Docket No. UE-011411
Exhibit ___(JL-T)

Before the
Washington Utilities and Transportation Commission

Public Counsel, Complainant, vs. Puget Sound Energy, Respondent
Docket No.
UE-011411

Direct Testimony of

Jim Lazar
Consulting Economist

On Behalf of
Public Counsel

February, 2002

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Direct Testimony of Jim Lazar
on Behalf of Public Counsel

I. INTRODUCTION AND QUALIFICATIONS

Q. Please state your name, address, and occupation, and summarize your utility regulation experience.

A. Jim Lazar, 1063 Capitol Way S. #202, Olympia, Washington, 98501. I am a consulting economist specializing in utility rate and resource issues. I have been engaged in utility rate consulting continuously since 1979. During that time, I have appeared before many local, state, and federal regulatory bodies, authored books, papers, and articles on utility ratemaking, and have been a faculty member on numerous occasions at training sessions for utility industry analysts. I have appeared before this Commission on more than forty occasions in proceedings involving each of the gas and electric utilities regulated by the Commission. I have served as a consultant to this Commission on several occasions, including participation in BPA rate proceedings, assistance with technical studies, and staff training. I am also an Associate with the Regulatory Assistance Project (RAP), headquartered in Gardiner, Maine; my work with RAP involves advising regulatory bodies throughout the world on the implementation of effective utility oversight programs.

Q. What is your special expertise with respect to this proceeding?

A. I have more than twenty years of experience reviewing Puget rate and other tariff filings, beginning with the Company's 1978 rate proceeding, Cause U-78-21. I was a consultant to the WUTC in its involvement in negotiations with the Bonneville Power Administration relating to the level of residential and small farm exchange benefits that Puget and other Washington regulated utilities were to receive after 2001. In 1996, I was the policy witness for Public Counsel in the Puget Sound Power and Light Company / Washington Natural Gas merger proceeding, WUTC Docket No. UE-960195 (Merger). In addition, I was the lead technical analyst and negotiator for Public Counsel in the development of the Merger Stipulation (Stipulation or Merger Stipulation) which was eventually adopted by the Commission as the basis for approval of the Merger..

Q. What topics are you covering in your testimony?

A. I am the overall policy witness for Public Counsel in this proceeding.

I first address the basic provisions of the Merger Rate Plan. Second, I discuss the context of the Merger Stipulation, the expectations that Public Counsel had when this language was agreed to, and the key elements of the Stipulation. Next, I review Puget' unexpected exchange benefits and record earnings during the Rate Plan period. I then discuss how it is implausible that the language could have a meaning other than that asserted by Public Counsel's Complaint. I compute the amount that Puget has charged residential and small farm customers in excess of the proper rate since July 1, 2001. Finally, I address why the residential exchange benefits which Puget has been receiving in the post-June 30, 2001 period are not related to this issue. ,

Q. What exhibits are you sponsoring in this proceeding?

A. I have five exhibits. Exhibit ___(JL-1) is a summary of my qualifications and experience. Exhibit ___(JL-2) is my calculation of the amount of overcharge the Company has collected since July 1, 2001. Exhibit ___(JL-3) consists of documents which were a part of the Merger proceeding which are relevant to this proceeding. Exhibit ___(JL-4) are documents which were provided by Puget in response to discovery requests in this proceeding. Exhibit ___(JL-5) are documents provided by WUTC Staff in response to discovery in this proceeding.

II SUMMARY OF FINDINGS

Q. Please summarize your findings.

A. First, I show that the merger stipulation by its own terms, expressly requires Puget to reduce rates by 1.0895 cents/kWh on July 1, 2001, and I therefore conclude that the language of the merger stipulation cannot be reasonably interpreted to allow Puget to charge the rates which have been in effect since July 1, 2001. The plain meaning of the terms "transfer" and "general rates" are not ambiguous. The Company has failed to reduce rates as called for in the Merger Stipulation, and has been charging rates in excess of the proper amount since that date.

Second, I demonstrate that the *context* of the Merger Stipulation unambiguously indicates that residential and small farm customers were to receive a permanent reduction of rates on July 1.

Third, I show that Puget was expected, at the time of the Merger Stipulation, to achieve sufficient savings from merger economies, best practices, and power stretch that the July 1 rate reduction was predicted to continue to allow the company a reasonable opportunity to earn a fair rate of return. This was demonstrated in testimony of WUTC Staff and Public Counsel in the Merger proceeding.

Fourth, I show that Puget, in fact <u>did</u> achieve a combination of savings and revenue enhancements that the predicted ability to provide the required rate reduction without impairing the fair rate of return was in fact achieved.

Next, I demonstrate that the new residential exchange benefits Puget is receiving are not related to this issue, were not a part of the Merger Stipulation, and are not relevant to this Complaint.

Finally, I demonstrate that Puget overcharged consumers by a total of $47.5 million between July 1 and December 31, 2001 and continues to overcharge customers at a rate of about $12 million per month this winter.

III. THE MERGER STIPULATION, THE RATE PLAN, AND THE PROVISION REQUIRING CHANGES TO GENERAL RATES.

Q. Please provide a general overview of the Merger between Puget Sound Power & Light Company and Washington Natural Gas?

A. In February, 1996, Puget and WNG applied to the WUTC for an order approving their plan to merge. Extensive proceedings were held in the following months, including full evidentiary hearings. Following the evidentiary hearings in the rebuttal phase, negotiations took place between the Applicants, the Commission Staff, and Public Counsel. These led to a Stipulation between these parties which was presented to the Commission at a hearing on December 18, 1996. The Commission approved the merger in accordance with the terms set out in the Stipulation signed by Puget, WNG, Staff and Public Counsel, and incorporated the Stipulation in its order. *In the Matter of the Application of PUGET SOUND POWER & LIGHT COMPANY and WASHINGTON NATURAL GAS COMPANY For an Order Authorizing Merger*, Docket Nos. UE-951270, UE-960195, Fourteenth Supplemental Order Accepting Stipulation; Approving Merger (Merger Order).

Q. Did the Merger Order and Stipulation address customer rates?

A. Yes. The Merger Order adopted a Rate Plan contained in the Stipulation in Section III.A.

Q. Please summarize the terms of the Rate Plan relevant to this proceeding?

A. There were three distinct elements. First, there was a one-time reduction in rates to reflect the expiration of Periodic Rate Adjustment Mechanism (PRAM) surcharges. This took effect when the Merger was consummated. Second, there were annual general rate increases for electric customers and a rate decrease for gas customers, according to a schedule that was contained in the Merger Stipulation. Finally, there was a requirement that the residential exchange credit then in force be frozen until June 30, 2001 and then “transferred to general rates” at the expiration of the then-current contract between Puget and the Bonneville Power Administration (BPA).

Q. Please explain what the Residential Exchange is, and how the Exchange Credit was historically calculated?

A. The Pacific Northwest Electric Power Planning and Conservation Act (the Conservation Act) allowed the investor-owned utilities to have access to federal hydropower economic benefits for residential consumers through an “exchange” arrangement. Puget was to sell power to Bonneville at Puget’s “average system cost” and then buy power from BPA to serve residential and small farm loads at the (lower) Bonneville rate. This was expected to provide benefits to Bonneville, which otherwise would have to buy this power from higher-cost new resources if the private utilities were successful in forcing BPA to sell them federal hydropower to meet residential needs without the Exchange mechanism. The Exchange Credit was the difference between the price paid by BPA to Puget and the price paid by Puget to BPA. It appeared as a reduction to applicable rate schedules in a separate rate element, Puget’s Schedule 94.

Q. How does the Exchange affect the individual customer?

A. Puget’s tariff rates have been calculated based on the Company’s cost of providing service, including the use of Company-owned and contracted power supply resources. Eligible residential and small farm customers then receive a credit, historically under Schedule 94, against the amount owed to reflect the savings that results from the Exchange.

Q. What is the specific language of the Stipulation which forms the basis of this Complaint?

A. Page 7, Line 19 of the Stipulation specifies that:

"At the expiration of the current Residential Exchange contract on June 30, 2001, the current credit under Schedule 94 shall be transferred to general rates."

Q. Please explain the meaning of the provision relating to the "transfer" of Schedule 94 into "general rates" which appears in the Stipulation.

A. The meaning of the provision, based on its plain language, is as follows: When the residential exchange contract with BPA came to an end at midnight, June 30, 2001, Schedule 94 was to expire, and the regular tariff rates for eligible residential and small farm customers were to be reduced by 1.085 cents/kWh. No other meaning is suggested by the language.

Q. What does the term "general rates" mean?

A. These mean the rates in the Company's tariffs of general application, exclusive of any temporary surcharges, tracker amounts, tax adders, or other externally-driven modifiers. These are the rates that are normally established in general rate proceedings.

Q. What does the term "current Residential Exchange contract" mean?

A. It referred to the contract between Puget and Bonneville covering the period 1981 - 2001, expiring on June 30, 2001.

Q. What does the term "current credit under Schedule 94" mean?

A. It referred to the Schedule 94 credit of $.01085/kWh in effect at the time of the Stipulation.

Q. In your opinion, are there any vague or ambiguous terms in this provision?

A. No.

IV. THE CONTEXT OF THE MERGER STIPULATION

Q. What was Puget's original proposal in the Merger negotiations?

A. In the Merger case Puget proposed a 5-year rate predictability period, with 1% annual increases in rates for each class of customers. That proposal was contained in the testimony of Colleen Lynch, Exhibit T-26, at page 2.

Q. What were the positions of the other parties?

A. Staff witnesses recommended that the merger be approved with specific conditions. The most relevant of these was that there be a 2% gas rate decrease, and no small electric rate increases for the duration of the rate predictability period. (Testimony of Dixie Linninbrink, Exhibit T-78, p. 3; Testimony of Roland Martin, Exhibit T-176, p. 2, and Testimony of Richard Lurito, Exhibit T-87, p. 14). Staff concluded that Puget would have a reasonable opportunity to earn a fair rate of return without any need for rate increases; as Dr. Lurito testified:

> *"...it should be noted that under Staff's rate plan, PSE management has an incentive to aggressively control costs and generate returns on equity above the 10.48% average implied by Staff's rate proposal. Even if it does not succeed in this endeavor, the 10.48% average equity return under Staff's rate plan is sufficient."* (Testimony of Richard Lurito, Exhibit T-87, p. 19)

Relevant excerpts from the testimony and exhibits of Staff are contained in my Exhibit ___(JL-3).

Public Counsel witnesses recommended that the merger be approved with specific conditions. The most relevant of these was that there be no electric rate increases for the duration of the rate predictability period, and that there be no reduction in the Residential and Small Farm Schedule 94 Exchange Credit during this period. (Testimony of Neil Talbot, Exhibit T-97; Testimony of Jim Lazar, Exhibit T-218). My testimony and relevant excerpts from Mr. Talbot's testimony are contained in Exhibit ___(JL-3).

Q. Please indicate the procedural history of the Merger Stipulation negotiations within the consideration of the Merger Application.

A. After the conclusion of evidentiary hearings in the Merger proceeding, Applicants, through Ronald Davis, their lead policy witness, approached Staff and Public Counsel, and negotiations ensued over a period of weeks in November and December of 1996. Ultimately a Stipulation was reached, and submitted to the Commission as part of the closing position of the four negotiating parties on December 11, 1996.

The other parties to the proceeding were not parties to the negotiation, did not execute the Stipulation, and did not necessarily support the Stipulation. The Stipulation was submitted by the four parties (Puget, WNG, Staff, and Public Counsel) in lieu of a brief. A hearing was held by the Commission on the Stipulation on December 18, 1996. A copy of the transcript of this hearing is contained in Exhibit ___(JL-3). The parties were then given an opportunity to submit briefs to address issues included in the Stipulation, and other issues as well. Ultimately, on February 5, 1997, the Commission approved the Merger and the Stipulation.

Q. What were the principal differences between the Merger Stipulation and the original position of the parties in testimony?

A. There were several significant differences.

First, the allowable annual increases were set at 1.5% for residential and industrial customers, rather than the 1% increases sought by the Company or the zero percent increases indicated in the testimony of Public Counsel and Staff.

Second, the Schedule 94 Exchange Credit was required to be maintained at the then-current level of 1.085 cents/kwh through June 30, 2001. This was consistent with Public Counsel's original position, but different from that of Puget or Staff.

Finally, upon the expiration of Puget's then-current contract with Bonneville, the Exchange Credit was to be "transferred to general rates." This was not contained in the original proposal of any party.

Q. What do these differences demonstrate?

A. The key fact here is that Puget received something of value (i.e., larger rate increases in the short run to cover the expected decline in the residential exchange credit) and ratepayers received something of value in return (the "transfer," a rate decrease on July 1, 2001).

Q. Were there other differences between the Stipulation and the positions of the parties?

A. Yes, many issues were resolved by the Stipulation, including gas distribution rates, the treatment of regulatory assets, certain "carve-outs" to accommodate a changing electric industry, the establishment of a service quality assurance program, and other issues. Those sections have been effectuated without need for a Complaint proceeding by any party to date.

V. THE OBLIGATION TO REDUCE RATES ON JUNE 30 WAS A KEY ELEMENT OF THE STIPULATION

Q. What was the genesis of the requirement to transfer the amount of the exchange credit to general rates?

A. Public Counsel was very concerned about granting the Company any rate increases at all during the 5-year rate plan, because our financial analysis showed that the Company could be expected to maintain its financial viability without any rate increases. (Testimony of Neil Talbot, Exhibit T-97, p. 7, contained in Exhibit ___(JL-3))

Puget had marketed the Merger proposal in the press as providing “rate stability” for all customers. Without assuring the level of the residential exchange credit, we did not believe that this was an accurate portrayal.

Our analysis included an assumption that the Residential Exchange credit would gradually drop to zero over the rate plan period. All other parties shared this expectation. (Merger Transcript, p.. 2515; p. 2527, contained in Exhibit ___(JL-3))

Staff’s analysis showed the same thing -- that Puget did not need rate increases. (Testimony of Richard Lurito, Exhibit T-87, p. 17 - 25, contained in Exhibit ___(JL-3)).

Puget agreed that the Exchange credits would gradually decline over the term of the Agreement, but did not agree with this analysis of their expected profitability without rate increases. In my opinion, the principal difference was that the Puget analysis included the anticipated reduction in revenues from Schedule 48 industrial customers in computing future profitability. (Exhibit TS-35, contained in Exhibit ___(JL-3)) Public Counsel did not include these reductions, because the Company had guaranteed no cost shifting as a result of the Schedule 48 approval, and the Commission had made this a condition of its approval of Schedule 48. (See Docket No., UE-960696, Order Approving Schedule 48 With Conditions, p. 7) Public Counsel’s calculation excluded this cost-shifting and was therefore consistent with the terms of the Schedule 48 approval, and Puget’s calculation did not correct for this factor.

Q. How did this disagreement affect the negotiations?

This disagreement created an impasse in the negotiations. Public Counsel was not willing to agree to general rate increases during the rate plan period knowing that residential rates would also increase significantly as the Exchange benefits declined. Staff objected to an increase in general rates, because their analysis showed that this was a method for Puget to recover the expected lost margin from Schedule 48. (See Testimony of Roland Martin, Exhibit T-176, pp. 11-13, and

Testimony of James Miernyk, Exhibit T-191, pp. 2-14, both contained in Exhibit ___(JL-3)). The Applicants were not willing to enter into a settlement on Public Counsel's terms. As Applicants stated in rebuttal testimony:

> "However, we are very concerned with the rate conditions that Staff and Public Counsel propose. These conditions are unacceptable." (Testimony of William Vitatoe, Exhibit T-259, p. 1)

Q. How was the impasse resolved?

A. The impasse was resolved with the language contained in the Stipulation, which provides the following inter-related elements:

> a) For Puget: Rate increases at a higher rate than requested by the Company during the rate plan period;
>
> b) For Residential Consumers: the residential exchange credit was frozen at 1.085 cents/kwh during the period through the end of the exchange contract;
>
> c) For Residential Consumers: at the end of the exchange contract, the 1.085 cent credit was to be transferred to general rates.

It is the last of these agreements, which has not yet been implemented, which is the issue in this Complaint.

Q. In your opinion, would Public Counsel have supported the Merger without the commitment by Puget to reduce residential and small farm rates on June 30, 2001?

A. No, I believe Public Counsel would have opposed merger approval without this understanding of this provision of the Stipulation. The testimony of Public Counsel indicated that the merger should be approved only with very specific conditions, including Puget absorbing any decline in residential exchange credits, a multi-year rate freeze, and several others. By the time the evidentiary hearings had ended, all of the consultants working for Public Counsel had concluded that there were serious problems with the merger as proposed.

Q. What elements of the Stipulation made the Merger acceptable to Public Counsel?

A. Basically, there were three elements. First, the commitment to preserve the level of exchange benefits through June 30 at 1.085 cents/kwh, so that there was reasonable certainty as to what the level of rates for all customers would be in that period. Second, the commitment to reduce the tariff rates by 1.085 cents/kwh at the end of the then-current Exchange contract. Finally, the agreement on a ten-point Service Quality Index and an associated enforcement mechanism.

Q. How crucial was the second element of this, the transfer of the then-extant Exchange credit to permanent rates?

A. It was a crucial element. First and foremost, it meant that even if Puget received no exchange benefits whatsoever from Bonneville at that time, that residential rates would not go up (other than the scheduled 1.5% per year increases in the Stipulation) until the Commission established new rates in a general rate case. This provided a continuation of the "rate certainty" that was a goal of the Merger settlement. No such general rate revision would occur before January, 2002 at the earliest. By the terms of the Rate Plan, Puget was not permitted to file a rate case prior to February, 2001, with an effective date of January, 2002. The only caveat to this was the "interim relief" condition afforded by the Stipulation.

Second, it meant that the general rate case expected to be filed in 2001 would refer to the lower general rates established after the transfer on July 1, 2001 as the base against which any change in rates after January 1, 2002 would be effective.

Finally, the transfer essentially returned to customers the rate increases that were granted during the 5-year rate plan period on a permanent basis, consistent with the testimony by both Staff and Public Counsel that the Company would not need rate increases to support a fair rate of return by the end of the rate plan period.

Q. What, in your opinion, was the purpose of the rate increases in the Merger Stipulation?

A. These rate increases were agreed to in order to support the Company during the early years of the merger, prior to the achievement of merger benefits, power stretch benefits, and best practices benefits. Because our financial analysis showed that by the end of the rate freeze period, Puget did not need the benefit of rate increases in order to earn an adequate return, a reduction in residential rates after merger benefits were achieved was a logical way to capture these benefits for consumers. Staff's testimony, particularly that of witnesses Miernyk and Martin, indicated the same situation was anticipated.

Q. What were the various party's estimates of their positions as far as Puget's return on equity, and how do these compare to what occurred?

A. The table below shows this comparison. The "Company" analysis is taken from Exhibit TS-35, and the staff analysis is taken from Mr. Lurito's testimony, Exhibit T-87. The Public Counsel analysis is taken from Mr. Talbot's Exhibit TS-100. The "Actual" results are from Puget's Annual Reports to Shareholders.

Table 1: Projected and Actual Return on Equity 1997 - 2001

Year	Company (Exhibit TS-35, p. 17)	Staff (Exhibit 88, P. 1)	Talbot (Exhibit TS100, p. 4)	Allowed Return on Equity	Actual (From Puget Annual Reports)
Rate Increases:	1% All Classes	None	None		1.5% Res/Ind 1% Other
Reduced Exchange:	Recovered	Recovered	Absorbed		Absorbed
1997	11.8%	10.48%	8.3%	10.5%	7.7%
1998	12.5%	11.01%	9.3%	10.5%	11.6%
1999	12.4%	10.25%	9.7%	10.5%	12.8%
2000	13.3%	10.52%	11.0%	10.5%	13.2%
2001	13.3%	10.16%	10.7%	10.5%	Not Released

Q. Please explain the meaning of the above table in the context of the negotiations?

A. Puget's proposal to both impose annual general rate increase and to further raise residential rates to recover any reductions in Exchange benefits, as reflected in the first column, would have produced a rate of return by the end of the rate plan of 13.3%, clearly in excess of the then-allowed 10.5% return on equity. Staff's analysis was largely similar to Public Counsel's, except that it assumed zero rate increases, and showed that the Company could earn a fair rate of return without any need for general rate increases. Mr. Talbot's analysis for Public Counsel was based on zero rate increases, and an assumption that Puget would hold the residential exchange credit at 1.085 cents/kwh for the entire period as benefits from BPA gradually declined to zero in July, 2001. By 2000 - 2001, it showed that the Company would be earning a fair rate of return even without increases and without exchange benefits from BPA. All of this information was available to the Parties at the time of the negotiation.

Q. What conclusions can be drawn from this information that was available to the parties negotiating the Stipulation?

A. First, using Puget's 10.5% allowed return on equity from Docket UE-921262 as a basis, it is clear that Puget's proposal was excessive. Second, Staff's proposal would provide a fair rate of return for Puget throughout the rate plan period (but result in significant rate increases for residential consumers as the Exchange benefits declined). Finally Public Counsel's proposal would produce less than a fair rate of return for the first few years, but by the end of the period, there would be a fair rate of return.

Q. Does the Stipulation effectuate a reasonable package if interpreted as set forth in Public Counsel's Complaint?

A. In the early years of the rate plan, it gives the Company significantly more revenue than the Public Counsel position, through annual rate increases. Thus the earnings in the early years will be more consistent with those in the Puget position shown in Table 1. After June 30, 2001, it reverts to the Public Counsel level of earnings, due to the reduction of residential rates by 1.085 cents/kwh through the Transfer. Basically, it shows that the parties negotiated reasonably.

The Stipulation allowed extra revenue in the early years through general rate increases, prior to the achievement of merger benefits, best practices savings, and power stretch savings to cover the shortfall caused by Puget absorbing the risk of lower exchange benefits. At the end of that period, after the savings were achieved, the Stipulation returned that benefit to customers on June 30, 2001, when the analyses showed that Puget would no longer need this extra revenue.

Q. What was the basis for assigning all of this benefit to the residential and small farm customers, through a 1.085 "transfer to general rates" of the previous Exchange credit?

A. There are two parts to this. The first is simply what I will call "negotiation glue" – the stuff that makes a Settlement stick together. Public Counsel believed that the total amount of revenue Puget was receiving was excessive. As expressed by Mr. Vitatoe in his rebuttal testimony, Puget was not willing to accept the level recommended by Staff and Public Counsel.

By giving the money to Puget for the initial period through annual rate increases, then applying a permanent reduction to residential rates before the end of the rate plan period, there was some compromise on both sides. Puget got reasonable earnings during the period when residential rates would be predictable, through the rate increases. Residential customers would get rate relief at the end of that time, on July 1, 2001.

In the event that merger benefits and other savings did not materialize as anticipated, Puget could file for general rate relief if the "total package" was producing less than a fair rate of return by the early part of 2001. At most, the Company was at-risk to have low earnings for six months. That was a gamble the Company accepted – with the Interim Relief standard as its insurance policy in case things went drastically contrary to our expectations.

Q. Why was this fair to the other customer classes?

A. The Company's rate study prepared in conformance with Commission direction (Puget response to Bench Request 515E in Docket UE-921262) clearly showed that primary and high voltage customers were paying far <u>below</u> their cost of service -- 79% of cost for the high voltage customers, and 91% of cost for the primary voltage customer. The Stipulation increased rates to these customers at 1.5% per year, and did not reduce them on July 1, 2001. This moved these customers toward this measure of "equity." However, it was expected that most of these customers would move to Schedule 48 and/or retail wheeling, and not be exposed to Puget's tariff rates for power supply anyway. This in fact occurred with the creation of Schedule 448 and 449 in early 2001.

The Commercial class, which did not object to the merger, received a better deal than what Puget had proposed – 1% per year – but only for four years, not five. We considered this a fair treatment of this group, the fastest-growing class on the system, most responsible for the need for new generating resources.

Because a substantial part of the merger benefits were in combined electric and gas distribution, customer accounts, meter reading, and customer service functions, we believed that the residential class was entitled to the largest share of merger benefits. Puget's testimony in the pending general rate case (Docket UE-011570), by Mssrs. Weaver and Swofford, confirms that the Company not only is achieving these type of savings, but in fact is ahead of the projections upon which we based the Stipulation.

Q. What was your own expectation at the time it was negotiated with respect to how this would play out in 2001?

A. I expected that Puget would probably file a general rate increase in February or March of 2001, for rates to be effective at the beginning of 2002, as allowed by the Stipulation. With full reflection of merger benefits that primarily affect small customers (distribution system maintenance synergies, joint meter reading and billing, administrative and general costs, etc), we believed that the result would be a relatively good alignment of revenues to costs by that time.

VI. PUGET OBTAINED UNEXPECTED EXCHANGE BENEFITS

Q. What expectation did the parties have at the time of this negotiation with respect to future exchange benefits from Bonneville?

A. I think all parties expected them to decrease over the period 1997 to 2001 from the levels that had existed in 1996. Bonneville had published its proposed schedule of exchange credits to Puget in the Wholesale Power Rate Development Study which accompanied the 1996 BPA rate case. This was the estimate we worked with during the Merger proceeding and settlement negotiations. This is confirmed by documents Puget provided in response to Public Counsel Data Requests 5, 6, and 7 and contained in my Exhibit ___(JL-4). These show that the Company expected to pay out $534 - $550 million in benefits under the Stipulation, but expected to receive only about $201 million in benefits from Bonneville, with the benefits terminating on June 30, 2001.

After the Stipulation was executed, Puget reached a settlement with BPA for a much larger amount of benefits. Following that settlement, Puget asked the WUTC for permission to "re-shape" these benefits for financial reporting purposes; this was granted by the Commission in Docket UE-970451.

Table 2: Estimated and Actual Exchange Benefits 1997 - June 30, 2001

Year	BPA WPRDS Estimate $ X 1000	Actual (UE-970451) $ X 1000	Re-Shaped Per Accounting Order (UE-970451) $ X 1000
1997	$23,971	$94,887	$71,970
1998	$29,595	$45,645	$55,562
1999	$37,885	$36,000	$39,000
2000	$47,924	$35,778	$41,000
2001 (through June 30)	$40,218	$22,222	$27,000
1997 - 2001 Total	$179,593	$234,532	$234,532

Q. How does this compare to the level of residential exchange credit that Puget was required to flow through to customers as a condition of the merger stipulation?

A. At the December hearing on the Stipulation, Puget's estimated that it would pay $534.1 million in Exchange Benefits over the five years of the rate plan (Attachment 2 to Response to Bench Request, contained in Exhibit ___(JL-4)). At that time, Puget estimated its benefits from Bonneville (including the PRAM true-up) at $200.7 million. Thus, by Puget's calculation at the time of the merger, it was exposed to $333 million in credits to customers in excess of expected credits from Bonneville.

Q. Let's move now to your original exhibit from the Merger, which is now marked as a part of Exhibit ___(JL-3) in this proceeding. What were the key differences between your analysis and that submitted by the Company's witness Ms. Lynch?

A. My analysis estimated that the Company would flow $511.1 million in exchange benefits to customers, and receive $179.6 million from BPA, for a shortfall of $331.5 million. I relied on the BPA WPRDS estimate. The "shortfall" estimate I prepared in September was almost identical to that estimated by Puget in December of 1996.

Q. Your testimony quantified some other offsetting items, though, did it not?

A. Yes. I computed the effect of transferring conservation program costs from general rates to the tariff-rider program (but leaving base rates at a level designed to recover conservation costs), the savings associated with depreciation of production rate base over the rate plan period, and the savings from joint meter reading and billing. These produced an offset of $193 million compared with the Company's case in the Merger. This compares with approximately $150 million that would have been produced by the Company's proposed 1% rate increases. Basically, I found as much "money" hidden in other areas as the Company was requesting in rate increases. This, together with Mr. Talbot's financial analysis in his Exhibits 97 - 102, formed the cornerstones of Public Counsel's conclusion, during the Merger proceeding, that the Company did not need the rate increases that it initially proposed.

Q. Do these calculations include the cost of absorbing the residential exchange benefits from Bonneville?

A. No, nor do they include the so-called "Power Stretch" benefits that the Company was expected to achieve.

Q. How did those other items factor into the analysis at the time of the Merger?

A. As shown in my Exhibit 220 from the Merger, the Company's potential maximum exposure to the residential exchange was about $331 million; I assumed, for analytical purposes, that it would actually lose half of that amount. If that occured, and the other offsetting cost savings I identified were experienced, the Company would need to achieve approximately $158 million in "power stretch" savings in order to achieve its "Management Surplus" target. This was approximately 20% of the estimated above-market power costs that the Company was experiencing at that time. My testimony was that if Puget could NOT achieve any Power Stretch savings, it would have to absorb approximately 20% of its above market power costs, or what we termed "Stranded Costs." I found this was a reasonable level of risk The Company's actual estimate of achievable Power Stretch benefits was $151.8 million. The point that was made by the combination of my exhibits was that the Company's cost of absorbing the residential exchange credit would be offset by other benefits, including the elements I identified on page 1 of Exhibit 220, and the Company's estimate of achievable "Power Stretch" benefits. All of these exhibits are contained in my Exhibit ___(JL-3) in this proceeding.

Q. At the time of the Settlement hearing before the Commission in December 1996, what expectation did Puget express with respect to its agreement to absorb the decline in the residential exchange benefits?

A. Puget had assumed $200.7 million in Exchange benefits in the December presentation to the Commission. Coupled with the $276 million in rate increases provided for in the Stipulation, this left the Company with $57 million of "responsibility" for absorbing the diminution of Exchange benefits. This is shown in the Response to the WUTC Settlement Questions contained in my Exhibit ___(JL-3).

Q. What did that calculation by the Company assume with respect to the period July 1, 2001 through December 31, 2001?

A. It assumed that the Company would reduce residential revenues during this period by 1.085 cents/kwh, with no Exchange benefits received from Bonneville to offset this amount. This is evident because the amount of benefits shown is $534 million (a 5-year figure) and the amount of "Estimated REA Credits with True-UP" is $200.7 million, a figure which does not include any amounts to be received from BPA after June 30, 2001.

Q. What was the actual result of Puget's negotiations with BPA for exchange credits?

A. Puget's settlement with BPA provided a total of $234.5 million in residential exchange credits, some 30% more than I had assumed in preparing my exhibits, and $34 million more than Puget assumed in its presentation to the Commission at the December 18, 1996 settlement hearing.

Q. Please compare the net cost to Puget of the original expected outcome of the original agreement to reduce rates as of July 1 with the actual outcome under the plain terms of the Stipulation, and with that of Puget's interpretation of the provision.

A. I will rely on the Responses to WUTC Settlement Questions, prepared on December 16, 1996, and included in my Exhibit ___(JL-3) as the basis for these figures. The table below compares these items based on the original presentation, the Public Counsel position, and the Puget position.

Table 3: Positive Financial Impact of Puget Interpretation of Stipulation

	December, 1996 Puget Presentation	Public Counsel Position	Puget Postion In Answer
Rate Credits @ .01085/kwh	$534,090,560 (through 12/31/01)	$534,090,560 (through 12/31/01)	$534,090,560 (through 12/31/01)
Received From BPA	($200,700,000)	($234,532,300)	($282,117,286 (Includes $47.6 million after 7/1)
Shortfall	$333,390,560	$299,558,260	$251,973,274
Rate Increases	($276,554,834)	($276,554,834)	($276,554,834)
Puget Responsibility	$ 56,835,726	$23,003,426	($24,581,560)

The first column is information that Puget presented to the Commission as its best estimate of the effect of the Stipulation as of December 18, 1996. This included providing $534 million of benefits at 1.085 cents/kwh through December 31, 2001, receiving $200 million in benefits from BPA, and $276 million in benefits from rate increases, leaving Puget with a $57 million cost responsibility for this package.

The second column is a portrayal of the Public Counsel position as it played out. I have assumed the same assumed level of benefits that Puget presented on December 18, 1996. Because the amount received from BPA in 1997 was $34 million greater than expected, the Puget cost responsibility declines to about $23 million.

The final column is the apparent effect of the Puget position in its answer in this proceeding. First, the amount of benefits provided to customers is unchanged from the first two scenarios. Second, the amount contributed by BPA increases by $47 million above the level in the second column, because Puget proposes that the 1.085 cent obligation from the 1997 Stipulation is paid out of future (post June, 2001) Exchange benefits received from BPA. When we add this $47 million from BPA to the unexpected bonanza Puget received in 1997, this position actually turns the Stipulation into a "profit center." Instead of sacrificing $57 million in order to get approval of the Merger (as it calculated at the time of the December 18, 1996 hearing), Puget actually would net $25 million in additional profits if its position is approved.

I think it is implausible that the Stipulation -- a compromise between the position of the parties -- can be interpreted in a manner that makes this a "profit center" for Puget. The Company's position gives it $34 million more at the beginning of the period (which we do not dispute -- the Company was put at risk for this amount in the Stipulation), and $47 million more at the end of the period (which is not consistent with the Stipulation).

VII. PUGET HAS HAD RECORD EARNINGS SINCE 1998

Q. How did Puget's financial results work out over the rate plan period?

A. Pretty much the way that I, my colleague Mr. Talbot, and Dr. Lurito had predicted. The Company absorbed the loss of residential exchange benefits as agreed, through June 30, 2001. Its profitability increased year by year. The table below shows Puget's return on equity for each year since its last general rate case. For the years after the Merger, this includes the effect of absorbing the portion of the residential exchange benefit flowed through in Schedule 94, but not received from Bonneville:

Table 4: Puget Sound Power and Light / Puget Sound Energy Earnings Per Share, Return on Equity, Allowed Return, and Schedule 94 Exchange Credits Absorbed

	$/share	% ROE	Allowed Return	Exchange Cost Absorbed
Puget Sound Power and Light Company Results:				
1993	$2.00	11.00%	12.80%	
1994	$1.64	8.90%	10.50%	
1995	$1.89	10.30%	10.50%	
1996	$1.89	10.30%	10.50%	
Merger Took Effect in February, 1997; Merged Company Results:				
1997	$1.25	7.70%	10.50%	$33,799,000
1998	$1.85	11.60%	10.50%	$52,218,000
1999	$2.06	12.80%	10.50%	$71,033,000
2000	$2.16	13.20%	10.50%	$71,558,000
1997 - 2000	**$1.83**	**11.32%**	**10.50%**	

Source: Puget Annual Reports to Shareholders; UE-970451 Order; Response to PC #8

As is evident from this table, after the first year, when merger expenses were a significant drain, the Company exceeded its allowed return on equity by significant margins for 1998 through 2000. This trend continued well into 2001. Further, it achieved this while absorbing $60 - $72 million of benefits flowed to customers through Schedule 94 which were unreimbursed. The analysis prepared by Public Counsel and Staff was clearly correct: once the merger benefits and other savings were achieved, Puget could afford to absorb the exchange benefits as called for by the Stipulation after June 30, 2001. The amount which the Stipulation, if effectuated, would have caused the Company to absorb in 2001 is $89 million, a relatively modest increase from the $72 million absorbed in 2000.

Q. What was the expectation with respect to how Puget would deal with the transfer of the exchange credit into general rates on June 30, 2001?

A. It was expected that by that time, Puget would have reduced its power cost and operating costs by enough that it could accomplish the transfer without impairing profitability below acceptable levels. Three separate analyses confirm this situation. First, there were the earnings estimates prepared by Dr. Lurito and by Mr. Talbot, showing their projection of Puget's earnings. Staff's analysis by Dr. Lurito shows that with zero rate increases, but with customers absorbing the loss of exchange credits, the Company would be earning a fair rate of return throughout the 5-year rate predictability period. Mr. Talbot's analysis shows that with zero rate increases and Puget absorbing the loss of the residential exchange credits, it would be earning a fair rate of return by the end of the 5-year rate predictability period. Finally, my own exhibits 219 and TS-221, showed that without absorbing the residential exchange credit, Puget's return on equity would be far above a fair rate of return. All of these exhibits from the Merger are contained in my exhibit ___(JL-3) in this docket.

Q. So, what's the bottom line?

A. The bottom line is that all independent analyses showed that Puget could absorb the loss of the residential exchange credit entirely as of July 1, 2001, and still have reasonable earnings.

Q. If these forecasts did NOT prove accurate, what was Puget's option in order to achieve satisfactory earnings?

A. The Merger Stipulation addressed this very specifically. During the rate predictability period, Puget was allowed to file for interim rate relief if it met the Pacific Northwest Bell 6-point test established in Cause U-72-30. This was to assure that the Company would be able to obtain funds needed to provide reliable service. Beginning in February, 2001, Puget was entitled to file a general rate case with an effective date after December 31, 2001.

Q. Did Puget exercise either of these options?

A. No, it did not do so until late 2001. Presumably Puget did not believe it was underearning and could not show a shortfall in earnings during that time period. In fact, the Company achieved record earnings in 1998, 1999, and 2000, three consecutive years. Its return on equity in those three years (as reported in its Annual Reports to Shareholders) was 11.6%, 12.8%, and 13.2%, all far above its allowed return on equity of 10.5%. Just to prevent any assertion that this is being compared with a "stale" ROE, all of these are also above the 11.16% Return on Equity allowed Avista in the Commission's September 29, 2000 Order in Docket UE-991606. In the 4th Quarter of 2001, Puget filed for both interim and general rate relief.

Q. Does this experience suggest that Puget could have reduced rates effective on June 30, as you state the Merger Stipulation requires, and still have had acceptable earnings?

A. Yes. Take the year 2000 as an example, as this was the logical test year that a general rate filing in February, 2001 could have been based on. In that year, the Company paid out approximately $112 million in Schedule 94 credits, but recorded only $41 million from BPA under its 1997 settlement as approved in UE-970451. It therefore absorbed about $71 million in Schedule 94 credits. In that year, however, it had net income of $185 million, producing a 13.2% return on equity.

Had it absorbed the remaining $41 million of the exchange credit it actually received from BPA and booked in that year (essentially the situation that the Merger Stipulation anticipates after June 30, 2001), its earnings would have been lower. After tax, a $41 million loss in revenue would have meant a $27 million additional "hit" to earnings, dropping net income to $158 million. That level of net income would have generated an 11.3% return on common equity. That would still be well above the allowed return on equity for Puget, and slightly higher than the more recent allowed return on equity for Avista.

The simple fact is that Puget would logically have filed a general rate increase in February, 2001 if it believed it could not absorb the residential exchange credit. Instead, all indications at that time were that it could have complied with the Merger Stipulation, reduced rates on a permanent basis on June 30, and still have acceptable earnings.

Q. How did Puget's earnings look in the first quarter of 2001?

A. They continued at record levels. Its First Quarter earnings report was down $6 million from the year before, but that calculation reflected a charge to earnings related to losses on derivatives; apart from its derivative losses, the Company posted record earnings in that quarter as well. Before the accounting item, net income for the 12 months ending March, 2001 were $202.7 million, another record. The Company's CEO stated: "Results for the quarter put us on target to meet our operational and financial objectives for 2001."

Q. Have Puget's earnings declined since that time?

A. Through the third quarter of 2001, Puget's earnings held up well. For the 12 months ending September 30, 2001, the Company reported net income of $1.84 per share. With a book value of $15.89/share, this translates into a return on equity of 11.6%, well above the allowed rate of return of 10.5%. So, yes, earnings declined, but they were still above a fair rate of return through the third quarter.

Q. To what extent is the Company achieving its goals with respect to merger benefits and best practices?

A. These achievements are being examined in the general rate case, Docket No. UE-011570. The Company's press releases continue to indicate that it is achieving or exceeding its goals in this area. Mr. Swofford's testimony in the Interim portion of this rate proceeding indicates that the Company has made huge achievements in cost control – on the order of a 17% reduction in the per-customer cost of delivering energy. (Docket UE-011569, Direct Testimony of Gary B. Swofford, p. 2) Mr. Weaver's testimony in the General rate proceeding states that "PSE is ahead of schedule" to capture the projected merger synergy savings, having achieved $156 million in savings in the past three years. (Docket UE-011569, Direct Testimony of William S. Weaver, p.

18) These are precisely the type of cost savings that we anticipated in developing the Stipulation, including the provision for a transfer of the exchange credit to general rates on July 1, 2001.

Q. Is it your understanding that the Company's earnings have slipped since the third quarter of 2001?

A. Yes, the Company's fourth quarter earnings are due to be released two days after this testimony was filed, and I expect them to be lower. This type of variation in earnings was anticipated when the Stipulation was drafted. As Mr. Davis testified at the December 18, 1996 hearing:

"On electric a five-year period is contemplated for the company to be able to manage its costs and revenues. Some years may look not very good and some may look good, but we had a five-year period contemplated in the plan." (Docket UE-960195, Tr. p. 2424)

Given the record earnngs in 1998 - 2000, and the strong performance through the third quarter of 2001, I think it is very likely that, on average the Company will have earnings very close to the 10.5% return on equity over the 5-year period that was our benchmark in negotiating the Stipulation.

VIII. PUGET's INTERPRETATION OF THE STIPULATION IS IMPLAUSIBLE

Q. What is Puget's basic assertion as you understand it, with regard to the meaing of the "transfer to general rates" provision?

A. Puget basically says that because it got additional Exchange benefits after 7/1/2001, that these should be applied against the obligation to reduce general rates contained in the Stipulation.

Q. What is the most compelling reason why the language of the Stipulation must be interpreted to require a reduction in general rates on June 30, 2001?

A. It is very simple. Puget asked for a **<u>1%</u>** per year increase in rates in it's Application. The Stipulation provided for a **<u>1.5%</u>** increase in rates for residential and industrial customers, and 1% for commercial customers. The Stipulation gave Puget more than it was asking for. Normally in a settlement, the parties agree on something in-between their litigation positions. In this Stipulation, the parties agreed on something more generous than the Company's original request. Obviously, there must have been a *quid pro quo* for such a concession by Staff and Public Counsel.

Q. Why is not just absorbing the 1.085 cents/kwh residential exchange credit through the rate plan period the *quid pro quo*?

A. The 1% and 1.5% increases to general rates continued after June 30, 2001. If the agreement were to be interpreted as Puget has asserted in its Answer, then the Stipulation would have provided for higher earnings in the post-June 30 period than the Company's original Application. As I have already testified, the Company's original Application showed that the return on equity would be over 13% by the end of the rate plan period if Puget was not absorbing the residential exchange credit.

It is simply implausible that the parties would have agreed to a plan that gave Puget a 13+% return on equity after June 30, 2001. These same parties had testified that a rate plan which produced returns on equity in the 9% - 11% range were fair, just, and reasonable. The testimony of Mr. Talbot for Public Counsel and of Ms. Linnenbrink, Dr. Lurito, and Mr. Martin for Staff all reached these positions.

Q. Was the obligation to transfer the exchange credit to general rates on July 1 limited to the rates that would be in effect during the Rate Plan period?

A. No. General rates do not expire. The obligation was to transfer the $.01085/kWh credit from Schedule 94 to general rates. General rates are also not the place that Residential Exchange Credits have <u>ever</u> been credited since the beginning of the Exchange, in 1981. General rates are the rates which compensate the Company for its costs of providing service, exclusive of any benefits received from BPA. If the Stipulation had meant that this benefit would only continue through December of 2001, it could have said so. The language "transferred to general rates" should be unambiguous: it is no longer related to the Exchange, and is a part of permanent rates until changed by the Commission.

Q. Does any analysis by the Commission staff support this interpretation of the meaning of the "transferred to general rates" language?

A. Yes. There is a May 24, 2001 memorandum to Commissioner Hemstad from staff members Steel, Martin, Elgin, and Assistants Attorney General Cedarbaum and Trotter which explains this in detail. This was produced by Staff in response to the subpoena issued by Public Counsel to Kenneth Elgin, and is included in my Exhibit ___(JL-5). This clearly supports the plain meaning of the "transferred to general rates" provision of the Stipulation.

Q. Did the Company recognize this obligation at the time the Stipulation was presented to the Commission?

A. Yes, I believe so. During the December 18 hearing, Mr. Davis, the Company's witness, stated:

> *"...at the end of this period the exchange wouldn't just go back to what it was, that if the company needed to do anything with that it would have to come back before this Commission in a general rate proceeding. So we are contemplating over this period the reliance on the exchange ends whether or not rights do and the exchange ends is a different issue with Bonneville, but the contemplation was that the company was going to get its costs down and its rates resolved and it ends."* (Docket UE-960695, Tr. p. 2527)

I believe that this demonstrates that the Company expected to use merger savings, best practices savings, and power stretch savings to offset the expected loss of exchange benefits by June 30, 2001, and that these benefits would be reflected in general rates after June 30, 2001 as a result of the transfer.

IX. RATE ISSUES

Q. What is the correct rate Puget should have charged its residential and small farm customers, after June 30, 2001?

A. The correct rate would have been $.01085 per kWh less than the rate which it actually charged. This would have been the effect of transferring the pre-June 30, 2001 exchange credit to general rates, plus flowing through the post-July 1 benefits actually received from Bonneville.

Q What rate treatment should the Commission order with respect to this dispute?

A. The Commission should declare that the rate that Puget has been charging since July 1, 2001 is not a proper rate because it is in violation of the merger Order and Stipulation.

Q. How is the rate a violation of the merger Order and Stipulation?

A. The merger Order and Stipulation required Puget to transfer the pre-June 30, 2001 exchange credit of $.01085 to general rates. It did not do so. Instead it asserted that this element of general rates is associated with the flow-through of post-July 1, 2001 exchange credits, which is inconsistent with the merger Order and Stipulation, which did not address post-July 1, 2001 credits from BPA.

Q. Why, in your opinion, is this not a proper rate?

A. Because it does not comply with the Order and Stipulation, which require that the $.01085 be transferred to general rates.

Q. In your opinion, is the current rate being charged by Puget to residential and small farm customers fair, just, and reasonable?

A. No, in my opinion it is excessive. It fails to comply with the merger Order and Stipulation, is higher than the rate allowed by the merger Order and Stipulation, and the record upon which the merger Order and Stipulation were based showed that Puget could be reasonably expected to earn a fair rate of return if the transfer occured as expected and as we assumed it would.

Q. How should the Commission order Puget to correct this violation of the merger Order and Stipulation?

A. The Commission should determine that the proper rate to have been charged to residential and small farm customers on and after July 1, 2001 was $.01085/kWh lower than Puget actually charged and collected.

Q. Please explain the calculation you have prepared in Exhibit ___(JL-2)?

A. This exhibit shows the amount that the Company has overcharged residential and small farm consumers since July 1, 2001. The data is based on actual sales to eligible customers through December 31, 2001, and estimated sales after that date, as supplied by the Company in response to Public Counsel Data Request Nos. 1 and 2.

X. THE STIPULATION HAS NO RELATIONSHIP TO POST-JUNE 30 EXCHANGE BENEFITS.

Q. Puget has asserted in its Answer that the Stipulation "concerns the pass through to Puget's eligible residential and small farm customers, of benefits received by BPA from the Bonneville Power Administration." Is this correct?

A. No, it is not correct. The Public Counsel Complaint has to do with the reduction in general rates that was called for by the Stipulation effective June 30, 2001, not with the pass-through of residential exchange credits.

Q. Would there have been any purpose to having the Stipulation deal with the pass through of exchange credits after June 30, 2001?

A. No. It is my understanding that the treatment of exchange benefits is controlled by federal law and the exchange contract.

Q. What is the connection between the Exchange credits and the language at issue in the Stipulation?

A. At the time the Stipulation was negotiated, Puget was receiving credits from BPA, and flowing them through to consumers as a 1.085 cents/kWh credit in Schedule 94. The Stipulation provided two different things with respect to this 1.085 cents/kWh.

First, the Stipulation provided that, regardless of any reduction in the level of credits received from Bonneville, that Puget would maintain the credits in rates at the current level through June 30, 2001. It was anticipated that the amount received from Bonneville would be insufficient to make this a break-even proposition for Puget; as my earlier testimony indicates, BPA was budgeting only about 40% of this level of credit.

Second, the Stipulation provided that "at the expiration of the current Residential Exchange contract on June 30, 2001, the current credit under Schedule 94 shall be transferred to general rates."

Q. Why is not the transfer of the Schedule 94 credit to general rates a part of the flow through of BPA exchange credits.

A. First, there was no relationship whatsoever prior to June 30 between the level of the Schedule 94 credit, and the benefits received from Bonneville. The Company was crediting customers over $100 million/year and receiving only a small fraction of that amount from BPA. By "transferring" that credit to general rates, those general rates were to be reduced. This is what was meant by the transfer. Any residential exchange benefits received after June 30 would be subject to the requirements of federal law that they be flowed through. Those benefits are flowed through in a manner that is trackable, so that every penny of the credit, including interest, reaches customers. General rates are not the place where this is done. Historically, residential exchange credits were flowed through a separate tariff, in this case, Schedule 94.

Q. Prior to July 1, 2001, what was the relationship between BPA credits and the residential exchange credit in Schedule 94?

A. They were completely unrelated. Puget was receiving from BPA only about one-third of the amount of the credit it was providing to customers. If at any time the credits had fallen below the amount paid by BPA, then it would have been necessary to raise the credits, but this was not the case.

Q. What was the expected relationship between the credit in place prior to June 30, and any exchange benefits received after that date?

A. There was no relationship. Once the credit was to be transferred to general rates, it was simply a component of general rates, no longer flowing through exchange credits. Any exchange credits received after July 1 were to be flowed through in the normal fashion, through a separate tariff.

Q. What did the Commission June 13 Order in Docket UE-010815 do?

A. This order was carefully crafted to avoid resolving the issue in this Complaint. That order established an adjustment to Puget's residential and small farm rates at a level $.01085 less than had been the case on June 30, but it did not require Puget to flow through the post July 1 Exchange credits it was receiving from BPA through a separate schedule. The Order specifically reserved the issue before the Commission in this docket for resolution.

Q. Did the action in the June 13 Order constitute compliance with the Merger Order and Stipulation with respect to the transfer to general rates of the $.01085 exchange credit in effect on June 30, 2001?

A. No. It addressed only the prospective credits that Puget began receiving from BPA on July 1, 2001.

Q. What possible interpretations are there of the relationship between Puget's rates and the Exchange credits after June 30, 2001?

A. There are two that are logical. Either Puget's current rates do not reflect the transfer of 1.085 cents/kwh into general rates, or else Puget's current rates do not flow through the Residential Exchange benefits that Puget is currently receiving. If the former is the case, then the Commission needs to correct the problem so that the rates comply with the Stipulation. That is the basis of this Complaint. If the latter is the problem, then Puget is at grave risk of losing a significant portion of the Exchange benefits which the Commission, Public Counsel, and Puget worked so hard to achieve. It is my understanding that if the Commission does not require Puget to flow these benefits through in a timely fashion, they will revert to Bonneville.

Q. What does Puget's answer assert with respect to this issue?

A. It is not clearly stated, but it seems to imply that the "transfer to general rates" also includes a flow-through of Exchange benefits. This position is inconsistent with any treatment of Exchange benefits since the program began.

Q. What does Puget's current tariff book contain with respect to these issues?

A. There are *three* separate relevant tariffs currently in the tariff book. First, there is the general tariff for each the rate classes eligible for the Residential Exchange credit. There are a total of ten tariff schedules (Schedules 7, 8, 10, 11, 12, 29, 35, 56, and 59, plus all of the Time of Use residential customers covered by Schedule 307) with eligible residential and/or farm load. Each of those tariffs now contains a column to remove $.01085 from general rates; it is this amount that Puget asserts BOTH implements the required transfer AND flows through current Exchange benefits. It can be only one or the other, since these two rate adjustments are unrelated. Second, there is Schedule 194, which passes through a portion of the benefits that Puget is currently receiving from Bonneville; that portion is computed to exclude the 1.085 cents/kwh at issue. Finally, Schedule 94 is still a part of the tariff book, but it has expired by its own terms.

Q. What form do the regular tariffs take?

A. The tariffs all state the rate that took effect on January 1, have a column labeled "Residential and Farm Energy Exchange transferred to general rates on July 1, 2001", and then a net rate, but reserves the right of parties to pursue . The issue in this proceeding is whether this credit of 1.085 cents/kwh is to be counted when measuring whether Puget is flowing through the current benefits it is receiving. I believe that the record is clear that this amount <u>should</u> represent the reduction in rates promised in the Stipulation, regardless of any future benefits from BPA. The only other possible interpretation is that they do not flow through the current residential exchange credits, and that interpretation would put those credits at risk.

Either the June 13 approval does not constitute compliance with the Merger Order, or else the June 13 approval does not flow through current Residential Exchange credits.

Pursuant to language in the Commission's Order in Docket No. UE-010815, Public Counsel is asserting that the tariffs approved on June 13 do NOT effectuate the transfer to general rates of the credits that were in effect on June 30, 2001 as called for by the Merger Stipulation.

XI. SUMMARY AND RECOMMENDATION

Q. What resolution should the Commission Order?

A. The Commission should find that Puget is not charging a correct and proper rate for residential and small farm service. It should order Puget to correct the rate being charged, to properly reflect the transfer of the pre-June 30, 2001 exchange credit to general rates. It should further order Puget to correct the current residential exchange credit to reflect the amount being received from BPA. The Commission should determine the appropriate level of refund to customers. Finally, the Commission should determine if a penalty should be imposed for Puget's non-compliance with the Merger Order and Stipulation.

This completes my prepared testimony.