

EXHIBIT NO. ___(JHS-10C)
DOCKET NO. UG-040640, *et al.* (consolidated)
2004 PSE GENERAL RATE CASE
WITNESS: JOHN H. STORY

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

Docket No. UG-040640
Docket No. UE-040641
(*consolidated*)

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

For an Order Regarding the Accounting
Treatment for Certain Costs of the Company's
Power Cost Only Rate Filing.

Docket No. UE-031471 (*consolidated*)

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

For an Accounting Order Authorizing
Deferral and Recovery of the Investment
and Costs Related to the White River
Hydroelectric Project.

Docket No. UE-032043 (*consolidated*)

THIRD EXHIBIT TO THE
PREFILED REBUTTAL TESTIMONY OF
JOHN H. STORY (CONFIDENTIAL)
ON BEHALF OF PUGET SOUND ENERGY, INC.

NOVEMBER 3, 2004

REDACTED
VERSION

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Docket Nos. UG-040640 and UE-040641
Puget Sound Energy, Inc.'s General Rate Case
for Gas and Electric Operations

ICNU DATA REQUEST NO. 06.12

ICNU DATA REQUEST NO. 06.12:

Please provide a copy of all studies, analyses and other documents that refer or relate to any of the following: a) bringing legal services performed by outside counsel in-house; b) the reasonableness of outside counsel legal expense; and c) opportunities to reduce legal expenses.

Response:

Puget Sound Energy, Inc. ("PSE") objects to ICNU Data Request No. 06.12 to the extent it calls for the production of privileged attorney-client communications or attorney work product. PSE also objects to ICNU Data Request No. 06.12 as overly broad, unduly burdensome, and beyond the proper scope of discovery, among other reasons because it is not restricted by any reference to a time frame. Without waiving these objections, PSE responds as follows:

Following the 1997 merger of Puget Sound Power & Light Co. and Washington Energy Co., PSE hired a General Counsel (Steve McKeon) and added a small internal Legal Department of two attorneys. This group worked to increase provision of legal services to PSE through in-house counsel as well as to evaluate other strategies for reducing costs associated with legal services. Studies, analyses, and other documents created in support of the growing role of the internal Legal Department included the following:

- Recommendations for Puget Sound Energy Major Litigation Strategy (September 9, 1999) prepared by PSE in-house counsel for Mr. McKeon, a copy of which is provided as Attachment A to PSE's Response to ICNU Data Request No. 06.12;
- 2002 PSE Legal Management Plan (February 25, 2002) prepared by in-house counsel Steve Secrist, a copy of which is provided as Attachment B to PSE's Response to ICNU Data Request No. 06.12; and
- Proposed Legal Dept Sharing and Division of Responsibilities (April 25, 2002) prepared by in-house counsel Steve Secrist and Rob Neate, a copy of which is provided as Attachment C to PSE's Response to ICNU Data Request No. 06.12

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ICNU Data Request No. 06.12

Date of Response: Sept. 09, 2004

Person who Prepared the Response: Steve Secrist; Jennifer O'Connor; Kimberly Harris

Witness Knowledgeable About the Response: John H. Story

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Steps taken as a result of such analysis include, as of January 1, 2000, transfer of all legal defense work associated with tort claims to a different outside law firm on a fixed-fee retainer basis.

In 2002, PSE made the decision to hire a new General Counsel to replace Mr. McKeon, who was also serving as PSE's Chief Financial Officer at the time. As part of that decision, PSE decided to increase the size of its internal legal staff to, among other things, help control legal costs. By the end of Mr. McKeon's tenure as General Counsel, PSE's in-house legal staff increased to four attorneys. PSE also took steps to further control outside legal expenses such as negotiating fee arrangements with outside counsel and instituting a gatekeeper function with respect to the hiring of outside counsel.

PSE then hired Jennifer O'Connor, who joined PSE as General Counsel in January 2003. Ms. O'Connor had previous experience building legal departments at Honda of America, Mfg., Inc. and at Starbucks Corporation. As one of her first actions, she undertook an assessment of PSE's past legal spending and practices regarding the hiring and utilization of outside counsel and law firms, including benchmarking. Ms. O'Connor utilized studies for this task undertaken by third parties including the Executive Board General Counsel Roundtable and PriceWaterhouse Coopers, copies of which are provided as Attachments D and E to PSE's Response to ICNU Data Request No. 06.12.

Ms. O'Connor also evaluated PSE's current in-house legal staff and projected the need for in-house legal skills to meet the needs of PSE efficiently and effectively. In addition to controlling outside legal spending, the development of the in-house legal staff is intended to enhance PSE's institutional knowledge of its legal affairs, practice preventative law, develop internal legal expertise, and enhance and develop systems and programs to support compliance.

Attachments F and G to PSE's Response to ICNU Data Request No. 06.12 are presentations of studies Ms. O'Connor developed during the Spring of 2003, and updated in August 2003, regarding PSE's legal expenses.

To date, PSE's Legal Department under Ms. O'Connor has taken over budgeting and oversight responsibilities related to legal expenses and staffing for all PSE departments except Regulatory and Government Affairs and the Claims and Risk Management departments. The steps the Legal Department has taken since Ms. O'Connor's arrival specifically include: further expanding PSE's in house legal staff by adding attorneys, paralegals and support staff; insourcing certain work previously undertaken by outside counsel; instituting a policy that restricts the retention of outside counsel without the approval of an in-house attorney; centralized management of outside law firms; and negotiated budgets and fee arrangements with outside counsel.

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PSE's Risk Management/Claims department continues to control legal expenses for legal defense work associated with tort claims through a fixed-fee retainer arrangement with outside counsel, combined with active PSE staff involvement in monitoring and overseeing potential claims and litigation and performing investigatory work and legal administrative support functions (such as discovery response preparation and witness scheduling).

PSE's Regulatory and Government Affairs department has also been engaged in ongoing efforts to control its legal expenses. As former outside counsel to PSE and other clients in the energy industry, as well as former in-house counsel for PSE, the current Vice President of Regulatory and Government Affairs, Kimberly Harris, is in a position to evaluate and monitor the legal services provided to and needs of the Regulatory and Government Affairs department and associated costs. Rates Department personnel handle most routine filings with the WUTC. With respect to larger filings and disputed proceedings where PSE is represented by counsel, PSE has to date preferred to staff such matters with outside counsel due to the infrequent or irregular and sometimes overlapping timing of such filings and the number and varying skill sets of legal personnel needed to handle such matters before the WUTC, the FERC and BPA. In an effort to balance advantages of in house legal staffing and of outside counsel, PSE's Regulatory and Government Affairs department hired an in house paralegal in May 2003 to assist in ongoing in house regulatory filings as well as proceedings involving outside counsel.

Attachments A through D, F and G to PSE's Response to ICNU Data Request No. 06.12 are designated CONFIDENTIAL per Protective Order in WUTC Docket Nos. UG-040640, et al.

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ICNU DATA REQUEST NO. 06.12

"CONFIDENTIAL" Table of Contents

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| 06.12 | Attachments A through D, F and G to PSE's Response to ICNU Data Request No. 06.12 are designated CONFIDENTIAL per Protective Order in WUTC Docket Nos. UG-040640, et al. |

REDACTED

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**Pages 5 through 73 are redacted as
Confidential per Protective Order in
WUTC Docket Nos. UG-040640, et al.**