. And perhaps you've just answered this  
6 question, Mr. Lazar, but would you recommend to the  
7 Commission, based on your review, that the Commission  
8 adopt Mr. Schoenbeck's fourth option?

9 A. I don't believe that there is enough  
10 information in the record to adopt it. It would need  
11 another round of examination in order to be fleshed  
12 out and understood well enough. The components would  
13 include a regulatory disallowance, the magnitude of  
14 which has not been calculated on the record. It  
15 would involve a restructuring of the PCA, which  
16 hasn't been discussed at all on the record, and so I  
17 think there'd have to be another round of testimony  
18 and hearing to move forward with this approach.

19 MR. FFITCH: Thank you, Your Honor. That  
20 concludes my direct examination.

21 JUDGE MOSS: Anything, Mr. Van Cleve?

22 MR. VAN CLEVE: No questions, Your Honor.

23 JUDGE MOSS: Anything from the bench?

24 CHAIRWOMAN SHOWALTER: Nothing.

25 JUDGE MOSS: All right. Mr. Lazar, we

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1 appreciate you being here this morning and  
2 testifying, and we'll release you from the stand,  
3 subject to recall if we have any further questions.

4 THE WITNESS: Thank you.

5 JUDGE MOSS: I see Mr. Gaines stirring back  
6 there. I think it's time for him to come up. Mr.  
7 Gaines, of course you have been previously sworn and  
8 you remain under oath.

9 THE WITNESS: Thank you.

10 Whereupon,

11 WILLIAM A. GAINES,  
12 having been previously duly sworn, was called as a  
13 witness herein and was examined and testified as  
14 follows:

15

16 DIRECT EXAMINATION

17 BY MR. GLASS:

18 Q. Good morning, Mr. Gaines. What is your  
19 understanding of Mr. Schoenbeck's Alternative Number  
20 Four?

21 A. Well, of course, like everyone else in the  
22 proceeding, I only heard about Alternative Four on  
23 Tuesday afternoon, as Mr. Schoenbeck was being  
24 cross-examined.

25 At the top level, my understanding of it is

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1 that he suggests picking a benchmark gas price and,  
2 as nearly as I can tell from a review of the  
3 transcript, it's not a definitive benchmark price,  
4 but rather one that is chosen arbitrarily or I think  
5 the term he used was based on his gut feeling of what  
6 a normal gas price would be, and that then, in turn,  
7 the actual costs of the company's gas purchases for  
8 Tenaska would be compared with this benchmark on an  
9 ongoing basis through the remaining term of the  
10 restructuring contract through 2011. And the  
11 overages or underages that resulted from that  
12 comparison then finally would be flowed through the  
13 sharing bands that are built into the PCA.

14 Q. What issues might be raised by adoption of  
15 this approach?

16 A. Well, I think there are several, and the  
17 Company would have several issues with this. Some of  
18 them are the same as the ones that Mr. Lott  
19 identified, and then there are others.

20 First, it seems awkward and inappropriate to  
21 set rates based on an arbitrarily-chosen gas price  
22 benchmark. There's been a lot of testimony in this  
23 proceeding already about what the mechanism should be  
24 for setting the gas price benchmark, and I'm sure we  
25 can find a better and more sophisticated method than

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1 picking it out of the air.

2           Of course, from the company's point of view,  
3 this proposal likely would hard wire in an  
4 under-recovery of costs and, as Mr. Lott testified,  
5 would skew the distribution around the set point for  
6 cost recovery in the PCA.

7           Also, the proposal attempts to single out  
8 the gas management and costs associated with Tenaska  
9 from all of the other gas costs in the company's  
10 portfolio. And as Ms. Ryan testified previously, the  
11 company, as its risk management techniques have  
12 matured, now manages its gas supply as a whole  
13 portfolio, and it is not clear to me mechanically how  
14 we would now separately identify those gas purchases  
15 that are for Tenaska.

16           I think Mr. Lott mentioned inconsistencies  
17 with the PCA, and I think Mr. Lazar even suggested  
18 that the PCA mechanism might need to be altered or  
19 amended in order to accommodate this proposal, and I  
20 think that's right. And I think that's not something  
21 that we are about in this proceeding.

22           And then, finally, there was some testimony,  
23 I think at least by Mr. Lott, about the regulatory  
24 asset and what the impact of this proposal on the  
25 regulatory asset might be. And I gather, from the

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1 earlier testimony, there's some thinking that there  
2 may be some discretion around what is done with the  
3 regulatory asset, and that might be right, but I --  
4 based on my understanding of the FASB rules, I think  
5 that if a gas price benchmark were set that did, in  
6 fact, hard wire a disallowance, that there may, in  
7 fact, be a write-off or write-down of the regulatory  
8 asset, as a matter of fact.

9           So those would be, I think, the primary  
10 concerns and objections that the company would have  
11 to Alternative Four.

12           Q. Do you have any further thoughts on the gas  
13 price benchmark in Mr. Schoenbeck's proposal?

14           A. Well, I do, the broader gas price benchmark  
15 that has been discussed I think by almost all the  
16 witnesses in this case. Earlier, Chairwoman  
17 Showalter asked me how I thought the benchmark should  
18 be set, and I've been reflecting on that some over  
19 the last day or two, and much of the concern that's  
20 emerged here seems to be that, by setting the  
21 benchmark too high, the company might over-recover  
22 its gas cost. And that is not the company's  
23 objective.

24           The company is not interested in trying to  
25 game the gas market or the gas price. Rather, what

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1 the company is attempting to do is just recover its  
2 costs. And while we think it's important to use  
3 actual market indicators to set the gas price, the  
4 company itself has had internal deliberations about  
5 what the appropriate measurement period or averaging  
6 period for the market prices should be.

7           And as I think about this some more, you  
8 know, one approach that the Commission and the  
9 parties might consider going forward is to provide  
10 for recovery of the actual gas cost by exempting this  
11 one component of power cost from the sharing bands in  
12 the PCA mechanism. And that approach would then  
13 eliminate the concern that there might be over or  
14 under-recovery. And actually, I think it would be  
15 fairly consistent with the approach that's taken to  
16 gas fuel costs in other regulatory jurisdictions, and  
17 also would be consistent with the approach taken in  
18 this jurisdiction for gas costs for LDC companies and  
19 all of the theories that underlie the passing through  
20 of gas costs in those circumstances.

21           Q. So the final question is what's the  
22 company's position with respect to Mr. Schoenbeck's  
23 Alternative Number Four?

24           A. For a variety of reasons, we would not  
25 support Alternative Number Four.

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1 MR. GLASS: Thank you.

2 JUDGE MOSS: Let me just clarify one point  
3 before we go on. You said -- your words were exempt  
4 this one component from the sharing mechanism under  
5 the PCA. Did you mean by that the Tenaska gas cost  
6 or all fuel gas costs?

7 THE WITNESS: I meant all fuel gas costs.

8 JUDGE MOSS: All right. Mr. Van Cleve, do  
9 you have any cross-examination?

10 MR. VAN CLEVE: No questions, Your Honor.

11 JUDGE MOSS: Does the bench have any  
12 questions?

13

14 E X A M I N A T I O N

15 BY CHAIRWOMAN SHOWALTER:

16 Q. Well, your having just clarified the  
17 question that you meant all gas costs, not just  
18 Tenaska, prompts another question in my mind. Does  
19 that mean that you would exempt all gas costs from  
20 the PCA and those gas costs would sit out there  
21 subject solely to a prudence review later? In other  
22 words, the company would simply buy gas as it needed  
23 it and determined it needed it and there would be a  
24 review of those prices at some point in the future?

25 A. Yes, and essentially the prudence review

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1 would take place on a regular schedule as the PCA  
2 results are reviewed annually.

3 CHAIRWOMAN SHOWALTER: I see. Thank you.

4 JUDGE MOSS: Okay. If there's nothing  
5 further from the bench, then I believe that will  
6 complete our examination of you, Mr. Gaines, and we  
7 appreciate you returning to the stand to assist our  
8 record.

9 THE WITNESS: Thank you.

10 JUDGE MOSS: Thank you. Well, we may be at  
11 that happy moment when our evidentiary proceeding is  
12 concluded. Is there anything further that counsel  
13 wished to raise?

14 MR. GLASS: No, Your Honor.

15 JUDGE MOSS: Anything further from the  
16 bench?

17 CHAIRWOMAN SHOWALTER: Thank you all.

18 JUDGE MOSS: Then we thank you all for the  
19 -- I think we've had very good witnesses in this  
20 case. We certainly enjoyed their presentations. And  
21 counsel have also done their usual excellent job in  
22 presenting the respective cases of the various  
23 parties. So we thank you, and with that, we'll be in  
24 recess.

25 (Proceedings adjourned at 10:15 a.m.)