

EXHIBIT NO. ___(KRK-3)
DOCKET NO. UG-040640, *et al.* (consolidated)
2004 PSE GENERAL RATE CASE
WITNESS: KARL R. KARZMAR

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*)

SECOND EXHIBIT TO THE
PREFILED REBUTTAL TESTIMONY OF
KARL R. KARZMAR (NONCONFIDENTIAL)
ON BEHALF OF PUGET SOUND ENERGY, INC.

NOVEMBER 3, 2004

EXHIBIT NO. ___ (JOINT-3T)
DOCKET NO. UE-011570 and UG-011571
WITNESSES: RONALD J. AMEN
MERTON LOTT
JIM LAZAR
DONALD SCHOENBECK

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY, INC.

Respondent.

JOINT TESTIMONY OF RONALD J. AMEN, MERTON LOTT, JIM LAZAR,
AND DONALD SCHOENBECK IN SUPPORT OF THE NATURAL GAS RATE
SPREAD AND RATE DESIGN SETTLEMENT

August 19, 2002

JOINT TESTIMONY ON RATE SPREAD:

Q: Please describe rate spread and its importance.

A: Rate spread allocates revenue recovery to each of the Company's customer classes. It is important to the Company that the recovery of revenue from a class of customers corresponds to the costs incurred to serve that class. If there is an imbalance, changes in revenues to a class of customers will not appropriately track changes in costs. Rate spread is important to the Company's customers because customers want to be treated fairly, and the allocation of revenue responsibility among the various classes of customers needs to be done in a fair manner.

Q: Please identify what policy interests are important in addressing rate spread issues?

A: Rate spread should recognize that rates must be just and reasonable and not cause undue discrimination, that is, it should be based on established principles of fairness, equity, and sufficiency. Any shifting of rate responsibility from one rate class to another should be based on the relative cost structures of the classes, the impact of the shift on these customers, and the likelihood that the customers will be able to absorb the shifted costs.

Q: What is the basis for rate spread decisions?

A: Typically, rate spread decisions are based on cost of service analysis, tempered with considerations of customer impacts. Starting from the cost of service analysis, rate spread decisions then take into consideration the timing of the impact of changes in rates on customers, with the possibility that necessary changes might better be implemented gradually.

Q: What are the basic elements of the settlement?

A: The key components of the settlement are shown in Exhibit B of the Settlement Stipulation for Remaining Natural Gas Issues and Application for Commission Approval of Settlement dated August 15, 2002 ("Gas Settlement Stipulation").

Q: What Cost of Service Methodology did the collaborative use to form its consensus recommendation to the Commission?

A: For settlement purposes, the parties agreed to rely upon the cost of service methods approved by the Commission in Docket No. UG-940814 and as demonstrated in the Cost Study Appendix ("Appendix 1") attached to Exhibit B to the Gas Settlement Stipulation. For settlement purposes, this is a reasonable approach as the policy considerations have been considered by the Commission in the past, though each party reserved the right to propose alternative approaches in future proceedings.

Q: How did the collaborative use the cost of service results to derive the proposed rate spread?

A. Using results of the cost of service analysis, the parties agreed to generally spread the rate increase differently to three broad groups of customers. To those customer classes that, according to the cost of service analysis, are paying substantially more than their allocated costs (i.e. are above parity), the collaborative assigned a smaller than average rate increase. To those customer classes that, according to the cost of service analysis, are paying substantially less than their allocated costs (i.e. are below parity), the collaborative assigned a larger than average rate increase. The remaining group of customers received an equal percentage rate increase to recover the remaining revenue requirement. The customer classes that were above parity according to the study (and received the smaller percentage rate increase) were the C&I Heating (Schedules 31, 36 and

51), Interruptible Sales (Schedule 85), and the Transportation classes (Schedules 57, 99, 199 and 299).

Q. What other adjustments are being proposed?

A. With the above as an overall framework, several other adjustments are proposed:

An offsetting adjustment was made to the increases assigned to Schedules 87 (Large Interruptible Sales) and 57 (Transportation) in order to facilitate equalizing their respective rate margins, as customers are able to migrate between these two schedules.

The Limited Interruptible Service Class (Rate 86), the non-residential interruptible heating class, including many school facilities, exhibited the lowest revenue-to-cost ratio of the customer classes, notwithstanding the two specialty service classes discussed below. The increase assigned to this class was limited to 150% of the system average increase, with consideration given to the impact of the increase on these customers.

The CNG class (Compressed Natural Gas for Vehicle Fuel) was assigned an increase of 125% of the system average increase, based upon that class being significantly below parity while recognizing the need for CNG to be competitive with other vehicular fuels.

The rental equipment service class (Schedules 71,72 and 74), another class significantly below parity, was assigned an increase equivalent to the average of the remaining classes. A portion of the revenue requirement stipulation provides for a minimum level of depreciation of the rental equipment investment resulting from the current depreciation deficiency for rental property. The test year level of depreciation on rental property is to be maintained over the next three years. This treatment is anticipated to result in a decrease or elimination of the depreciation deficiency on rental property thus resulting in the rental revenues covering rental

costs at the end of the three-year period contained in the stipulation during which the Company is not allowed to request an increase in the revenue requirement associated with the existing gas water heater and conversion burner rental programs. Recognition was given to the competitive nature of water heating equipment, the largest component of the Company's rental equipment program, and the interest in preventing significant attrition in rental customers.

Q. How does this settlement address the policy interests addressed above?

The rate spread is based on cost of service analysis, though parties may advocate different methodologies in future cases. The new rates generally reflect costs. The settlement also addresses the issue of the rate differential between Schedules 87 and 57, which is a concern as customers may migrate between these two schedules. Further, the settlement reduces the disparity between the classes above and below parity.

JOINT TESTIMONY ON RATE DESIGN:

Q Please describe the importance of rate design.

A: Rate design is the pricing mechanism for the Company to recover its costs, which consists of both the recovery of the revenue requirement from within the various customer classes and the determination of rate structures within tariff schedules. Rate design determines the rates that each individual customer actually pays. As a result, rate design is important for the same reasons that rate spread is important.

Q: Please identify what policy interests are involved in addressing rate design issues?

A: A reasonable balance between the various cost guidelines and other criteria must be established in the process of designing rates. There are a variety of interests that need to be addressed. Rates should be designed to correctly reflect costs and