BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

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WASHINGTON UTILITIES AND          )
TRANSPORTATION COMMISSION,        )
                                  )
          Complainant,            )  Docket Nos. UE-011570
                                  )  and UG-011571
          v.                      )  (consolidated)
PUGET SOUND ENERGY, INC.,         )
                                  )  Volume VI
          Respondent.             )  Pages 929 to 1140
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A hearing in the above matter was held on February 21, 2002, at 9:30 a.m., at 1300 South Evergreen Park Drive Southwest, Room 206, Olympia, Washington, before Administrative Law Judges DENNIS MOSS and THEODORA M. MACE and Chairwoman MARILYN SHOWALTER and Commissioner RICHARD HEMSTAD and Commissioner PATRICK J. OSHIE.

The parties were present as follows:

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JUDGE MOSS: Looking around the room, I don't think we need to take appearances again. We have Ms. Kinn back reporting, so she knows all the players by now, and I don't see any new faces in the room, so we will just skip that part and proceed directly to -- well, I guess I do have a couple of preliminary points.

Mr. Quehrn distributed an errata sheet for Mr. Donald Gaines's rebuttal testimony, which is Exhibit 25T, and I have noted for the Bench that the second change, the penultimate change and the final change, have already been made in the testimony, and the fourth change from the bottom can be stricken. Other than that, those are the errata.

I also have furnished to the Bench, Mr. Quehrn has furnished to the Bench a revised exhibit, or actually I guess it was Mr. Cedarbaum, revised Exhibit 75, so that should be substituted for the current exhibit, and I will note that the new Exhibit 75 is not confidential.

We also had distributed previously from the Industrial Customers of Northwest Utilities PSE's response to Data Request Number 8-I which I have marked as Exhibit Number 80 for identification.

And Mr. Quehrn has also distributed a table

this morning that bears the legend U.S. Bank account number, I'm not going to give the number, reconciliation of bank account for non-regulated cash for the period May 1999 to January 2001. And as I understand it, he intends to use this in some fashion or another with this witness this morning, and we will deal with that when we deal with that.

Is there any other preliminary business before I swear the witness?

Yes, there is from Bench.

CHAIRWOMAN SHOWALTER: We have a Bench request, and I'm not sure who the right person is to produce it, but it may be ICNU. So if you could turn, there are two exhibits that are relevant, and one is Exhibit 208 and the other is 322, and these were both produced by Mr. Schoenbeck. And if we begin with 322, I can explain what we would like. All right, well, 322 lays out the different parties' positions in terms of revenue amount as spread across the different classes. Now if you go to Exhibit 208.

MR. VAN CLEVE: Okay.

CHAIRWOMAN SHOWALTER: It shows percentage amounts over the different classes, but only according to some of the recommendations. And the further thing I don't completely understand is that if you look at the

residential schedules that the revenue months are not the same, but I will just get at what I'm interested in, I should say we are interested in. And that is something that looks like Exhibit 208 that shows both revenue and percentage increases but for all of the different options.

What we're getting at here is if we have to decide or once we decide that we will give an increase, and I'm not saying we will, but if we decide that, then we need to decide how to do it, and it would be helpful to the Bench to have in front of it the different ways to go about it in one single place both as to revenue amount and percentage increase.

MR. VAN CLEVE: We can do that. And the difference between 322 and 208 on the numbers is that 208 is based on the $136 Million proposal in the rebuttal testimony during the interim period, and the other one is based on the full 170.

CHAIRWOMAN SHOWALTER: Okay, well, I think it would be sufficient to take the rebuttal proposal of the company since that's their latest proposal.

MR. VAN CLEVE: Okay.

JUDGE MOSS: And I'm going to mark that as Bench Request 8 which I inadvertently led Judge Mace to skip yesterday, so we will go back and fill that in.

MR. CEDARBAUM: Can I ask a question about the Bench Request, clarifying question. None of -- neither Exhibit 208 or 322 included a Staff recommended, and I assume that you meant to include that in your Bench Request.

CHAIRWOMAN SHOWALTER: Yes, I did.

JUDGE MOSS: Mr. Van Cleve, are you clear?

MR. VAN CLEVE: I think so. Do you want -- I understand the percentages that you want, but for what assumptions about the increase, just the company's rebuttal and Staff?

CHAIRWOMAN SHOWALTER: No, any party that has a recommendation or even a contingent recommendation, we would like it laid out in a column both as to amount, for example, Schoenbeck would be what, $68 Million, whatever.

MR. VAN CLEVE: So we're defining four rate spread proposals to four or so revenue increase proposals, okay.

CHAIRWOMAN SHOWALTER: I would see it as four payers of the columns, revenue amount, percentage amount, spread over the different rate classes.

MR. QUEHRN: Excuse me, Your Honor, I have a question. As I recall, when we were discussing Staff's recommendation, there were some adjustments to that that

also the company had proposed, and that would be another version of that. Should that be included in the spreadsheet?

CHAIRWOMAN SHOWALTER: That would be fine if it's identified as a separate column of Staff's proposal as adjusted by PSE. If you need to get together on that.

MR. QUEHRN: We will work with Mr. Van Cleve on that.

CHAIRWOMAN SHOWALTER: Okay.

MR. QUEHRN: Thank you.

MR. CEDARBAUM: Then how about a column for the company's proposal as adjusted by Staff, I mean --

CHAIRWOMAN SHOWALTER: That would be fine too. Really what we're looking for is to have the options in front of us. Should we decide that there is interim relief, then we would have to decide the amount, but it would be helpful to have in one place what the different options actually look like as spread across the rate classes, both by amount and percentage, and it's to allow us to have one place where we can look at these proposals if we get there.

MR. VAN CLEVE: We will circulate it to the parties and try to get some agreement on what it says.

JUDGE MOSS: Circles and arrows and photos on

the back.

CHAIRWOMAN SHOWALTER: I mean in essence, I think it's an illustrative exhibit that explains what the different parties have been saying in the course of the hearing.

JUDGE MOSS: We do have quite a volume of material in this record, so this is a way to pull the sort of central focus of it into one place, and we do appreciate the parties' efforts in pulling it together in that fashion.

Anything else?

All right, Mr. Donald Gaines, I will ask you to please rise and raise your right hand.

(The following exhibits were identified in conjunction with the testimony of DONALD E. GAINES.)

Exhibit 21T is DEG-1T: Pre-filed Direct Testimony (revised 2/7/02). Exhibit 22 is DEG-2: Donald E. Gaines Professional Qualifications. Exhibit 23 is DEG-3: PSE Utility Operations - Credit Protection Measures, 12 Months Ended October 2002. Exhibit 24 is DEG-4: Standard & Poor's Report Re PSE, October 30, 2001; Moody's Report Re PSE, October 29, 2001. Exhibit 25T is DEG-5T: Pre-filed Rebuttal Testimony (2/11/02).

Exhibit 26 is DEG-6: Reconciliation of Lisa Steel

Exhibit (LAS-14C) Including the Use of Unregulated Cash. Exhibit 27 is DEG-7: Reconciliation of Stephen Hill Calculation. Exhibit 29 is PSE's Response to Public Counsel's Data Request No. PC-135-I. Exhibit 30 is PSE's Response to Public Counsel's Data Request No. PC-50. Exhibit 31 is PSE's Response to Public Counsel's Data Request No. PC-55. Exhibit 32C is PSE's Response to Public Counsel's Data Request No. PC-62. Exhibit 33 is PSE's Response to Public Counsel's Data Request No. PC-64. Exhibit 34 is PSE's Response to Public Counsel's Data Request No. PC-65. Exhibit 35 is PSE's Response to Public Counsel's Data Request No. PC-66. Exhibit 36C is PSE's Response to Public Counsel's Data Request No. PC-71-I. Exhibit 37 is PSE's Response to Public Counsel's Data Request No. PC-73-I. Exhibit 38 is PSE's Response to Public Counsel's Data Request No. PC-74(b)-I. Exhibit 39 is PSE's Response to Public Counsel's Data Request No. PC-128-I. Exhibit 40C is PSE's Response to Public Counsel's Data Request No. PC-9-I. Exhibit 41 is PSE's Response to Public Counsel's Data Request No. PC-24-I. Exhibit 42C is PSE's Response to Public Counsel's Data Request No. PC-43-I. Exhibit 43 is PSE's Response to Public Counsel's Data Request No. PC-51. Exhibit 44 is PSE's

Response to Public Counsel's Data Request No. PC-54.

Exhibit 45 is PSE's Response to Public Counsel's Data Request No. PC-56. Exhibit 46 is PSE's Response to Public Counsel's Data Request No. PC-57. Exhibit 47 is PSE's Response to Public Counsel's Data Request No. PC-76-I. Exhibit 48 is PSE's Response to Public Counsel's Data Request No. PC-130-I. Exhibit 49 is PSE's Response to Public Counsel's Data Request No. PC-136-I. Exhibit 50 is PSE's Response to Public Counsel's Data Request No. PC-139-I. Exhibit 51 is PSE's Response to Public Counsel's Data Request No. PC-140-I. Exhibit 52 is PSE's Response to Public Counsel's Data Request No. PC-142-I. Exhibit 53 is PSE's Response to Public Counsel's Data Request No. PC-143-I. Exhibit 54 is PSE's Response to Public Counsel's Data Request No. PC-144-I. Exhibit 55 is PSE's Response to Public Counsel's Data Request No. PC-145-I. Exhibit 56 is PSE's Response to Staff Data Request No. 30-I. Exhibit 57 is PSE's Response to Staff Data Request No. 60-I. Exhibit 58 is PSE's Response to Staff Data Request No. 63-I. Exhibit 59 is Compilation of PSE's Response to Public Counsel's Data Request No. PC-65 and PSE's Responses to Staff Data Request Nos. 142-I - 147-I. Exhibit 61 is PSE's Response to Staff Data Request No. 104-I. Exhibit 62 is PSE's Response to

Staff Data Request No. 105-I. Exhibit 63 is PSE's

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Response to Staff Data Request No. 134-I. Exhibit 64 is PSE's Response to Staff Data Request No. 135-I. Exhibit 65 is PSE's Response to Staff Data Request No. 166-I. Exhibit 66 is PSE's Response to Staff Data Request No. 168-I. Exhibit 67 is PSE's Response to Staff Data Request No. 248-I. Exhibit 69 is PSE's Response to Staff Data Request No. 11-I. Exhibit 70C is PSE's Response to Staff Data Request No. 85-I. Exhibit 71C is PSE's Response to Public Counsel's Data Request No. PC-62. Exhibit 72 is PSE's Response to Staff Data Request No. 82-G. Exhibit 73 is PSE's Response to ICNU Data Request No. 6.1-I. Exhibit 75 is PSE Response to Staff DR 288-I. Exhibit 76 is PSE Response to Staff DR 290-I. Exhibit 78 is PSE Response to Staff DR 293-I. Exhibit 79 is PSE Response to Staff DR 323-I.

Whereupon,

DONALD E. GAINES,

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

JUDGE MOSS: Thank you please be seated.

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

BY MR. QUEHRN:

Q. Good morning, Mr. Gaines.

A. Good morning.

Q. Mr. Gaines, do you have before you the direct testimony that you adopted, revised, and that was pre-filed in this proceeding as Exhibit 21T, the revision being I believe on the 7th of February?

A. Yes, I do.

Q. Do you also have before you and did you prepare or oversee the preparation of exhibits to your direct testimony, Exhibits 22 through 24?

A. Yes, I have them.

Q. Do you have any revisions to your direct testimony or these supporting exhibits?

A. Not the direct, no.

Q. Do you have before you and did you prepare the rebuttal testimony that was pre-filed in this proceeding as Exhibit 25T?

A. Yes, I do.

Q. And do you have any revisions or corrections to this testimony?

A. Well, there was the errata sheet that was passed out, but beyond that, there's one other

adjustment I see that I need to make as a result of the
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recharacterization of one line of Exhibit 414C, and if I could direct your attention to page 11 of that exhibit.

MR. CEDARBAUM: Your Honor, if I could interject, I apologize to Mr. Gaines, but I think we're getting into an area that relates to an exhibit that -- the proposed exhibit that Mr. Quehrn distributed yesterday, which we will be objecting to and as well as to this discussion, so we might as well have that argument now before we hear Mr. Gaines and I have to move to strike it.

JUDGE MOSS: Well, we don't have anything to strike yet I don't think.

MR. CEDARBAUM: Well, I guess I object to the question as asking for supplemental rebuttal testimony that was not pre-filed.

JUDGE MOSS: There's clearly been some discussion between counsel in advance of this morning, and I suppose we should hear whatever argument we need to hear with respect to the objection you have to the proposed direct I guess I will call it that's been initiated here. So let's hear from Mr. Quehrn in terms of what it is he's proposing to do, and let's here from you, Mr. Cedarbaum, as to why you object to him being allowed to proceed in that fashion.

MR. QUEHRN: Thank you, Your Honor, and we

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may actually want to take some testimony, foundation testimony, on this from the witness, but let me briefly summarize first. Mr. Gaines's rebuttal testimony among other things addressed Staff's proposed interim relief recommendation that was set forth in Ms. Steel's Exhibit 414C. On Monday morning of this proceeding, I believe it was line 2, Ms. Steel changed the methodology for coming up with the $25 Million entry. Previously it had been identified as a long-term debt adjustment, and then the methodology or the rationale I should say for that $25 Million changed on Monday morning to an adjustment for some transactions involving Infrastrux. We had not seen that adjustment or heard that rationale for that adjustment until Monday morning, and consequently Mr. Gaines' testimony was not responding to ultimately what Staff presented to the Commission on Monday. Consequently, what we were going to do is have the corresponding provisions of Mr. Gaines' testimony that address that issue and an additional exhibit to elaborate in response to the material that Ms. Steel presented on Monday.

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

Mr. Cedarbaum, what is your objection?

MR. CEDARBAUM: The objection is, Your Honor, that the company was well aware all along as to what

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Ms. Steel's adjustment was and the theory underlying that adjustment. We asked data requests early on in this case with respect to issues so that Staff could reconcile some differences that she saw between the company's financial statements for September 30th last year and the October projections that the company included in its case. And Ms. Steel explained, I think, all of that on the stand on Monday. Those data requests were responded to by the company, and they were unhelpful in reconciling that information. We continued to do discovery on that subject, and the company understood that we were having problems with that all along. There were many discussions between Mr. Gaines and Ms. Steel about the subject matter before the Staff filed its case, and then additional information was provided, but there was still difficulty in reconciling all of those numbers. She explained all of that on the stand on Monday.

The company has been well aware of this problem all along, and to try to bring additional testimony in now really amounts to additional rebuttal testimony that could have been pre-filed all along, because the company has understood what the Staff case was all along. And we're prejudiced, I think, by that.

It violates the procedural schedule the Commission

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established in the case. It's something that could have been anticipated and was not.

JUDGE MOSS: But, Mr. Cedarbaum, as I understand it, this additional exhibit I will call it and it's not been marked as such, is intended to respond to a change Ms. Steel made in her exhibit which was not announced prior to her appearance on the stand that changed the characterization of an adjustment on Exhibit 414C. I don't have that in front of me, but I do recall that, I believe it's line 7. And if the company, and Mr. Quehrn has just represented that, and we can have Mr. Gaines answer the question, that Mr. Gaines did not understand that adjustment to be what it was changed into by Ms. Steel on the stand, and he now wishes to respond to it for what it was recharacterized as, that doesn't seem to me to be out of order.

MR. QUEHRN: Your Honor, I think it would be helpful actually if we could allow Mr. Gaines to address the circumstances giving rise to preparation of the exhibit without discussing the substance, because it is not the case that we were aware of that change or had any clue of the change being made prior to Monday, and I think Mr. Gains has some background that would be helpful to your deliberation of the issue.

MR. CEDARBAUM: Your Honor, I guess if I

could just interrupt for a second, I apologize, but I think it's fair to say that a change was made to the exhibit on Monday. My point is that that should have been no surprise to the company and that now we're in a position of having to respond to something that we only saw yesterday morning. Now it appears that there's a factual issue about whether or not the company should have known, and I know that Ms. Steel has a difference of opinion about the subject matter, so if Mr. Gaines -- if this is going to be, you know, turn into a critical issue and ruling by the Commission on whether to go into the subject matter, then I would ask the ability to recall Ms. Steel to give her side of the story, because it is a factual issue apparently as to whether or not the company should have been able to anticipate this issue and include it in its pre-filed case.

CHAIRWOMAN SHOWALTER: Well, I have a question here. How this arose aside, it's usually the standard question when the witness gets up on the stand says, would you answer every question the same today as when you wrote it, and the witness either has to say yes or no. But it seems to me to pose the question of, is the testimony in front of us, you know, under oath accurate, so what do you do if it's not. We need all of the testimony to be.

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MR. CEDARBAUM: I understand that, I think my -- and I'm not saying that that change wasn't necessary. I'm saying that that change could have been anticipated by the company and dealt with in their pre-filed case rather than yesterday and this morning.

JUDGE MOSS: Well, didn't the description of what that line represented change from the time Ms. Steel filed it until she got on the stand and recharacterized it? Am I mistaken about that? Is the description just a difference in words that mean the same thing, or did the words that she used to describe it when she corrected her exhibit mean something different from what was written on that page at the time it was pre-filed?

MR. CEDARBAUM: I think it's fair to say it's the latter, that that was a change.

JUDGE MOSS: Okay, well, we can't expect the company to be prescient, and whatever background there was in terms of dispute back and forth between the company and the Staff about the discovery process and they knew or should have known, so on and so forth, if a line of testimony describes a number in a particular way and then that is changed at the time the witness takes the stand, and the company in the meantime has filed rebuttal with respect to the way it was originally

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described, I don't see how we can hold the company to the standard that it should have anticipated that Staff was going to make that change with its witness on the stand and say they can't now respond to what that line really represents.

You know, the search here is for the truth. The search is for the evidence that we need to make a good decision. And if the company was responding to that line of the exhibit or electing not to respond to it because it misunderstood what it represented, then we need to know, and we need to have that be part of the record.

Now in terms of any prejudice, Mr. Cedarbaum, I don't, you know, I haven't really looked at this exhibit, but certainly we're going to have Mr. Gaines on the stand for a good long time this morning, I'm sure, and probably through the luncheon hour, and if that does not give you sufficient time to study this with your support from Staff and whatnot, you let me know, and I will not allow you to be prejudiced. I want to give you adequate time to study this and go over it with your analysts and cross examine Mr. Gaines with respect to it, but I do think we need to have it as part of the record because of the change that was made on the stand.

I don't see any other way around that.

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MR. CEDARBAUM: Well, seeing where this is headed, then I guess I will, rather than wasting more time, I will withdraw the objection on that.

JUDGE MOSS: All right, we appreciate that, Mr. Cedarbaum.

And so we will -- I suppose we need to mark this as an exhibit then. It will be 81, and I think perhaps the easiest way to describe it will be as reconciliation of bank account for non-regulated cash. That's a portion of the caption, and that should be adequate.

And is it necessary that we have some additional amendment then to Exhibit 25T, or is the errata sheet adequate?

MR. QUEHRN: Currently 25T refers to a line in 414 as it was initially presented such that Mr. Gaines was going to modify his rebuttal testimony accordingly. And then essentially that induces or that references this exhibit. So if we could have his -- that line changed and then move forward, I think that would be fine.

JUDGE MOSS: All right, and you had, I believe, directed us to page 11.

A. That's correct, page 11, and specifically lines 7 and 8, there's an item -- and I will wait for

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you to get there. Exhibit 25T, page 11, lines 7 and 8, and specifically on line 7, there's an item numbered 2 that starts with inappropriately deducted current maturities from long-term debt, and that needs to be changed to read, inappropriately deducted an adjustment for unregulated investments, and then in parentheses, Infrastrux.

COMMISSIONER HEMSTAD: I will have to have you read that again.

A. Certainly. On line 7, the sentence that starts after the item 2 where it says, inappropriately deducted, the next part where it says, current maturities from long-term debt should be stricken, then replaced with, an adjustment for unregulated investments, and then in parentheses, Infrastrux.

BY MR. QUEHRN:

Q. Mr. Gaines, could you then please explain how the exhibit that has been marked as Exhibit 81 relates to that change in your testimony, please?

A. Yes, I can. As I think the room is well aware, that exhibit and specifically line 2 of 414C was originally described when it was filed on January 30th as a current maturity of long-term debt. That exhibit was then revised on February 4th. That correction was not made until just on Monday. And so as a result, the

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implication was that moneys from Infrastrux had come from the utility, and this exhibit now shows that that's incorrect.

I need to -- had I known that that was going to be the change, I would have filed this exhibit earlier to show where the sources of that money came from and what the uses were to show that there is, in fact, no money from the regulated business that went to Infrastrux, and therefore no adjustment to equity needed.

Q. Thank you, Mr. Gaines. So revised, if I were to ask you the same questions set forth in your direct and rebuttal testimony today, would your answers be the same and the supporting exhibits be the same?

A. With the corrections, yes.

MR. QUEHRN: At this time, Your Honor, I offer into evidence exhibits 21T through 27 and Exhibit 81.

JUDGE MOSS: All right, that was 21T through?

MR. QUEHRN: 27.

JUDGE MOSS: 27, we had previously disposed of 28.

MR. QUEHRN: Correct.

JUDGE MOSS: All right, that series will be received as marked, and then 81, hearing no objection or

no further objection, that will be admitted as marked.

And the witness is available for cross-examination. I believe Mr. Cedarbaum or Ms. Smith would go first.

MR. CEDARBAUM: Thank you, Your Honor. Before I start my questioning of Mr. Gaines, I thought I would -- it seems like we have had the practice running in this case of offering cross exhibits at the beginning. I would like to do that, but there are some that we pre-marked that I am not planning on offering, so I thought I could just run down the list of the ones that I would offer hopefully by stipulation.

JUDGE MOSS: All right, I think yours start around 56, right?

MR. CEDARBAUM: Yes, if I'm correct, mine went from 56 through 79, if that's accurate. Then I can either tell you -- I can tell you what in that sequence I'm not offering, or I can just run down the list of what I am offering.

JUDGE MOSS: Why don't you tell me the ones you -- and this is under the stipulation?

MR. CEDARBAUM: I hope so.

JUDGE MOSS: Okay, why don't you tell me the ones you are offering, and I will go ahead and mark those as admitted per the stipulation.

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MR. CEDARBAUM: The following have been offered by Staff then, 56, 57, 58, 59, 61, 62, 63, 64, 65, 66, 67, 69, 70C, 71C, 75, 76, 78, and 79.

JUDGE MOSS: All right, the exhibits that Mr. Cedarbaum has identified will be admitted without objection per the stipulation, and I will just note for the record then, you're not going to offer 60, 68, 72 through 74, or 77.

MR. VAN CLEVE: Your Honor, if I could interrupt --

MR. CEDARBAUM: I think some of those were other parties'.

MR. VAN CLEVE: Yeah, I had a question, I think 73 was an ICNU cross exhibit.

JUDGE MOSS: Saves time if we just -- all right, were there any others?

MR. VAN CLEVE: Also I think it was mislabeled on the exhibit list.

JUDGE MOSS: It may very well be, I've got it as PSE response to ICNU Data Request 6.1-I.

MR. VAN CLEVE: That's correct.

JUDGE MOSS: You're right, I had previously mislabeled it, but you may not have the updated exhibit list.

MR. CEDARBAUM: Just so it's clear, the ones

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that Staff had marked for identification that we are not offering are 60, 68, 69, and 77.

JUDGE MOSS: 69 I have received into evidence, Mr. Cedarbaum. Now 74 apparently was not used. That's a notation I have on my exhibit list.

MR. CEDARBAUM: That's right.

JUDGE MOSS: So just the one ICNU exhibit, Mr. Van Cleve?

MR. VAN CLEVE: Yes. Well, there's Exhibit 80 that we marked earlier.

JUDGE MOSS: Right.

MR. FFITCH: And, Your Honor, for Public Counsel, Exhibit 72 has been marked as one of our cross exhibits for Mr. Gaines.

JUDGE MOSS: All right, thank you for the clarification, so that one I'm going to remove the notation, and when we get to you, we will take that up.

MR. CEDARBAUM: Glad I helped.

JUDGE MOSS: That sped things along, didn't it. So we are then, I suppose, ready for your cross-examination, Mr. Cedarbaum, thank you.

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

BY MR. CEDARBAUM:

Q. Mr. Gaines, I wanted to start off at page 2
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toward the bottom where you discuss the two step phase-in proposal that --
A. That's of my rebuttal testimony?
Q. Yes, I'm sorry, I'm in Exhibit 25.
A. Page 2 you mentioned, right?
Q. Yes, starting at line 21 you discuss the rebuttal proposal for the two step phase-in.
A. Yes.
Q. Okay. And the first phase would be to collect $136 Million between March 15th and October 31st, and then the remaining 34 is deferred and recovered beginning November 1, 2002?
A. That's correct.
Q. The total recovery though over the two phases still relates to recovering all of the power costs that Mr. William Gaines identifies; is that right?
A. No, it relates to recovering the amount of money needed to keep financially viable, which is $170 Million.
Q. But that $170 Million was calculated by the company with respect to the power costs of Mr. William Gaines?
A. I think the power cost was actually $163 Million, and it was grossed up.

Q. If the Commission were to grant the company

0959

$170 Million in relief but didn't identify those dollars associated with any power cost deferrals, is the company's proposal still to have that recovery happen over this two step phase-in?

A. I'm not sure how that would work if it was done that way, Mr. Cedarbaum. The reason is I don't know which costs would be deferred and then recovered. The alternative approach the company offered here in the rebuttal was to defer some power costs and then collect those. By doing that, it enabled the company to have both the earnings that it needs for the book coverages as well as the amount of cash that it needs during the interim period. So if it was just a dollar amount, I'm not sure what costs would be deferred to the other period.

Q. So if what the Commission grants in relief, if it's at the $170 Million level but not directly tied to what's been deferred and what's being projected for power costs, you're not proposing a two step phase-in?

A. I don't think that we could, because we wouldn't have the book coverages needed to try and strengthen the bond rating.

Q. What if the Commission were to grant you more than the 136 that you proposed, $136 Million that you propose be recovered during phase one but less than $170

0960

Million total recovery, is there still a two step phase-in proposal there or not?

A. I think if it were tied to deferred costs, then we could probably do something like that.

Q. If the Commission in its order were to somehow adjust the power supply costs that William Gaines -- that's being deferred in the -- that's being projected as referenced in his testimony to remove some of those power supply costs, would your financial projections also have to then be adjusted?

A. I think your question was if some of the costs were adjusted or disallowed and so the --

Q. Removed.

A. Removed, I don't know what that means. You either expense them or you defer them, so removed doesn't make sense to me.

Q. Well, Mr. Gaines has the company's deferring power supply costs between January 1st and the end of March.

A. That's right.

Q. And there's a portion being projected, and that's what Mr. Gaines was, William Gaines' testimony was partially about. If those projections were changed say so that less power supply costs were being projected for the post March 31st time period, would that have an

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impact on your financial analysis?

A. If there was a new set of projections and so that we had new better information let's call it on power costs, be they higher or lower, yes, I would need to relook at the impact on the company of the amount of money that we have requested to see if it's sufficient to fill in the gap that we currently have between what's in rates and the devastation that's happening to our financial health.

Q. Can you turn to page 9 of your rebuttal testimony 25T.

A. I'm there.

Q. At the top of the page, and this again relates back to the two step phase-in that's in your rebuttal case, you reference a rate cap at the top of that proposal.

A. Yes, I do.

Q. And you say that the rate cap is based on earnings for the 12 months ended October 31st, 2002; is that correct?

A. That is correct.

Q. When you say overearn on line 2, is that -- does that tie to the company's authorized rate of return?

A. That was the intent, yes, 8.99.

0962

Q. So if the company earns up to 8.99, it's not overearning, and so there is -- it collects -- if it earned up to 8.99, if the Commission, I'm sorry.

If the Commission were to grant $170 Million but that doesn't cause you to go over your authorized return, you collect the entire 170. If it does cause you to go over 8.99%, then there's a return of that overage?

A. That's in essence it, yes. The idea was that there seems to be a fear that perhaps the company might make too much money, and that's certainly not the intent nor the part of the PNB standard. So the idea was to address people's concerns to that effect, that we would cap what we would earn so that we would never earn more than the previously authorized combined rate of return of 8.99.

Q. That was my next question, this is the total company authorized return?

A. Yes, it is, it's melding the electric and the gas from the two prior gas cases, or sorry, gas and electric cases pre-merger, which I think were around the '92, '93 time frame.

Q. And I don't think your testimony says this, but you can correct me if I'm wrong, how would you go about measuring whether or not you get to that cap?

0963

A. What we would do is track on a monthly basis the, a cumulative monthly basis, the rate of return, operating income divided by rate base. And then at the end of the interim period, we would take a look at that and see if cumulatively we were up or down, we had earned more than the 8.99. We would then have that adjusted down in the general rate proceeding prospectively, take that money back and give it to customers. And if we had not exceeded that 8.99 level, then there would be no adjustment.

Q. So it's done on an actual monthly basis; is that what you're saying?

A. Actual cumulative basis.

Q. Okay.

A. Adjusted for the Commission items that -- so it's consistent with the Commission basis report that we file.

Q. So it's not actual per rate of return, it's Commission based rate of return but done on a monthly basis?

A. Cumulative monthly basis, that's right.

Q. I think that the earnings cap at 8.99%, you're basically saying that if you -- that you're in an emergency relief situation up to 8.99%, and that even maybe over that 8.99%, you're still in an emergency

0964

situation, but there's a concern about overearning, so you will give the money back. Is that what you're saying?

A. No, not exactly. What we're saying is we have a financial condition that needs to be addressed. The amount that's appropriate to address that amount is $170 Million. That in my direct testimony there's tables that show that even with that, we don't get anywhere near 8.99% rate of return. This is really separate from that just to show that were there concerns, as there have been, that the company may be overearning, that we would be happy to put a rate cap in. Frankly, we think it's like giving the sleeves off our vest, because we don't think we can ever get there.

Q. I guess I'm not sure I understand that, because it seems as if you have, not as if, you have proposed a rate cap of 8.99%, and you have said you need to recover dollars on an emergency basis up to that cap, so there's a spread of earnings up to 8.99% that you believe the company should recover on an interim basis.

A. I think maybe my testimony is unclear then, Mr. Cedarbaum, because that's really not what I'm saying. What I'm saying is that the company would accept the lesser of $170 Million or to the amount that would be capped. And if you go to page 19 of my Exhibit

0965

21, there's a table there that shows what those allowed rates of return are expected to be both with and without the requested relief, and in neither scenario does the company get anywhere near 8.99%.

Q. What was that reference again?

A. I'm sorry, it's Exhibit 21T, my exhibits, it's actually labeled as RLH-1T, page 19, and I'm specifically talking about the chart between lines 5 and 13.

Q. I'm sorry, I guess I don't -- I know that you adopted Mr. Hawley's testimony, so maybe there's some confusion here, but in my --

A. Oh, I'm sorry, it's page 11, I misspoke, sorry.

Q. And you're directing me to which of the charts?

A. On page 11 if we have it proper, there should be only one chart. It's the one labeled actual versus authorized rate of return, and it appears from lines 5 through 14.

CHAIRWOMAN SHOWALTER: The witness has a different version than we do, so there are two charts on ours, and it starts at line 17.

JUDGE MOSS: We are working off of the

revised filling dated February 7th, 2002.

A. And I apologize, I don't have that version, but it was just handed to me, so the one that I was talking about is on page 11, and it is the one on lines 17 through 26, thank you.

BY MR. CEDARBAUM:

Q. So if I understand correctly, if the company -- if the Commission allows the company to earn -- to collect an additional $170 Million and that brings you up to the 8.99%, then you will recover it?

A. I'm not sure I follow what you're saying.

Q. If the Commission grants you the relief that you have requested, the $170 Million, and you can collect that without exceeding cap, you will collect it?

A. That's right, and the thought was let's say power costs actually were lower and so the money made from off system sales were higher, so that $170 Million would cause us to earn more than the authorized rate of return, we're not asking to keep that excess.

Q. But if collecting the additional $170 Million brings you up to the cap, you will collect the $170 Million?

A. Yes.

Q. And the $170 Million is the amount of money you believe the company should receive in additional revenues to avoid the emergency that you testified to?

0967

A.   In essence, yes, but I think to be accurate,
part of it was the collection of a deferral, and then
part of it was revenue.

Q.   Let's switch to your rebuttal testimony, 25T,
at page 10.

A.   All right.

Q.   And I'm looking at table 3, which is I hope,
it's at the top of my page, hopefully the top of yours?

A.   It is on mine, yes.

Q.   Okay. And everybody else's. For sources of
internal cash in the 2002 without relief column, you
show $348 Million; do you see that?

A.   Yes, I do.

Q.   And then in the rate relief column, which is
one column to the right, that's increased by $106
Million up to $456 Million, correct?

A.   It looks like it's 108, but I can check the
math.

Q.   I'm sorry, you're right, I'm wrong, it is
108.

A.   Thank you.

Q.   And that $108 Million increase going from the
first column I referenced to the second is the net of
taxes recovery of the company's requested $170 Million

increase?

0968

A. That's correct.

Q. In the company's rebuttal case, it's seeking to -- it's proposing this two step phase-in and deferring recovery of I think Ms. Luscier said $34.5 Million; is that right?

A. I think on a grossed up basis, that's correct.

Q. So if we go to the final column in table 3 where you show $423 Million for internal cash, we were uncertain why there's a $33 Million difference there instead of the $34.5 Million difference in the phase two part of the two step phase-in.

A. And since that's not a question, I suspect you want it explained what that is.

Q. I would like you to answer, if you can, why the 423 -- why there's a difference of only $33 Million between the 2002 with relief column and the 2002 revised column rather than reflecting the impact of the $34.5 Million.

A. Yeah, I can certainly explain that. You will see it on page 1 at the bottom of my workpapers which were filed with my testimony, specifically lines 54 and 55. But just to explain what that shows, line 54 shows --

CHAIRWOMAN SHOWALTER: Where are you?

THE WITNESS: It's on my workpapers.

MR. CEDARBAUM: I don't think it's an exhibit.

THE WITNESS: I will try to explain it orally, Mr. Cedarbaum.

CHAIRWOMAN SHOWALTER: Please slow down.

THE WITNESS: I'm sorry.

CHAIRWOMAN SHOWALTER: Partly because we have nothing in front of us, also because this is dense material, so.

THE WITNESS: I will try and not be dense.

CHAIRWOMAN SHOWALTER: It really helps if we can be digesting it at a rate that our brain can keep up with.

THE WITNESS: I'm sorry, certainly.

A. As I mentioned, the $170.7 Million that the company requests in aggregate is 163 grossed up for taxes. If you then look at the interim or the split period, the two phase period as you have described it, Mr. Cedarbaum, that 163 pre-grossed up is split between $130 Million in the interim period and then $33 Million in the second period, the following period. So it's just the difference, the difference between the 34, the 5 and the 33 is the gross up for taxes, revenue sensitive taxes.

0970

BY MR. CEDARBAUM:

Q. Okay, so are you -- you're saying that there should be -- basically I'm -- what I'm getting after is whether or not you made a mistake in this table.

A. I don't think I did, and I would explain it this way. Let's say, for example, the Commission did grant the $34 Million of revenue in that period, which is a collection of deferred costs, so it would be costs being collected and revenues being collected, so there's no federal income tax basis, the company would still pay the revenue sensitive items on that $34 Million. So $34 Million would come in as revenue, and then miscellaneous taxes, the filing fee, all the components of the revenue sensitive items would be taken out before you get to the interim cash.

Q. I have some questions about some of the cross exhibits that were just introduced. If you could look to Exhibit 75, and actually maybe also keep your thumb at Exhibit 67. Why don't we start off with Exhibit 67. That's the company's response, your response to Staff Data Request 248.

A. I have that in front of me.

Q. And there we asked about the company's plans for its next shelf registration, and there's a description there that the company's working on the

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shelf registration statement and so forth; is that correct?

A. That's the statement at that time, yes.

Q. Then if we turn to Exhibit 75, does this exhibit constitute the shelf registration that actually was filed with the Securities and Exchange Commission?

A. Yes, it does, it was filed on the 15th, I believe, if my memory is correct.

Q. And just for clarification purposes, the first page of the exhibit on the first side of the page, this is just a summary of the shelf registration; is that correct?

A. It is correct. Most often when we ask our board to authorize a shelf, we put together a one page summary that sort of clarifies the purpose, intent, use of proceeds, and so forth as just an informational item, and that's what the first page, the first side of the first sheet is.

Q. Is that first page actually filed with the application with the SEC, or is that just an internal document?

A. It's an internal document for updating the board.

Q. So the actual application with the SEC would start on page 2?

0972

A. My pages aren't numbered, but it's the second, it's the back side of the first sheet of paper, yes.

Q. I'm sorry, that's correct, it's the page that says Securities and Exchange Commission at the top.

A. That's the one.

Q. And can you just briefly explain what's in the rest of the exhibit?

A. The rest is the registration. And you're talking about Exhibit 75?

Q. Yes, I am.

A. Okay, thank you. Yes, this is what's called a universal shelf, and it enables the company either -- it enables Puget Energy the holding company to issue common stock, and then it also authorizes Puget Sound Energy to issue first mortgage bonds, trust preferred, I think unsecured debt is in there as well.

Q. And you indicated, I believe, or would you accept subject to check that this was filed with the SEC on February 15th?

A. That is the correct date.

Q. And since then, is it also correct that you filed an application with this Commission with respect to this shelf registration?

A. With respect to the portions of PSE issuing

0973

securities, that's correct. PE issuing securities, that is an unregulated entity, so it doesn't require -- it's not subject to the application.

Q. Would you agree or accept subject to check that the company has asked for Commission action on that application, and I mean this Commission, by the end of February?

A. The date, I believe, was February 27th, if I remember right, yes.

Q. I have -- I'm done with this exhibit, and I have a question about trying to reconcile statements in two data requests that were inconsistent. They're not exhibits, so I can provide you with copies of the data requests, or perhaps your counsel can, or maybe you remember them from memory. But in Staff Data Request 292, your response to that data request, you indicated that the company first exceeds its line of credit in June 2002, but in your response to our Data Request 181 sub part B, you gave that date as August 2002. And if you need to take a minute and check those, that's fine, but we're looking -- my question is basically for you to reconcile those two and tell me which is correct in your opinion.

MR. QUEHRN: Your Honor, since those aren't exhibits, if Mr. Cedarbaum has extra copies, that would

be very helpful.

MR. CEDARBAUM: I can let the witness look at my copies. I don't have extra copies beyond that.

JUDGE MOSS: That would be fine.

THE WITNESS: It would be helpful to me, as I believe the questions may have been different.

JUDGE MOSS: I believe Mr. Cedarbaum is getting copies for you, Mr. Gaines.

THE WITNESS: Thank you.

MR. CEDARBAUM: May I approach the witness?

JUDGE MOSS: Yes.

A. I think I can explain that, Mr. Cedarbaum, and I could give you your book back. It would require us to turn to one of the exhibits here that are -- it's Public Counsel Data Request 62, which I believe is Exhibit --

JUDGE MOSS: 32C.

A. Is it 32C or 71C?

BY MR. CEDARBAUM:

Q. It could be both, but it is in 71C.

A. And it's page 7, which is my understanding not one of the confidential pages.

Q. This is the page where there's short-term debt, no interim relief?

A. That's correct, yes. Do you have that in
0975
front of you?

Q. Yes, I do.

A. Okay, thank you. In the far right column labeled column K, there's an item that shows the amount by which we exceed the credit line. And then if you look across the row to the left, there's a corresponding date, and you can see the first data request said, without relief, when do you exceed your credit limit. And you can see we exceed that by about $5 Million in June of '02. And then the second question -- and I -- when I say first and second, Mr. Cedarbaum, I'm not sure which of these two data requests is the first and second, but one said correcting for the $40 Million issuance of secured note that we issued in January, then when would you exceed the credit limit. What would happen is you would go along and subtract in essence 40 from these numbers, so it becomes August I think is the date on row 12 where it's $101 Million over. That would be reduced by 40, and so we would be over by $61 Million in that month. We would be under in the two prior months, June and July.

Q. So the difference between our Data Requests 181 and 292 is that 181 takes into account the $40 Million debt issuance from January, but 292 does not?

A. The first one was asked before I think we

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issued that request, and the one that specifically asked that we update for that, then we put that in, yes.

Q. Now referring back then to your rebuttal testimony, 25T, on page 2, line 17, that bullet.

A. Yes.

Q. Is the June 2002 date that's shown in your testimony the same June 2002 date that you responded to us in Data Request 289?

A. Yes.

JUDGE MOSS: Mr. Cedarbaum, would this be a convenient time to take a break?

MR. CEDARBAUM: I actually don't have that many more questions for Mr. Gaines, but it's fine with me.

JUDGE MOSS: 15 minutes?

MR. CEDARBAUM: Or less.

JUDGE MOSS: Okay, why don't you go ahead and finish then. I think that would be better.

BY MR. CEDARBAUM:

Q. There was a fair amount of discussion, Mr. Gaines, with respect to credit ratings and things like that. It's not your testimony, is it, that if the company's credit rating is downgraded that that downgrade triggers a default on debt; is that correct?

A. A downgrade doesn't trigger a default on
0977
debt, but it does become problematic with respect to wholesale power costs. As Mr. Bill Gaines described, it does increase our costs.
Q. Sorry to bounce around here, but.
A. That's okay.
Q. If you could turn to page, not page, but Exhibit 78, that's your response to our Data Request 293; is that right?
A. I'm not quite there yet.
Q. Okay.
A. It was Exhibit 78, Mr. Cedarbaum?
Q. Yes.
A. Okay, I'm there.
Q. And this is truly just a clarification question.
A. All right.
Q. Trust me.
A. As difficult as I find that, I will try.
Q. If you look at the second page of the exhibit, am I correct that there's been discussion about the $80 Million of elective debt redemptions over the course of these past few days and various testimony, the $80 Million that we're talking about is detailed on page 2, the bottom part of that table that's labeled MTN's

that are callable in 2002?

A. That's correct, that's the 80.

Q. If you could now on, again I apologize for jumping around here, but if you could turn back to your rebuttal testimony at page 7.

A. All right.

Q. The second table at the bottom, table 2, the line that references credit rating, do you see that?

A. I do.

Q. Is it correct that the credit rating that is shown for no relief and relief involves the company's corporate credit rating as opposed to its senior secured debt rating?

A. That's correct.

Q. And finally, Mr. Gaines, I had a few questions for you about the company's SEC 10-Q report for the quarter ended June 30th of 2001.

A. Is that an exhibit?

Q. No, it's not, so I could ask you to subject to check, and we can provide you a copy of that right away so you could check it. Or if you want to take a minute, I can go get it for you.

A. Maybe I can just hear the question and I can see if I need it.

MR. QUEHRN: Just a question, Your Honor, would it suffice, perhaps we could inquire if it would

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suffice just to submit the report to the record and let it speak for itself.

MR. CEDARBAUM: We can do that. If you just want to make it another exhibit, that would be fine.

JUDGE MOSS: I understand that the proposal is that you not inquire about, it be allowed to speak for itself.

MR. CEDARBAUM: And I was just going to ask a couple of clarifying questions about it, and the exhibit would speak for itself after that.

JUDGE MOSS: All right, well let's just make it an exhibit then. We'll mark it as 82, and we'll let Mr. Cedarbaum ask some clarifying questions with respect to it. Now you're going to furnish that after the break?

MR. CEDARBAUM: Yes, I will try to make enough copies of it during the break and get it to you right after the break.

MR. QUEHRN: Your Honor, could Mr. Don Gaines have a copy of it while you're asking the questions, if that's --

JUDGE MOSS: One is forthcoming.

MR. QUEHRN: Thank you.

JUDGE MOSS: I think.

MR. CEDARBAUM: Your Honor, maybe it's better

that we just go ahead and take that break now.

JUDGE MOSS: That does make a lot of sense, Mr. Cedarbaum, let's take our recess.

MR. QUEHRN: Thank you.

JUDGE MOSS: So we will recess for 15 minutes until 10 before the hour.

(Recess taken.)

JUDGE MOSS: We're going to mark then as Exhibit 82 the form 10-Q.

And then, Mr. Cedarbaum, you also handed up a PSE's response to Staff Data Request 62-I.

MR. CEDARBAUM: Yes, I did, Your Honor, and if you would like, you can -- I had also handed up what I think Mr. Gaines will agree is page -- is the page 5 referenced in his response to 62-I, so this can be one exhibit if you would like or two exhibits.

JUDGE MOSS: Well, if it's all part of the response, let's just make it one.

MR. CEDARBAUM: Technically it wasn't part of the response, it was just the referenced document from the response.

JUDGE MOSS: Well, that's fine, it still relates sufficiently to it, so 82 will be the form 10-Q for the quarterly period ended June 30th, 2001, and 83 will be the PSE response to Staff Data Request Number

0981

62-I and document referenced therein.

And while we're dealing with housekeeping, Mr. Cedarbaum, let me just ask you, in the event that on your review of the new information that came in this morning on the Infrastrux thing or on the Bench's review for that matter, if we needed to have Ms. Steel back, would she be available this afternoon?

MR. CEDARBAUM: Yes.

JUDGE MOSS: Okay, thank you.

Then I believe we can proceed with your questions.

MR. CEDARBAUM: Thank you.

BY MR. CEDARBAUM:

Q. Mr. Gaines, referring you first of all to Exhibit 82 for identification, do you recognize this as the company's 10-Q report to the SEC for the quarter ended June 30th, 2001?

A. Yes, this is a revised one, that's correct, 10-Qa.

Q. This is what's on file with the SEC?

A. That's correct, yes.

MR. CEDARBAUM: I would move the admission of Exhibit 82.

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

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BY MR. CEDARBAUM:

Q. Referring you now, Mr. Gaines, to Exhibit 83 for identification, do you recognize page 1 as your response to Staff Data Request 62-I?

A. Yes, I do.

Q. And the second page of the exhibit is page 5 of your Exhibit 4C in the general rate case phase of this docket?

A. That's right, DEG-4.

MR. CEDARBAUM: Your Honor, I would move the admission of Exhibit 83.

JUDGE MOSS: And there being no objection, it will be admitted as marked.

BY MR. CEDARBAUM:

Q. I would like to move, Mr. Gaines, into a discussion of Exhibit 81, which was entered this morning, and while I do this, I would like you to have before you and I asked Mr. Quehrn to warn you earlier that I will have questions about Exhibit 425 as well, which was an exhibit that Ms. Steel was questioned about. When you have that in front of you, just let me know.

A. 81?

Q. 81 and 425.

MR. QUEHRN: Your Honor, a question with

respect to 425.

JUDGE MOSS: Yes, Mr. Quehrn.

MR. QUEHRN: It would be helpful to know if the questions are also going to refer to the attachments, because I don't seem to have a complete set of my attachments to give to the witness right now.

JUDGE MOSS: 425 currently consists of four pages.

MR. CEDARBAUM: I was going to ask the witness questions about his answer, the company's answer, to part F, which I understand the question is in evidence and the answer is in evidence, and the answer includes another page that's also in evidence, which has a handwritten annotation page 4 at the bottom.

JUDGE MOSS: That's all correct.

MR. QUEHRN: And I now have a complete copy, thank you.

JUDGE MOSS: You do?

MR. QUEHRN: Yes.

JUDGE MOSS: All right, so I think we're in good shape to go forward with your question, Mr. Cedarbaum.

BY MR. CEDARBAUM:

Q. Mr. Gaines, if you could look at Exhibit 425 and just to yourself, it's not always necessary, just

0984

reread part F in the question part.

A. (Reading.)

Q. Are you --

A. I'm sorry, yes, I read it.

Q. And your answer on the second page of the exhibit refers to the handwritten page 4, excuse me, the page that has the handwriting page 4 at the bottom, and you indicate that the major assets sold and transferred since 1988 are listed, but then in the last sentence, you say:

Documentation of all assets sold/transferred greater than $1 Million during this period would be extraordinarily large and burdensome.

Do you see that?

A. I do.

Q. So what's shown on the page of the exhibit that has handwritten page 4 at the bottom is not a complete list; is that correct?

A. It's not a complete list, because it doesn't have all individual payments over $1 Million, which would be in the thousands for the time period requested. When you think of cash as an asset, any payment of $1 Million or more would fit under that definition. It would just be thousands of pages.

Q. Well, if we were to look at Exhibit Number 81, are there sales that are shown on Exhibit 81 that are not listed on Exhibit 425, page 4?

A. When you say sales, what do you mean?

Q. Well, sources in Exhibit 81, under the sources section at the top.

A. I see where you're going. I don't believe there are. There's two major sources there as I glimpse at this exhibit, three, I take it back. There is the Cabot common one which ties right into line 2 of page 4, handwritten 4, in Exhibit 425.

Q. My question is, is it correct or not that you show sources on the top half of page 81 that are not reflected on the handwritten page 4 of Exhibit 425? And I think that's either a yes or a no.

A. I don't believe that I do. I think they're all listed. There's three sources shown, and they're all listed on this page 4. If there's one that you're not able to see, I would be happy to point it out for you.

Q. Well, maybe I'm not understanding the exhibit completely. If you -- let me turn the question around. Are there transfers shown on Exhibit 425, page 4, that are not shown on Exhibit 81?

A. Oh, certainly, because 425 was a request just

for this one for the company, and this is one specific bank account only dealing with non-regulated cash, a very small subset of the company's finances.

Q. Does this specific bank account include all, what did you say, non-regulated cash?

A. That's what I said. It doesn't include all. Actually, let me think about that. Well, on a consolidated basis, we had a difficulty with this earlier in the week, PSE is consolidated, and so in its books of account, specifically, for example, if you were to look at the pages in the 10-Q it includes Puget Western and HEDC, some of those non-regulated subsidiaries that have cash, and this was something that somebody thought was a source to the utility. This is specifically -- and this excludes the Puget Western subsidiary and HEDC. This is moneys that originated actually from the WECO holding company for assets that came -- money that came from the sale of assets from the WECO holding company, specifically set up to keep track of these dollars which would otherwise be described as fungible to keep them separated, so there would be no possibility of confusing unrelated cash with dollars from the regulated business.

Q. But on page -- there are transfers shown on page 4 of Exhibit 425 that don't show up on Exhibit 81?

A. Oh, absolutely, they were two different questions, two different responses.

Q. Is it correct that Exhibit 425 does not show all losses either from the sale of any transfer, from the transfer of any assets?

A. Well, the list was just to -- the question was just to provide the asset transfers. There was no mention of gains or losses.

Q. But there are losses from transfers?

A. I don't know that.

Q. Well, if we look back at the question F on Exhibit 425, it just says, list each asset transferred. It doesn't distinguish between transfers that result in a loss or transfers that result in a gain.

A. That was exactly what I was saying, why we didn't put gains or losses on the sheet, it just says transfers.

Q. But again, page 4 of the exhibit does not include all transfers?

A. As I mentioned, the list of all transfers would include every cash payment as this question was written in excess of $1 Million. Every day we make payments to all sorts of vendors for power, for wages, for payments to subcontractors, to gas suppliers.

There's a lot of payments in our company that would be

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deemed asset transfers under this definition. And so as I mentioned, the list would number in the thousands if I were to give you every check that exceeded $1 Million.

Q. So this list on page 4 wouldn't include any losses the company might have incurred from the sale of any gas transportation contracts or the sale of capacity under gas transportation contracts?

A. This has the major asset transfers. On our books of account, a contract isn't deemed an asset, so a contractual change I don't think would appear on this list. It's not an asset by an accounting definition.

Q. Does this list include the sale of Washington Energy Services?

A. I'm not sure that I know the answer to that. The reason that I hesitate is I'm not sure of the date of that. This says '98, I'm not sure if it was prior to that date or if it would be assumed in one of these lines that are sort of aggregate lines like sales transfers of property and so forth. I don't see that as a line item on here.

MR. CEDARBAUM: Your Honor, I will have a couple more questions from Mr. Gaines about this, but I think I am quite frankly suffering a little bit from the lack of being able to prepare on this, and so I would like perhaps to kind of have until lunch time to have

other parties question before that, take some time over lunch, and perhaps come back to this.

JUDGE MOSS: We can certainly do that, Mr. Cedarbaum.

BY MR. CEDARBAUM:

Q. Let me ask you a couple of questions though on Exhibit 81, Mr. Gaines. When it says proceeds in the sources part of the page, is that synonymous with a gain, or is that just the cash that was received whether it was a gain or a loss?

A. This is just a bank account, so its's just the cash. It doesn't have gains or losses. It just has the cash that went in and out of this specific bank account.

MR. CEDARBAUM: Thank you.

Your Honor, that completes my questioning at least for now of Mr. Gaines, but I appreciate the opportunity to get another chance later if I think it's necessary.

JUDGE MOSS: We will allow for that, Mr. Cedarbaum, as I indicated first thing this morning in our discussion.

I believe, Mr. ffitch, aren't you to follow Staff?

MR. FFITCH: Yes, Your Honor.

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JUDGE MOSS: All right, then you may proceed.

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

BY MR. FFITCH:

Q. Morning, Mr. Gaines.

A. Morning, Mr. ffitch.

Q. You did not submit direct testimony in this interim proceeding, but you're now adopting the testimony submitted by Mr. Hawley, correct?

A. That's correct.

Q. Did you prepare the initial testimony of Mr. Hawley in this proceeding?

A. I did a lot of the numerical work for his testimony and worked with him on its creation and writing.

Q. Can you tell us why Mr. Hawley is not available today to participate in the hearing?

A. I believe he's out of the country.

Q. Who determines what Puget Sound Energy's dividend will be?

A. The board of directors.

Q. And the board of directors of Puget Sound Energy?

A. Correct.

Q. And who determines what Puget Energy,

Incorporated's dividend will be?

A. The board of directors of Puget Energy, Inc.

Q. Can I ask you to turn to Exhibit 72, please, and that's the response to Staff Data Request 82-G.

A. I have it.

Q. Tell me, the second page of that exhibit lists the members of the board of directors of Puget Energy and Puget Sound Energy, correct?

A. Let me make sure I'm on the right page. The first page is the response. The second appears to be an organizational chart of the utility. And then starting on what I would think would be the third page is a list of directors and officers of various subsidiaries.

Q. All right, that's the page that I'm looking at, the third page from the front of the exhibit.

A. I have it here.

Q. And the board of directors of Puget Sound Energy and Puget Energy are the same people, are they not?

A. They appear to be on this exhibit, yes.

Q. And so if the board of the unregulated parent company, Puget Energy, decided that it needs a larger dividend contribution from the regulated subsidiary, Puget Sound Energy, it's unlikely that the board of

Puget Energy would object to that request, wouldn't you

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agree?

A. I don't know that I can answer that, because the boards of the two separate entities, and they are separate entities, have their own fiduciary responsibilities to the investors and owners of those two companies. So just because the person sits on the same board of different companies doesn't mean that they would necessarily do the same thing. They have to act according to their fiduciary responsibility, and I don't know how they would act. I'm not a board member.

Q. All right. You're aware that one of the issues raised by Public Counsel in this proceeding is the level of information provided to the PSE board of directors regarding dividend policy and its impact on capital structure?

A. I know there has been lots of data requests about that.

Q. Well, you actually comment on that in your rebuttal testimony, don't you, that's Exhibit 25?

A. Do you have a page reference?

Q. Page 26.

A. Yes, I do comment on that, page 26, I believe the lines must be it looks like 21 1/2.

Q. 21 1/2 to 22 1/2?

A. That's correct, Mr. ffitch.

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Q. Now that's the full discussion in your narrative testimony regarding the manner in which the board is informed of the capital structure issues?

A. Well, that testimony that you just cited is a specific reference to something that Mr. Hill commented on, so it's not complete discussion of anything other than the lines referenced in Mr. Hill's testimony, which are in the question that immediately precedes that reference.

Q. All right. Well, the question says that Mr. Hill alleges that the board of directors was not properly informed of the impact of the company's capital structure, impact, excuse me, on the capital structure of its dividend policy, and the answer is designed to give Puget Sound Energy's response to that allegation.

A. That specific question, yes.

Q. And that sentence is the company's answer?

A. That sentence is that the board is fully informed, that's correct. It would be hard for me to believe how Mr. Hill could make such an assertion having never attended a board meeting and only reviewing the minutes where it says there's lots of discussion, but he would have no way of knowing what the discussion entails.

Q. Well, other than this answer, has Puget Sound
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Energy presented any evidence in this proceeding that
the board was provided with information on the impact on
the capital structure of paying out a dividend which
exceeds the company's earnings?
A. I'm not sure I know the answer to that. I
don't know all the data requests by heart. There's been
over 600 of them.
Q. All right, well, let's take a look at a
couple of those, perhaps help you out. If you turn to
Exhibit 31, that's Public Counsel Data Request 55-I and
your answer. Do you have that?
A. Exhibit 31, 55, yes, I do.
Q. And that asks whether the option of reducing
dividends has been discussed and asks for complete
copies of any board minutes related to that discussion.
It's the narrative response stating that it's addressed
quarterly, and then there are excerpts of minutes there.
Can you point to anything in those minutes which again
addresses the impact on capital structure paying out a
dividend exceeding the company's earnings?
A. Well, I can certainly turn you to what would
be the it looks like, oh, it's the numbered, hand
numbered page 2 at the bottom, and these are excerpts
from the October 9th board meeting, and I'm sure there

are similar statements in others, we can go through them

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if you would like, where it says, Mr. Elders then reviewed various financial considerations as they bear on dividend policy. It doesn't provide any additional information as to what those considerations were, but it does say that he reviewed various financial considerations as they bear on dividend policy, so I would say that yes, the dividend policy is addressed or was addressed.

Q. But you're not pointing to any specific information on that page that indicates any expressed discussion of the issue that I asked you about, are you?

A. It says they discussed various financial considerations with respect to the dividend. That's what I'm pointing to.

Q. And it doesn't say what those financial considerations are?

A. It does not.

Q. Is there anything more specific anywhere in this exhibit about what financial considerations were discussed with the board?

A. Well, certainly there are other similar statements. For example, on handwritten page 4 toward the bottom just before it looks like a motion was made that says, after full discussion of the various factors affecting dividend policy, motion was made. Let me see

if there's any other. I'm sure there's other ones like that.

Q. I would concede -- I'm happy for you to go through and find those other references, I guess I would concede that there are a number of references in the minutes of essentially that same nature, that various factors affecting dividend policy were discussed.

A. Right.

Q. But there's nowhere a discussion of what those factors were, right?

A. I don't see them here, no. And the minutes, of course, are not word for word minutes in essence, word for word transcripts of a board meeting. They are minutes, not transcripts.

Q. Let me ask you to turn to Exhibit 37. That's the response to --

A. 73-I.

Q. 73-I, and this is a follow-up response, excuse me, a follow-up question to the last data request. It notes that a portion of the response was missing, there were missing minutes, and asks for those to be supplied, indicates that it was not possible to discern an answer to the question about whether dividend reductions were considered, and asks for a copy of any reports given to the boards regarding cash flow

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implications of dividend reductions. You then provided an answer. Can you see -- can you look through that response to the data request and see if there's any depiction of capital structure or of the discussion with the board of the impact on capital structure of paying out a dividend which exceeds the company's earnings?

A. I can certainly look through there, Mr. ffitch, but the question doesn't at all address capital structure, so I would -- and as these are, as you admitted, were subsets to minutes, I'm not sure that there would be a reference. It's an incomplete record here of minutes, and the question wasn't addressing capital structure at all unless I'm missing it as I read the question quickly here. But it looks to me as if there is plenty of discussion on dividend, but I don't see anything related to capital structure. I suspect it's certainly not part of the question, so that's probably why it wasn't part of the answer.

Q. Now when you say there's plenty of discussion of dividend, what are you referring to?

A. Well, all the attachments, specifically pages 3 through 10. That would be eight pages I suspect.

Q. Do any of those discussions of dividends again bear on the impact of capital structure of the company's dividend policy, or are they simply the same

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kind of general discussions that you referenced earlier in a discussion of the prior exhibit?

A. I thought that I answered that question. There's no question regarding capital structure, so we wouldn't expect to find an answer to that in here.

Q. Is there any question regarding, excuse me, is there any discussion about the option of dividend reductions in any of the minutes materials that you have provided?

A. Well, I think that in my earlier response to the earlier exhibit you just asked me to go through there was plenty of discussion. I gave you specific citations. You said that you would accept that there's probably several more.

Q. Well, I think the record is clear that we're referring to references of a general nature which -- am I correct?

A. I'm not sure I know what you mean by references to a general nature.

Q. Well, if you turn to the first page of Exhibit 37 I will give you an example.

A. All right.

Q. And the next to the last sentence of the text before the resolution states:

Mr. Hawley reviewed various financial

considerations as they bear on dividend policy.

A. Correct, yes, I see that there, second page.

Q. And there are a number of references like that throughout this exhibit, correct?

A. Yes, there are. That's what we were talking about, yes.

Q. But as with the previous exhibit, there's no specific explanation of what those various financial considerations were?

A. Well, there was the ones that we just went through in the other page, in the ensuing pages. That's some of it obviously.

MR. QUEHRN: Your Honor, if I may interject at this point. I think Mr. Gaines has already testified that this is not a transcript of the board meeting, and I think this question has been asked and answered.

JUDGE MOSS: It does seem that the witness has adequately addressed the question, Mr. ffitch.

MR. FFITCH: All right, thank you, Your Honor, we can move on.

BY MR. FFITCH:

Q. Let me ask you to take a look at the data response that's been marked as Exhibit 44, and that's a response to Public Counsel Data Request Number 54.

A. I see that, yes, thank you.

Q. And in the second paragraph of the response, you state:

If the retail environment allows the company to collect the necessary revenues to recover its total cost of service as required by the Hope case, there are no credit protection problems.

That's a correct reading?

A. That is a correct reading, yes.

Q. Would you agree with me that this statement is a pretty fair summary of Puget's position in this case, that is, if the Commission raises rates high enough to cover your costs, there won't be any bond rating downgrades or credit protection problems?

A. Well, when you said this case, I'm not sure that I can agree, because I'm not sure that the, in fact, I know for a fact that the $170 Million that the company is requesting does not fit the Hope standard here. It's nowhere near sufficient.

Q. Well, let me ask you a couple of hypothetical questions. Let's assume, first of all, hypothetically that the company made a very large purchase of expensive power for the sole purpose of selling that power off system. Do you have that hypothetical in mind?

A.   When you say high price, what do you mean, with respect to what?

Q.   Let's assume that the price is in the range of high prices that were experienced in the Western electricity market in late 2000 and into 2001.

A.   What would that be?

Q.   Let's pick a number of $200 a megawatt hour.

A.   All right.

Q.   Just hypothetically.

A.   Sure.

Q.   Do you have that in mind?

A.   I do, yes.

Q.   Do you agree that that is expensive power?

A.   Well --

Q.   Just so that we have a good hypothetical to work with here.

A.   Well, when you say a high price or expensive and we have said that that would define the number we're talking about is $200, I think that has to be defined with respect to what. I'm not sure that that was a high price at the time that you mentioned. It's certainly a high price compared to today's prices, probably ten times the amount of today's prices. But, you know, when you ask me to compare high or something, it's relative to some base. I don't know the base that you want it to

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be relative to.

Q. I would be very happy for you to select a number for this hypothetical which you would view as expensive power.

A. Well, with respect to what, with respect to today's prices?

Q. Why don't you decide, and you tell us what you would view as expensive power let's say during that time period of 2000/2001.

A. You know, I don't know what prices were to know what would be high or low for that period. You know, that's a question that would have better been asked Bill Gaines when he was on the stand as he is our power supply witness. I am a little bit confused, Mr. ffitch, this is your hypothetical. I'm trying to figure out also why I'm the one trying to construct it.

Q. Well, I just want you to be comfortable with the terms. I mean I understand the company's request in this case is essentially based on the fact that the company paid some high prices for power sometime during 2000 and 2001; isn't that correct?

A. No, that's not the case at all. There's nothing -- there's no dollars in this request at all related to 2000.

Q. All right.

A. The request is to cover expenses from the period January 1 through October of 2001.

Q. Okay, I stand corrected.

CHAIRWOMAN SHOWALTER: 2002?

A. 2002, sorry, thank you for the correction.

Q. You're correct, I'm sort of blending two things. Let's get back to the hypothetical. Let's if you will just agree with me for purposes of the hypothetical that we're going to use the number $200 per megawatt hour as expensive power.

A. I got that.

Q. Do you believe this Commission should raise rates to cover those costs?

A. Oh, I would think that they would, sure. You said it was for a purchase for an off system sale, I think that they should credit the revenues from the sale if it was sold at $100 or $500, I think that that all should be netted out. I don't know that it would necessarily result in a rate increase. It could result in a decrease depending on the sale price that we assume.

Q. Let's assume again a second hypothetical.

A. Is this independent of the first or in addition?

Q. Separate, independent, new hypothetical.

Let's assume the board of directors of Puget Energy elected to double PSE's dividend contribution from its current level.

A. What was that, did you say Puget Energy or Puget Sound Energy?

Q. Puget Sound Energy's dividend contribution.

A. The dividend to PE?

Q. Yes.

A. Okay.

Q. Do you have that in mind?

A. I do.

Q. Do you believe this Commission should raise rates to cover those costs to avoid credit protection problems?

A. The Commission doesn't regulate the dividend. The Commission regulates the rate of return, and it's the board's consideration as to how that rate of return is to be divvied up between retention and pay out. That's not the jurisdiction of the Commission. It's the responsibility of the board.

Q. Well, that's not exactly -- that isn't really what the hypothetical asked for, so let me ask the question again.

If the board of Puget Energy did decide to double PSE's dividend contribution from its current

level, do you believe this Commission should raise rates to cover those costs to avoid credit protection problems?

A. I don't know how a dividend would get into the rate making equation, Mr. ffitch. The rate making equation, as I understand it, is rate based times rate of return plus operating expenses, that when grossed up for revenue sensitive items would equal the revenue requirement, so I'm not sure how the dividend gets into that equation. That's obviously a very simplistic equation. There's a lot more detail certainly in the company's general rate case, but I don't know that the dividend level is a piece of that file.

Q. So in your view that's irrelevant?

A. For my view, rates are set based on a fair rate of return applied to rate base and covering all operating expenses, and we're just trying to get some to remain financially viable in this proceeding.

Q. And in the hypothetical, the dividend would have nothing whatever to do with the level of rates to be charged by the regulated company?

A. I don't know how it would get into the equation.

Q. Moving on to another area, Mr. Gaines, from the period following 2000, the year 2000, did Puget pay

out an amount of dividends which was roughly equal to its earnings?

A. What was the -- post 2000?

Q. Post 2000.

A. So meaning 2001 to date?

Q. Yes.

A. Yeah, I think because the earnings have been eroded from the underrecovery of power costs, that's probably correct.

Q. And for the year 2000, the company's dividends were about twice its income available for common stock, correct? I can give you some references, exhibit references.

A. Yeah, because I don't know the number.

Q. Let's take a look at, well, first of all, you would accept that the dividend is a $1.84, right?

A. Per share, yeah.

Q. Right.

A. For Puget Energy.

Q. So let's look at Exhibit 32C, page 17, and these are handwritten page numbers. This is confidential, it's marked confidential at any rate. I would ask if the company still asserts confidentiality with regard to the bottom number in the first column which is now a historical number?

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A. The bottom number of the first column we can waive the confidentiality on.

Q. Thank you. And that number is 88 cents, correct?

A. 88 cents per share, that's right.

Q. So again, the question is, and maybe now you can answer it with those basics established, for the year 2001, the company's dividends were about twice its income available for common stock?

A. Well, no, because the dividend that you asked me about is a dividend from Puget Energy. This financial statement is a financial statement of Puget Sound Energy, one subsidiary, and it also excludes the non-regulated entities of Puget Sound Energy, the non-regulated subsidiaries of Puget Sound Energy, such as Puget Western and HEDC. And so this would only show a subset of the earnings. I believe the company reported earnings for 2001 of $1.14 per share, Puget Energy did, and so that would not quite be double. And I believe we released those earnings on February 8th.

Q. All right. Now one of the points you made in your rebuttal about Infrastrux is that it's small compared to PSE, and a default of Infrastrux would not be a credit problem for PSE; is that right?

A. I think my testimony says that it's small. I

have the -- if you give me the page reference, I can double check that. I can probably thumb through and try and find it as well.

Q. I would appreciate it if you would do that. I didn't note that in the question. I can also look for it.

MR. QUEHRN: Starting on page 24, I think, going over to page 25.

Q. If you look at pages 7 through 12 of page 25 of your rebuttal testimony, is that --

A. Lines 7 through 12?

Q. Is that the correct page reference?

A. Yes, that's the one. It talks about the relative size and assets or in terms of the asset of PSE versus Infrastrux investment.

Q. Right, but the plan, Puget Sound Energy's plan for Infrastrux or Puget's, Puget Energy's plan for Infrastrux is that it's going to be big; isn't that right?

A. That's the plan with no additional capital investment from Puget Energy, just the ones that appeared at the outset on Exhibit 81.

Q. And the plan is for it to be a billion dollar company according to --

A. In revenues.

Q. According to the CEO, former CEO, Mr. Weaver, correct?

A. I believe in terms of revenues, that's correct, in five years.

Q. You note also in your testimony that Infrastrux has a credit line which is guaranteed by Puget Sound Energy.

A. That's incorrect.

Q. All right, can you show me in your testimony where --

A. I don't know that I have it in my testimony, but I know that the guarantee is from Puget Energy. There's no relationship between Puget Sound Energy and --

Q. All right, I stand corrected, I misread my notes and inadvertently said Puget Sound Energy. I did mean Puget Energy.

A. All right.

Q. So again, just to clarify the record, your testimony is that Infrastrux has a credit line which is guaranteed by Puget Energy?

A. That is correct.

Q. Does Puget Energy have any tangible assets other than desks and paperclips?

A. It has investments in subsidiaries.

Q. All right. Isn't it true that Puget Energy derives its credit strength from Puget Sound Energy?

A. It would derive it from all of its subsidiaries, yes.

Q. And that would include Puget Sound Energy?

A. Absolutely.

Q. And would the relative amount of credit strength derived from the subsidiaries sort of track the relative size of the subsidiaries?

A. I would think that it would and their expectations, certainly.

Q. Can Puget Energy guarantee a line of credit for Puget Sound Energy?

A. I don't know that it would make any sense to do that.

Q. Well, I'm not asking if it would make sense. First question is can they do it?

A. Well, certainly it's physically possible. I don't know that it would be of any value to a lender.

Q. If Puget Energy were to guarantee a line of credit for PSE, would that be an optional source of capital for PSE?

A. No, a guarantee is not a source of capital. A guarantee just says there's some person stepping in much like a co-signature, co-signer on a car loan. It

doesn't necessarily mean that the co-signer has the financial wherewithal to make the payment. They're just signing that they will accept partial responsibility.

Q. But a guarantee typically allows the transaction to go forward, correct; it allows the person whose credit is guaranteed, it allows them to go forward with the transaction, correct?

A. I don't follow you by go forward with the transaction.

Q. If a lender seeks a guarantee from a borrower and the borrower is able to provide a guarantee that satisfies the lender, then typically the transaction will go forward; isn't that correct?

A. With respect to that one item assuming there's no other thing that blocks it and gets in its way.

Q. Mr. John Durbin is the president and CEO of Infrastrux; is that accurate?

A. He is the head of Infrastrux. I'm not sure of his exact title. I would accept that.

Q. Right. And is it true that Mr. Durbin is also on the board of directors of both Puget Energy and Puget Sound Energy?

A. I don't have that earlier exhibit in front of me, but I would accept that.

Q. All right, if you want to check that, that's Exhibit 72. And again, it's the same page 3 of the exhibit.
A. Thank you. Yes, he appears on both lists. Thank you for the reference.
Q. Are there any other officers or directors of Puget Sound Energy or Puget Energy that sit on the board of directors of Infrastrux?
A. Again, going to this page, that page 3, I believe you said, of Exhibit 72, the board of Infrastrux appears at the bottom of the page, and it looks like the only one that I see in addition to Mr. Durbin would be Douglas Beighle.
Q. And am I correct that Mr. Hawley, the CFO of Puget Sound Energy, is also shown as a director of Infrastrux?
A. He is, yes.
Q. And Mr. McKoen, who is the general counsel of Puget Energy, also appears on the board of Infrastrux?
A. Yes, he does.
Q. Now can I ask you to take a look at your response to Public Counsel Data Request 50, which has been marked as Exhibit 30.
A. Yeah, I have that.

Q. All right, you're ahead of me.

A. I can double check, you said Exhibit 30, our response to Public Counsel Data Request 50?

Q. Yes.

A. Thank you.

Q. And the attachment to the data request itself is a consolidating balance sheet for Puget Energy; is that correct?

A. That's what it appears to be, for November 2001, yes.

Q. All right. I can walk you through the specific lines if you would like, but would you agree subject to check that if we look at column F, which shows the data for Infrastrux, those numbers indicate a capital structure for Infrastrux of about 53% common equity and 47% long-term debt?

A. Did you say 56% common equity?

Q. 53%.

A. I wonder if maybe I should have you step me through this. I'm talking of the Infrastrux column line 40, which is common equity, and dividing it by total capitalization -- oh, I see, it includes this short-term debt here, excuse me.

Q. I have been looking at lines 40 and 43.

A. Okay, and your question is -- it looks to me as if the line on -- the item on line 40, $94 Million,

if you were limiting it to line 44, which would be the sum of the two that you mentioned, it would be 56%. I suspect to be accurate, I wonder if perhaps you included the items down in lines 44 and, sorry, lines 48 and 49, the current maturities. I'm trying to read my lines across here. It looks like current maturities of long-term debt as well as the short-term debt as that's typically how we would calculate capitalization, included the short-term debt and the current maturities in that. I can check that to see. It would have the effect of reducing the 56.

Q. All right, could you do that, please?

A. I will, yeah. I believe that's how you got your 53, Mr. ffitch. If I add in the Infrastrux column F lines 44, lines 48, and 49, I get a total of approximately $177 Million. And if I were to divide that into the amount on column F, line 40, of 94, I get 53%.

Q. And the long-term debt?

A. It would be 100 minus that, so it would be 47%.

Q. And would you agree that that's a reasonable approximation of the capital structure of Infrastrux?

A. On that particular date, yes.

Q. All right. Now the same page indicates PSE's

capital balances on that particular date, correct?

A. Yes, it does.

Q. And if you did that same calculation, would you accept that the common equity ratio of PSE on that date is 30.4%?

A. I would accept that subject to check.

Q. All right. And finally, if we could just take a look at line -- well, first of all, pardon me, let's take a look at column B for Puget Energy, and I asked you about desks and paperclips a little bit earlier, and you indicated that the primary asset was investments in subsidiaries?

A. Yes.

Q. And that's shown on line 16, correct?

A. That's correct.

Q. And that's $51 Million and a little bit.

A. Right.

Q. And if you look at line 60, we see that the total capitalization of Puget Energy is 51,300,099, correct?

A. Yeah, it includes the 51 from above and $370,000 of other items.

Q. All right. And if we look over on line 60 in the Puget Sound Energy column, the total capitalization of Puget Sound Energy is $5.3 Billion, correct?

A. Total capital liabilities, yes.

Q. And for Infrastrux $213 Million?

A. That's correct.

Q. I would like to follow up on a question that Staff counsel had a bit earlier in the questioning about the rate cap. If you earned an 8.99% overall rate of return, given that your current equity ratio is approximately 30%, what would the return on equity be in that case?

A. I don't know the answer to that off the top of my head.

Q. Could you calculate that in the hearing room today?

A. No.

Q. Could you provide that in response to a record requisition?

A. I'm not sure that I can.

Q. Let me ask you another question first. Perhaps you have already answered this by indicating some level of confusion, but can you even say whether the return on equity would be greater than 10.5%?

A. I think it would be greater than 10.5%.

Q. So let me understand your earlier answer. You're saying that you could not calculate what the return on equity would be with a 30% common equity ratio

and an 8.99% overall rate of return?

A. I'm not sure what the rate base would be. I'm not sure what -- and then there would be some earnings that flow down, so I would have to make a bunch of assumptions. And if you specify those, I might be able to make a calculation for you.

Q. All right.

A. If you have made one, I would be happy to review it.

MR. FFITCH: Thank you.

Your Honor, perhaps during the next break, we could prepare a request with certain assumptions built into it, discuss it with the witness, and then form that as a records requisition.

JUDGE MOSS: We will be breaking for lunch here fairly shortly, so if you want to formulate such a question during the recess, you could do that.

MR. FFITCH: And, Your Honor, I'm just about finished as well, so just one or two more questions.

BY MR. FFITCH:

Q. Under both the originally filed and under the revised proposal, the total amount of Puget Sound Energy's request for relief is around $170 Million, correct?

A. That's right, 177.27.

Q. 177?

A. 27, $170,727,000.

Q. All right. As I understand Puget Sound Energy's position in this case, if the company receives anything less than that amount, the company will go to junk bond status; is that correct?

A. I believe what my testimony says is if we receive less than that, we will be downgraded to junk status. I don't know that it says the bond rating or the corporate credit rating. I will be happy to check that if you have a reference for me.

Q. I don't have a reference at the present time, but the record in the proceeding will reflect the company's statement at the hearing to that effect.

A. I think my testimony speaks for itself in that regard.

MR. FFITCH: All right. I don't have any further questions. Thank you, Mr. Gaines.

THE WITNESS: Certainly.

MR. FFITCH: Thank you, Your Honor.

JUDGE MOSS: Well, ordinarily we would break just at the noon hour, but it's pushing up against that. In fact, my watch says it's about 6 minutes before the hour, so I think what we ought to do is go ahead and take our recess now.

And, Mr. ffitch, if you would refine your question that you mentioned over the luncheon hour, then I will let you ask that when we get back.

And then we have some additional cross by I guess, Mr. Kurtz, you have a little bit, and, Mr. Van Cleve, you also have indicated a little bit, so we will pick up with that. And then we will turn back to Mr. Cedarbaum and see where we stand.

MR. FFITCH: Your Honor, I'm sorry, I also do need to offer our cross exhibits.

JUDGE MOSS: All right, why don't you do that.

MR. FFITCH: And again, we had reached an agreement as to stipulation with counsel for Puget Sound Energy that Public Counsel's cross exhibits would be admissible, and those are Exhibits 29 through 55, and Exhibit 72. And if I may just check one other, Your Honor. I just want to make sure that Public Counsel -- the response to Public Counsel Data Request 135-I is included, and I do see that as Exhibit Number 29, so that list was correct, Your Honor.

JUDGE MOSS: All right, and those will be admitted as marked.

All right, with that then, why don't we take our luncheon recess until 1:30 this afternoon.

(Luncheon recess taken at 11:55 p.m.)

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

(1:35 p.m.)

JUDGE MOSS: Mr. ffitch is distributing a docket, I mean a document. I must be getting tired.

MR. FFITCH: Your Honor, this is a representation of the assumptions that we are going to incorporate in our question to Mr. Gaines that we had posed before the break, before the lunch break. And we simply put those down on paper for the assistance of the witness in looking at our question.

I have also spoken with Mr. Quehrn beforehand and indicated that if the company wants to respond to this in some fashion, they can -- we have no objection to them doing that in terms of alternative calculations.

However, I would like to go forward now with the question and describe our assumptions and then place that -- place this in the record for the background that it provides. So if I can go ahead, Your Honor.

JUDGE MOSS: All right, you don't want me to mark this at this time?

MR. FFITCH: Oh, yes, I'm sorry, if you would mark it.

JUDGE MOSS: And the anticipation is that

there will be some further response from the company, and so we should mark it as a records requisition.

MR. FFITCH: That would be fine, Your Honor.

JUDGE MOSS: All right, we will call it Number 14.

MR. QUEHRN: Excuse me, Your Honor, I think we already have a 14.

JUDGE MOSS: Is there a 14? You're quite right, it's written in the margin of my exhibit list, and I didn't see it. Thank you for the correction. It will be 15.

All right, Mr. ffitch, go ahead.

MR. FFITCH: Thank you.

BY MR. FFITCH:

Q. Good afternoon, Mr. Gaines.

A. Good afternoon.

Q. In case you don't recall the specific question that I posed before lunch, I will just repeat it, and it's shown at the top of this Record Requisition 15. If Puget Sound Energy earns 8.99% overall with approximately a 30% equity ratio, what is the effective return on equity? That is the question. And here are the assumptions we're asking you to use in answering that question. The capital amounts are for November

30th, 2001, and that data in that column comes from

Exhibit 30 that we were looking at just before lunch. So are you with me so far?

A. I am.

Q. And then the percent column just is a mathematical calculation based on that first column. The third column of cost rate comes from the Gaines rate case direct testimony, DEG-4C. And then the final column is the weighted cost rate. On the fourth line, you can see long-term debt, and our assumption states that that includes current maturities of long-term debt. In the third and fourth columns in the first line are numbers in boxes. These are our calculations of these amounts -- of the answer to the question, really what the cost rate for common equity, i.e., the return on equity amount, and then the weighted cost rate. So we're asking you to accept those subject to check. Can you accept those subject to check?

A. Actually, because, Mr. ffitch, you and your witness were kind enough to show me this ahead of time and I do recall some of these numbers from the exhibits that you have described, I think I can just accept those specific numbers as they are stated on the sheet.

Q. All right, thank you very much.

MR. FFITCH: Your Honor, I did have one other question, if I might, just with regard to a

clarification to an answer that we had this morning in my cross-examination.

BY MR. FFITCH:

Q. Right at the end of our conversation this morning, Mr. Gaines, I asked you about your position regarding the potential downgrade if the company did not receive $170 Million, and I just want to get a clarification. When you talk about the potential downgrade to junk bond status that would occur if the company did not receive $170 Million, are you referring to Puget Sound Energy's first mortgage bond rating or to the corporate debt rating?

A. When we were speaking this morning, and I should preface this by saying, you know, these are my opinions, of course, the rating agencies would make their own determination, and the rating agencies do state that the ratings process is as much art as it is science, but when I was -- recalling back the conversation that we were talking about, it was with respect to the table that I had in my testimony, and that was the corporate credit rating.

There is, of course, the possibility of the bond rating itself, the senior secured bond rating being downgraded as well both, but -- I think that would be the case certainly with Moody's. I think they have

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stated as such. But certainly the corporate credit rating and possibly the senior secured rating as well. And if you would like, I can give you the reference into Moody's reports as to why I think that's pretty much a given.

Q. Those reports are in the record, are they not?

A. They're in the Bench Request, yes.

Q. Okay, that's fine if you want to give those references.

A. Oh, certainly. With respect to Moody's, Moody's put out a report, it's the one that should be fairly close to the top of that exhibit. It's the one dated January 14th, 2002.

JUDGE MOSS: This is Bench Request 1 that you're referring to.

A. I don't have it, and I don't think that I need it, but it's the thicker one that has all the Standard & Poor's and Moody's reports.

Q. Yes, that would be the one.

A. In that report, there's a couple statements that I think bear relevance to this proceeding. Remember this is a report that came out after both Staff and Public Counsel had announced their proposals and after, of course, the company was denied its previous

request. There's a statement that they say:

> State regulatory actions in Washington during the fall of 2001 were troubling from Moody's perspective given the effects of changed market dynamics on PSE's ability to withstand resulting net power cost volatility. We note that surrounding jurisdictions were taking a far more supportive action at that time, enabling other utilities to better cope with similar challenges.

And then they further go on to state:

> PSE's ratings are under review for possible downgrade reflecting concerns about how regulators will ultimately rule on the company's request for interim and base rate relief. Supportive rulings, especially relating to interim relief, are essential to enable PSE to maintain sufficient earnings and cash flow to support its current ratings.

Q. All right. So in that rating that's being referred to there is which one?

A. That was the Moody's report. It's not just

tied to a specific rating, but their report covers all of their ratings, and certainly the footnote on that report talking about that ratings are subject to review for potential downgrade covers all of the ratings with the exception of the commercial paper rating P2.

MR. QUEHRN: Excuse me, Your Honor, could we make it clear for the record that Mr. Gaines was reading from page 5 of 40, Bench Request Number 1.

JUDGE MOSS: Thank you, Mr. Quehrn.

BY MR. FFITCH:

Q. And what is Moody's current first mortgage bond rating for Puget Sound Energy?

A. The bond rating is Baa1, the corporate credit rating Baa2, and that's capital B, two small A's, and then the number 1. And the other one was capital B, two lower case A's, followed by the number 2.

MR. FFITCH: All right, thank you.

I don't have any further questions, Your Honor.

JUDGE MOSS: Thank you, Mr. ffitch.

Mr. Cedarbaum told me off the record that he had had an opportunity to study exhibit I believe it was 81 further and has about five minutes or so worth of questions, and I believe this would be a good time to go ahead and have that before we turn to Mr. Van Cleve.

MR. CEDARBAUM: Thank you, Your Honor.

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

BY MR. CEDARBAUM:

Q. Mr. Gaines, I will need you to take a look at Exhibit 81. I will let you get settled up there.

A. Sorry, I seem to have misplaced my notebook here.

Q. Do you have the exhibit?

A. I do.

Q. At the top of the exhibit, there's reference to U.S. Bank account number --

A. Yes, I would appreciate you not reading the account number into the record.

Q. That's fine. Is this the only account in which non-regulated cash would be placed, or are there other accounts?

A. There would be other accounts. I know that Puget Western, the real estate subsidiary that disposes of the non-regulated property has its own bank accounts that then get consolidated on the financial books of account with Puget Sound Energy. Of the ones, of the accounts at PSE, Mr. Cedarbaum, I believe, and I would have -- I would have to do this subject to check, I believe this is the only bank account with respect to

that.

And clearly there's two ways of tracking the non-regulated dollars. One is with accounts, chart of accounts type accounts, accounting accounts, and then another way to segregate cash as we have done here is with bank accounts. I know there are other charts of accounts that have non-regulated dollars in them at the PSE level.

Q. And are the proceeds that you show on Exhibit 81, do they cover all of the cash that would reside in this particular bank account that's shown on Exhibit 81?

A. Yes, they did, it's a summary of all the transactions from the beginning through the duration of the account. You can see the moneys coming in, and then you can see the moneys going out. In fact, the very last line shows that just to clean up the account there was a $2 1/2 Million transferred from this non-regulated cash account into the utility for utility purposes.

Q. And again, I think you stated this before lunch, but when you use the term proceeds, you're just saying the cash received from a sale whether that transaction was a gain or a loss?

A. Right, this is a bank account, so the only thing you can deposit in a bank account is cash, and so it has all the cash inflows and outflows.

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Q. And since there are other bank accounts that have proceeds from other non-regulated transactions, what's shown in Exhibit 81 would not show all of those proceeds whether or not those transactions resulted in a gain or a loss as well?

A. Correct. For example, the balance that we were describing earlier at the end of the year with $60 Million of cash is actually at Puget Western, not at all related to the utility, and it's in its own separate account governed by Puget Western.

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

Your Honor, I would just note for the record, you had asked this morning whether Ms. Steel was available to be recalled for purposes of this exhibit and this topic, and she is if the Bench would like that to happen.

JUDGE MOSS: But you have no independent need to recall her?

MR. CEDARBAUM: No.

JUDGE MOSS: Okay, thank you.

All right then, Mr. Van Cleve, I believe you're next in the order.

MR. VAN CLEVE: Thank you, Your Honor.

As the other parties have done, I would like

to offer Exhibits 73 and 80.

JUDGE MOSS: All right, is there any objection?

There does not appear to be. Those will be admitted as marked.

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

BY MR. VAN CLEVE:

Q. Are you ready?

A. Certainly, thank you, I appreciate your waiting.

Q. The current power cost deferral ends at March 31st, 2002; is that correct?

A. I think the order that we got enabling us to defer costs for recovery purposes only goes through the end of March. But I believe that the proposal that we have, and this I would have to have subject to check, is that we would defer, I think we have assumed in here, that we would defer through I think March 14th and then begin collecting on March 15th. And the counter proposal then was you defer under the counter proposal all the way along through the end of October.

Q. What's your proposal in the case, that the deferral end in March or that it continue?

A. Our what I would call sort of the -- we gave

two options, if you will, but the most recent one that's in my rebuttal testimony is one where we remain consistent with the order that was granted for the first three months, carry that deferral through the end of the rate period, and again that's really to true up power costs so there's no over or under collection of power costs, and then we would collect $130 Million, 136 I believe grossed up, during the period from March 15th through the end of October. And then the resulting numbers that Mr. Cedarbaum and I were discussing, the roughly $34 1/2 Million or 33 after the gross up would be deferred and collected over the one year period beginning concurrent with the general rate case.

Q. Are you aware that the Staff is proposing that the deferral terminate on the date of the interim rate order?

A. I believe that that is their proposal.

Q. And do you oppose that proposal?

A. Well, certainly keeping the deferral in place is a good thing, I think. So keeping that aspect of their proposal we certainly incorporated into ours. There's a lot of other aspects of their proposal that I certainly disagree with.

Q. But the question is whether you oppose that proposal?

A. Well, as I mentioned, I think I answered that question, we are requesting a deferral mechanism through the end of the interim period truing up power costs and deferring a collection of the balance going forward. I don't know what they have done with the balance to the extent there's an over or under recovery at the end of that period.

Q. There's been a little confusion in this case about whether this is a power cost recovery case or an interim rate case. Can you explain that?

A. I would be happy to, Mr. Van Cleve, because I agree with you 100%, there's a whole bunch of confusion on that topic. And clearly as the standard is for interim rate relief, you look at the six part PNB standard, the bit of case law as I understand it from October of 1972. And our case is about measuring the results of our operations, financial operations, and financial condition. With respect to that standard through six or seven ratios and some other qualitative aspects of the company, comparing those to the standard, and showing that in this case granting the full amount barely gets you there, if you will.

And when I say barely gets you there, I mean that the resulting book coverage ratios do not result in ratings that are concurrent or consistent with the

current bond level. The amount of cash flow coming in even with the elimination of the elective redemptions is barely sufficient to enable us to operate within our existing line of credit, $375 Million. Table 4 I believe it is in my testimony shows that in that scenario we would have a $25 Million leeway, if you will, short-term debt by the end of the interim period. I believe Staff had proposed, as Mr. Lott correctly described Ms. Steel's testimony, they're proposing a cushion of $126 Million, so we have 1/5 the cushions that Staff had proposed. So that's the piece of our case.

Certainly, certainly the key driver and the root cause I think is the word we have used is the underrecovery of net power costs. And the way I think about it and the way I think is good for all of us to think about it is the PNB standard really addresses symptoms, and it's appropriate to do that, because as we heard from other witnesses earlier, there's a lot of different diseases that could result in symptoms that should be addressed through that standard. In this case, the disease is underrecovery of power costs, and that's really, Mr. Van Cleve, how the case is constructed, how it's put together, and how the request of relief is justified.

Q. Could you please refer to Exhibit 73.

A. This would be the response to the ICNU Data Request 6.1-I?

Q. Correct, this is a response that you prepared?

A. Was that a question?

Q. Did you prepare this response?

A. In all honesty, I'm not sure if it was prepared by me or under my supervision, but it would be our response, yes.

Q. Okay. And in response to sub part A, it looks like the company is agreeing that the interim rate relief be subject to refund; is that right?

A. Yes, as a matter of fact, through the true up provision that we had just discussed.

Q. And in sub part C, it asks what the methodology would be for the refund, and can you explain what you meant by your answer?

A. I will try it again, I thought I did, and I have to admit, Mr. Van Cleve, I'm not an accounting expert, I'm not a CPA, but I can give it my best shot certainly.

What we're proposing is, you know, consistent with the order for the first three months we would defer, we would collect dollars based on the requested

projected levels. We would then track the actual costs and defer the difference between actual costs and the cost presently embedded in existing rates, if you will, and track that going along and then collecting $130 Million.

At the end of the interim period, at the end of the October period, to the extent there was a balance in that account that was a receivable to the company, that would be collected going forward. To the extent power costs let's say were, net power costs, were lower, that money would then be refunded prospectively to customers. And I believe as Ms. Luscier described, our proposal is that we would accrue interest on the receivable or the payable as well. Because to the extent there is a receivable balance, that means that we financed that, and so really the interest just covers the interest expense.

Q. So that means that what you're trying to collect as interim rates is based solely on the company's power costs, correct?

A. Well, as I mentioned, certainly the underrecovery of power costs is the key driver or the disease that we're trying to cure, but by addressing the symptoms.

Q. But you're actually trying to track the power

costs to determine the amount that you recover, correct?

A. We had proposed that, that that's how it would work, because clearly the power cost is the root cause of the symptoms.

Q. And are you aware that in a typical interim rate case that refunds are based on the difference between the interim rates and the final rates adopted in the rate case?

A. I'm not aware of that at all. It seems like they would cover two different periods. An interim rate case covers a period between the time typically of filing and the time that the general rates go into effect. The general rates then start at that point in time going forward. It seems like what you described would be retroactive rate making.

Q. What is retroactive rate making?

A. It's when you set rates for a historic time period to be put in place during a historic time period is my understanding, and there's probably a legal definition that I can't give you, because I'm a lay person.

Q. So it's your understanding that in prior interim rate cases that refunds would be calculated by reference to some sort of deferral account?

A. You know, I did review, I believe, three or

four cases of prior interim relief in this state, and they all stated that rates were set to be set to recover -- to allow the company the ability to finance on reasonable terms. I don't remember in those cases if there were true up provisions or not. There very well may have been, and I'm sorry, Mr. Van Cleve, I don't have those to go through at this moment, but I can certainly give you the references to the causes, cause numbers, if you would like.

Q. Could you refer to page 2 of your rebuttal testimony, I believe it's Exhibit 25T.

A. It is, and I'm there.

Q. And if you refer to line 16, your statement regarding access to wholesale markets, are you relying on the testimony of Mr. William Gaines in drawing that conclusion, or do you have any personal knowledge about that issue?

A. This is the -- and I just want to make sure before answering we're referring to the same piece, it's at a bit of an angle here, Mr. Van Cleve, but I believe you're referring to the sentence that states, PSE's access to wholesale energy markets will become untenable.

Q. That's correct.

A. I am really referring to the testimony of

Mr. William Gaines as well as a response to Staff Data Request 291-I. I'm not sure if that's an exhibit. I would be happy to check from my exhibit list, but I believe mine is a partial list. Actually, I don't see it on here. I don't believe it's in the record.

Q. Were you involved in the letter of credit that was provided to Enron?

A. I personally was not, no.

Q. Do you know anything about that transaction?

A. I don't -- I don't about that. I know about the ability or lack thereof to get letters of credit. I can talk about that, but I don't know -- I have people in my staff who work directly with people in Mr. Gaines' area when companies request letters of credit, as has happened in the past.

Q. And has anyone in the last three months requested a letter of credit from Puget Sound Energy?

A. I don't know the answer to that. I believe the answer, I'm guessing the answer is yes, because I do know clearly Bank of America totally cut off the ability to do gas financials with us, and I would suspect that prior to doing so they would have requested a letter of credit. I would check that, and Bill Gaines certainly would better know the answer or someone in his staff.

MR. VAN CLEVE: That's all I have, Your

Honor.

JUDGE MOSS: Thank you, Mr. Van Cleve.

I think Mr. Kurtz has a few questions.

MR. KURTZ: Actually, a little bit more than a few, but.

JUDGE MOSS: Well, you're down for 10 minutes, are you estimating now that you will need more time than that?

MR. KURTZ: Yes.

JUDGE MOSS: How much?

MR. KURTZ: Probably 20.

JUDGE MOSS: Thank you.

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

BY MR. KURTZ:

Q. Mr. Gaines, I would like to ask you some questions that follow up on the dialogue you had with Mr. ffitch. It was a short dialogue, but it got to sort of the differing roles between the utility and the regulator. Do you remember when you stated that the Commission regulates rate of return, not dividends?

A. I do recall that discussion.

Q. And you went on to say that dividends are not in the rate making equation, and you gave the rate making equation as rate base times rate of return plus

operating expenses and taxes.

A. Yes.

Q. Is that right?

A. Yes.

Q. Also not in the rate making equation are things such as interest coverage ratios; is that true?

A. Well, not exactly, because the rate of return contains interest expense, and that's a component of the interest costs.

Q. Well, we will see in the rate of return testimony in the general case from the various experts how they calculate the reasonable return on equity, and there will be cap M models and DCF and interest coverage ratios. But once the Commission sets the reasonable rate of return on equity, it's up to the company to do with the money and manage it as a prudent business. It's not -- that's not the Commission's job after it determines what the return on equity should be, is it?

A. The company certainly -- the Commission certainly does not get into micromanaging a company. They simply set rates. I don't say that because it's a simple process, I mean from distinguishing whose responsibility it is.

Q. You also -- you brought up, I think, I think that the Hope standard, and I think you cited it for the

proposition that regulation should maintain the financial integrity of the regulated entity?

A. That's how it was used in my testimony.

Q. You would agree, would you not, that the Hope standard does not set forth the proposition that the rate payers are the guarantors of the utility or that the utility is guaranteed to earn any given rate of return?

MR. QUEHRN: Objection, Your Honor, he's being asked to give a legal opinion.

JUDGE MOSS: Well, the witness cited the opinion in support of his own testimony, so to the extent he can answer the question, I think he should.

A. I can attempt to, Your Honor. There's an aspect of it that I -- there's two cases that are usually used together, and as I sit here, I combine them in my mind, the Hope case and the Bluefield case, and they are both legal cases. And certainly I can't give legal opinions on those, but I believe that what those cases do or are used in the standards for is the process of setting rates that are to be fair, just, reasonable, and sufficient, sufficient to cover all costs.

BY MR. KURTZ:

Q. All prudently incurred costs, true?

A. Costs that are deemed to be imprudent are

typically disallowed.

Q. And rate making is not intended to guarantee a utility a given profit level or return, it's intended to give you the opportunity to earn that return; isn't that right?

A. It is provided, yes, that's correct, to give the company the opportunity to earn the allowed return in the ROE.

Q. Now the manner for setting rates, at least in all jurisdictions that is not deregulated, it is typically the general rate case process?

A. Well, certainly the way for setting general rates is a general rate case process. There's a lot of other ways of setting rates, for example, purchase gas adjustment mechanisms as this company has. A lot of other companies, in fact, I believe the majority of states have electric cost adjustment mechanisms as well.

Q. That's exactly true, and those recover cost, not the profit margin; isn't that right? Which is the reason --

A. Not always.

Q. Can I finish my question?

A. Sure.

Q. Typically -- well, your gas commodity, you don't earn a profit margin on the gas you buy and pass

through to your gas customers, do you?

A. Not currently, but for a while, Mr. Kurtz, we did have an incentive PGA where one third, roughly one third of the benefit to the extent we could purchase I believe below index went to shareholders and customers to have two thirds of that benefit.

Q. Okay, I don't want to divert us too far.

A. Okay.

Q. In general for base rates, the process for establishing the reasonable rate of return is the general rate making process?

A. Correct.

Q. Okay. And in Oregon, the suspension period to give the Commission time to review the general rate case is how much months?

A. In Oregon, I'm not sure, in Washington --

Q. Washington.

A. In Washington I believe it's a 30 day period that rates are suspended for 30 days, and within that period, the Commission typically sets -- can set them for hearing, and that would be a -- typically as much as a 10 month process, so we say effectively 11 months.

Q. That's typical across the country. When a utility goes to raise rates, they're almost automatically suspended for the maximum period of time,

the Commission holds a rate case, at the end of the suspension period, you get new rates?

A. Unfortunately, yes.

Q. And oftentimes if there's a rate reduction the suspension period will be waived. Are you familiar with that concept?

A. I'm not at all, I'm sorry.

Q. Now that 10 month suspension period sometimes is referred to as regulatory lag, because you come in and file for new rates and you won't get them for 11 months; is that right?

A. That's correct.

Q. And one way to cure traditionally, traditionally cure regulatory lag or at least address it is through the use of a future test year.

A. Well, one way is to have interim rate relief.

Q. Does the future test year concept, isn't that intended to provide some form of relief to the regulated company from regulatory lag?

A. I don't know the answer to that question. I'm not a rate making accountant.

Q. Well, if you use a future test year, you're projecting your costs, your costs, your revenues, your rate base going out into the future instead of using historic --

MR. QUEHRN: Objection, Your Honor, the witness has already said he's not familiar with the future test year concept.

JUDGE MOSS: Well, let's test that a little further.

Go ahead with your question, Mr. Kurtz.

BY MR. KURTZ:

Q. Do you understand the question as I have stated it?

A. Partially yes, I think. For example, we have a historic -- we have a future test year or we have a historic test year in this case and a historic rate base. I don't know when you move to a future test year what the rate base is, what the other costs are that you're allowing or disallowing. I'm just not familiar with them, sorry.

Q. In your general case, are you using a future test year?

A. I believe we're using a historic test year for the 12 months ended June 2001 with power costs that are projected through the rate year. This, I believe, is a historic test year state.

Q. Let me contrast the process for setting when a utility goes in to raise rates versus reducing rates, can Mr. ffitch file a complaint on behalf of the public

at large that your rates are too high; do you know the answer?

A. It sounds like it's a legal question. I'm just -- I believe that he could. I do not know.

Q. If somebody were to file such a complaint and allege that your rates are too high, would you agree as a policy matter to some form of symmetry where the new lower rates would go into effect automatically until the Commission would have time to fully review that?

A. I don't know the answer to what you're constructing.

Q. Well, I'm trying to contrast it to the interim process here where rates are going to go into effect you're proposing during the review process for the general case. Do you know if that's possible in Washington?

A. Actually, it is possible, it's been done in the past several times.

Q. What examples are those?

A. One of them is the WUTC versus Washington Water Power, Cause Number U-80-13. Another one is --

Q. And you're citing that case for the proposition that new lower rates went into effect before the end of the complaint process was over?

A. I'm citing them in my testimony from the

standpoint of that in the interim, the process for setting interim rates in this state is to allow for the company to finance on reasonable terms or allow access to financing on reasonable terms.

Q. No, I thought you were giving me examples of where complaints had been filed against utilities in this state and the new lower rates went into effect --

A. I'm sorry.

Q. -- before the end of the complaint process.

A. I'm not sure of when other people have initiated, I apologize, I misunderstood.

Q. Okay. Now here with the -- what the company is doing is you're asking for $170,727,000, which is the difference between the power costs from your 1992 electric case and your projected power costs through the end of October, WAG Exhibit 3, which has a new exhibit number, that's where you get the 170,727?

A. Well, the deferral to power costs I believe is $163 Million. What we're doing is requesting an amount of money that fits within the PNB standard to allow us to finance.

Q. And then you gross it up for the 9 1/2% non-federal income tax rate, and you get $170,000,727 on that exhibit?

A. When Mr. Gaines does his calculation and

grosses it up, he gets that calculation, yes.

Q. In your -- in your -- that's ten months worth of projected power costs grossed up for the utility use tax?

A. Revenue sensitive items.

Q. Revenue sensitive items, and you're proposing to recover that over the seven and a half month period March 15th through October 31 in your primary recommendation, your first recommendation?

A. I think the first recommendation actually had the deferral going for two or three months, two months I think it was.

Q. Now just as a matter of pure mathematics, that the ten month -- annualizing those ten months worth of costs, I get $204,872,000. Would you accept that?

A. I don't think that I would. I don't know how you annualized.

Q. Well, simply take 177.27 over 10 months, divide by 10, and then multiply over 12.

A. That would be an inappropriate calculation, because the power cost numbers in WAG, the exhibit there that has that, vary month by month, so you would have to look at the I guess preceding three months.

Q. Well, I'm not trying to -- I'm not trying for this simple mathematic calculation to project your net

power cost differential for an additional two months. I'm trying to annualize the ten months of actual data you have.

A. I wouldn't agree with annualizing it that way.

Q. Well, how would you annualize it?

A. Well, first of all, I wouldn't, because there's no reason to. I would probably, if you wanted to go back and look at the numbers, I believe you can find them on page 1 of Mr. Hawley's workpapers, which are in an exhibit here, they provided in response to Public Counsel Data Request 62, which is exhibit --

CHAIRWOMAN SHOWALTER: 32.

A. 32C, that's correct, thank you. And it shows there the underrecovery reaching back is a quarter of a billion dollars.

Q. That's not my question. You said you had a better way to annualize the ten months worth of cost recovery.

A. I said I --

Q. What is your way to annualize the 170.7?

A. Actually, Mr. Kurtz, I said that I wouldn't because there would be no reason to, but if you were going to look at a 12 month period, which is what you were trying to get to, I would look at the costs on that

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page, specifically lines, rows, excuse me, 3 through 14.

Q. What I'm asking you to do is you're asking for rate relief additional -- a rate increase of $170,727,000 to be recovered over a seven and a half month period which reflects 10 months of net power cost differential. Now if we wanted to put that 10 month cost number on a 12 month basis, it would be $204,872,000 just as a matter of mathematics.

A. I don't know what you're using that for, so I don't know. I would not do that. I don't know what you're doing.

Q. Well, let me ask you this question, Mr. Gaines. Would it be an improper use of the interim rate making process to use that process not to avoid a financial hardship, but to simply negate the rate case suspension period and to boost your earnings during the rate case suspension period?

MR. QUEHRN: Objection, Your Honor, again we're being asked to give legal opinion about what the appropriate use of the interim rate making process is, and that's not within the witness's expertise.

MR. KURTZ: If I could respond, I think this witness's entire rebuttal testimony is about what's appropriate for the interim rate making process.

JUDGE MOSS: The objection is overruled.

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Do you have the question in mind?

THE WITNESS: I do not.

Please restate the question, Mr. Kurtz.

BY MR. KURTZ:

Q.   Would it be an inappropriate use of the interim rate making process to use it not to negate, not to cure a financial hardship or calamity, but to simply negate the suspension period?

A.   Well, as I understand it, the standard used here is the PNB standard, which talks about the ability to finance on reasonable terms. So assuming we were going to keep with that standard, we would use that standard and put it in effect in setting rates. There's not an aspect that I have recalled of that standard that says boost earning. I don't know what you're getting to at that. It's to address the company's financial viability, as I understand it.

Q.   So you would agree then it would be inappropriate to use the interim rate process simply to ride out, to avoid, to negate the 11 month suspension period built in to the law, and it's only appropriate to use it to prevent undue financial hardship under the PNB standards to paraphrase?

A.   Those seem synonymous to me. They seem the same thing.

Q. Well, if that were true, every time a utility filed for a rate increase, they would be entitled to interim rate relief also, because they need more money, hence we need to put it in during the suspension period.

A. No, they wouldn't, because they, as I mentioned, they would have to do that with respect to the PNB standard.

Q. So you do agree that simply to use the interim rate relief process to negate the suspension period would be wrong, and it would only be proper to use the interim rate process to meet the PNB standards of financial hardship, to paraphrase those standards?

A. That's how it is applied. I don't know the contrast that you're making of negating the lag period. It seems like to the extent a utility has a hardship, an inability to finance on reasonable terms, during that stay out period or the lag period, that is an appropriate time to be filing for interim relief, especially in a situation like this when it's due to circumstances largely outside of the control of the utility.

Q. Let me refer to your direct and rebuttal testimony, if I could. First of all, your direct testimony on page 8. It's the portion which begins on line 12 and runs through line 16. Do you have that,

sir?

A. I'm sorry, what was the page reference again?

Q. Page 8 of the direct, lines 12 through 16.

A. This is that one where I'm having the wrong -- two different copies, so it's the one -- it's the part where it starts, per the chart above?

Q. Yes.

A. Okay, thank you.

Q. Okay. Here is the portion of your testimony where you calculate the return, the rate of return on the combined gas and electric rate base, but for the period ending October 2002 on a projected basis, and you project -- you project that the gas and electric combined rate of return will be 5.5%, 5.55% without any interim relief.

A. For the 12 months ended October, that's correct.

Q. 12 months end. And you contrast that to the 8.99% combined rate of return authorized in the gas and electric rate case?

A. The last time that the cases were allowed, sorry, the returns were set, yes.

Q. And you repeat that, this point, four times, I take it, in your rebuttal testimony. This is sort of highlighted on your errata sheet, page 4, line 4, page

10, line 17, page 30, line 17, page 32, line 2, because you corrected that, that 5.55% number, in each of those places.

A. So it's consistent, that's right.

Q. So this is a theme that appears in your direct as well as four places in your rebuttal testimony; is that right?

A. Yes, it is.

Q. Now can you turn to page 30 of your rebuttal testimony.

A. I'm there.

Q. Okay. Line 16, you discuss this, in my direct testimony, you point out, without interim rate relief, the return, the rate of return on the gas and electric combined rate base will drop 5.55% below the 8.99%?

A. It is below that, it's not 5.55 below 8.99, the number would be 5.55.

Q. Yes, yes, if I misspoke. And then you compared this to the 1980 interim rate case, I take it did Puget get a interim rate relief in 1980?

A. Yes.

Q. Okay. You also got interim rate relief in 1973?

A. Yes.

Q. Okay. And you're asking for interim rate relief in 2002, so is this -- this is sort of a -- is this a trend, do you -- is this a historic practice to come in during the suspension period and seek interim rate relief?

A. No, actually we have had several general rate cases where we didn't do that. This is just citing other examples and what the shortfall was then compared to the shortfall now and pointing out that the shortfalls historically when we have had interim relief granted were substantially smaller with respect to the previously allowed returns than where they are in this proceeding.

Q. And I think you agree that it would be improper to use the interim process simply to avoid the suspension period, and apparently you -- so these two prior times -- let me strike that question.

Let me -- let's -- I would like to go to the workpapers that go behind this calculation, and there are a number of places in the record.

A. 32C I think has the workpapers.

Q. Well, I've got it in Exhibit 424 also.

A. All right.

Q. 71C, but maybe 424 since this one is not confidential, page 11, of Exhibit 424.

JUDGE MOSS: I do have it marked with a C designation, Mr. Kurtz.

MR. KURTZ: Okay.

JUDGE MOSS: I realize it's not all on colored paper, but portions of it are, and that's how we flag our confidential exhibits. Have we waived confidentiality on this whole exhibit?

MR. QUEHRN: Actually, Your Honor, I don't believe this portion of the workpapers were marked confidential at least for mine, so there's no --

JUDGE MOSS: There are portions that are and portions that aren't. I think it would be better -- are yours also segregated by colored paper?

MR. KURTZ: Yes, page 11 is the only page I will refer to.

JUDGE MOSS: All right, well, that's not confidential, so you may refer to it freely.

MR. KURTZ: Okay.

BY MR. KURTZ:

Q. And I would like to use -- if you have page 11 of Exhibit 424 as well as page 8 of your direct testimony, that will be the two things to look at.

A. All right, I have both in front of me.

Q. Okay. I think these exhibits track.

A. Track in the sense certainly that page 11 is

the source of the 5.55% we were discussing.

Q. Okay. Now let me see if I understand this exhibit. Column B is 12 months of operating income for the gas and electric company combined?

A. Yes.

Q. Is that right?

A. Yes.

Q. Column C is the rate base for the month stated for the gas and electric company combined?

A. It really starts with an average or monthly averages as rate base is typically calculated, but that would be what it was as of that month or projected to be as of that month.

Q. One thing I noticed about this rate base calculation is it stays fairly constant. September of '01 it's $3.650 Billion, and October of '02, $3.673 Billion. Is that accurate; is that correct, am I understanding that right?

A. It is a relatively flat calculation, right. It grows it looks like by $23 Million or so over this period.

Q. On a rate base of $3.6 Billion, that's a pretty small percentage.

A. Pretty small percentage.

Q. Is this true for the gas and electric

portion, are they both fairly constant at that point in time, or stable?

A. You know, I don't know the answer to that, Mr. Kurtz. It depends on their growth rates and the cost of having that growth. Because typically the adder, of course, is the additions to plant, and the deduct is to depreciation. I'm just not sure where those two are.

Q. Okay. Now the other column D, the rate of return, is simply the operating income, which is your after tax income, correct?

A. Yeah.

Q. Times the rate base?

A. Divided by the rate base in this case.

Q. Yes, divided by the rate base, and so that gives you the rate of return on rate base. And for October of '02, you project that it will fall all the way to 5.55% for the gas and electric company combined?

A. Yes.

Q. Okay. Now your -- the last authorized rate of return in your last -- in the combined cases were 8.99%?

A. Correct.

Q. And Mr. ffitch and Mr. Hill have this new exhibit they have that gets into this same topic?

A. It attempts to, yes.

Q. Records Requisition 15.

Now what you then calculate is the shortfall or the amount that you project your rate of return will be below the authorized return, 3.44% multiplied by the rate base, and you calculate a net operating income shortfall of $126,407,000 for the gas and electric company combined?

A. That's correct, as of the October period, yeah.

Q. Okay. Now if you earned $126,407,000 of net operating income, you would be exactly at your authorized rate of return of 8.99%?

A. Yes.

Q. Did you calculate the revenue requirements required to bring -- I got divide by the -- divide by the revenue conversion factors in .62, we get a revenue requirements of $203,882,000 to yield this level of earnings?

A. Right.

Q. Okay. Now if you got this -- so $203,882,000 to get your earnings up to the 8.99% authorized in the last rate case. Are we there so far?

A. I'm sorry, no, would you repeat the question?

Q. Grossing up the --

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A. I got that part. The $203.8 Million.

Q. Okay. Now from Records Requisition Exhibit 15 we learn that -- well, let me just back up. The 8.99% was from the last rate case, which included we learned last night a 45% equity balance for the electric company. I think Ms. Luscier testified to that.

A. I believe it's the weighted combination of the electric at 45% and the gas, which was at 44%.

Q. Okay. Now the current equity proportion for electric is 29.79 or as of, what is it, November of '01?

A. That was the date of this sheet for -- there's a little bit of an apples to oranges here, because this is for Puget Sound Energy, so it includes those non-regulated subsidiaries we were discussing.

Q. So if you earned, under this exhibit, Records Requisition 15, if you earned 8.99%, Public Counsel calculated that the return on equity at the current equity capitalization percent of 30% would be 12.76%.

A. That's what their mathematics shows. It's a different calculation.

Q. Because it includes these unregulated companies?

A. Well, beyond that, it's not a 12 month ended or average of the monthly average calculation as rate base is supposed to be. It's taking costs from a future

test period and applying them to a point in time capitalization. It says that you're able to earn 8.99, yet it doesn't flow that earning down to retained earnings, growing the denominator of the calculation and reducing the effective ROE. There's a tax piece missing. There's a bunch of things like that that are inappropriate to it.

Q. Well, I just want to back up a little bit, because I want to continue with this exhibit. But I have from Exhibit 70C, which I guess is confidential, the -- oh, that's combined also. I think we're going to have the same unregulated problem. Let's go back to the workpapers supporting your testimony. If you got $204,800,000 in additional revenues --

A. 204 or 203 did you say?

Q. Oh, excuse me, 203,882.

A. Thank you.

Q. For the 12 months period ended October '02, you would be completely at the last authorized rate of return for both the gas company and the electric company before the suspension period was over and right when the new rate case was started?

A. Presuming all the projections came out in actual as they're projected to be, that would be the result.

Q. Well, these are your projections.

A. Right.

Q. And you based your rate increase on these projections; is that true?

A. Well, we said it would be subject to a true up so -- and we've done really two calculations, Mr. Kurtz. One is to true up to the extent it's related -- there's a deferral part related to power costs true up with respect to that so that we would not overearn on that at all, we would pass through exact cost, and it's also put in, as I mentioned, something that we believe is the sleeves off our vest, an ROR cap just in case the parties are nervous that we should overearn. So I think there's two protection mechanisms built in for customers here.

Q. Well, just as an aside, I thought the sleeves off your vest was not -- because you don't think it's much of a protection.

A. Well, it's a protection, I just don't think it's going to happen.

Q. So if you got additional revenue for the gas and electric company of $203,800,000 by October '02, you would be earning exactly the rate of return authorized in your last rate case. That's what this exhibit shows;

is that right?

A. Yeah.

Q. Okay. Now you're asking for $170,727,000 to be collected over 7 1/2 months for the 10 month power costs that we have talked about at length, right?

A. Yes.

Q. Okay.

A. It is the collection of the amount needed to keep financially viable.

Q. Now I know you didn't agree with my annualization number because you probably anticipated where I was going. If you annualize the 170, that comes out surprisingly enough to $204 Million, which is almost exactly the $203 Million you need to be completely financially whole earning your exact authorized rate of return.

A. Of course, I will only get to the extent it's granted $170 Million, and part of that will be a collection of a deferral, so it won't be treated as earnings, so I will earn the allowed rate of return as shown on the last page of the table that we were looking at earlier in my testimony, or shown in this workpaper as well, which is well below the allowed rate of return. If you're proposing that I collect 203, I would be happy with that.

Q. Are you proposing to use this interim rate

making process as a way to get to your authorized rate of return as a method to negate the suspension period?

A. No, as I mentioned, what we were doing was requesting an amount of money to solve the undue financial hardship, and as the third item of the PNB standard states:

The mere failure of a utility's currently realized rate of return to equal the rate of return previously authorized to the utility by this commission as adequate is not sufficient standing alone to justify a grant of interim relief.

It's only one of six standards.

Q. Now this workpaper is the gas and electric company combined. That's correct, isn't it?

A. Yes, it is.

CHAIRWOMAN SHOWALTER: I just want to make sure, is this something we don't have, or are you looking at an exhibit?

MR. KURTZ: No, this is the same exhibit, page 11 of Exhibit --

A. 424C.

CHAIRWOMAN SHOWALTER: I'm sorry.

BY MR. KURTZ:

Q. This is for the gas and electric company combined?
A. Yes, it is.
Q. Now the rate increase you're proposing here only goes on the electric customers?
A. Yes, it does.
Q. Okay. Now where would we be able to calculate the rate of return just on your electric rate base? What we would need is we would need the 12 months operating income, electric only, 2002 October, and the electric rate base?
A. Yeah.
Q. Do you have those numbers?
A. I do not.
Q. Okay. Now there's a lot of evidence in this record. Surely the electric operating income and the electric rate basis is somewhere in this record, or am I mistaken?
A. It really isn't. This isn't a rate of return type case. This is an interim proceeding. The test is not rate based return, it's ability to finance on reasonable terms with respect to the PNB standard. The company's operated as a combined gas and electric basis, and so we have in this case the only rate base

information is that contained in this exhibit. I

believe it appears on a couple of other pages, but this is the only place I believe you will find it. As I mentioned, there has been 600 data requests, I don't believe there's been any -- certainly I have not seen any, Mr. Kurtz, that have that separation.

Q. Well, there is at least one exhibit that has the electric rate base. That would be Exhibit 207, the Heidell electric cost of service study, and that would be Exhibit JAH-2. This is the summary sheet of the cost of service result. It's the first spreadsheet after the written testimony.

A. Mine has written page numbers, Mr. Kurtz, is it --

Q. It's the first spreadsheet after the testimony. It's the summary of the cost of service results. It's labeled JA-2.

A. I see it. Mine has a page number of 45, page 1 of 29 at the bottom.

Q. Yes, that's it. Now this is as of June 30, 2001, but this has an electric rate base of, 2,662,676,446. That's investment and plant, line 23?

A. I see that, yes.

Q. Now I know you testified you don't know if the electric and gas rate bases are both stable, but on a combined basis, they're surely stable if this is the

only electric base number in the record. Do you have one that would go to October 2002?

A. I'm sorry, I don't. This is the only -- I didn't even -- wasn't even aware we had this one. In fact, this is actually it looks like general rate case testimony that was just incorporated in this exhibit.

Q. In any event, the electric, the gas rate base is approximately $1 Billion?

A. Roughly, sure, for the sake of argument.

Q. Now -- and, of course, if you're -- when you have a lower rate base, if you multiply earnings by a lower rate base, you get a higher rate of return. Multiply the same operating income by a smaller rate base, you get a higher rate of return?

A. You would.

Q. Okay. So to calculate this on an electric only basis to see the impacts of your $170 Million rate increase just on the electric, I think we have kind of one piece of the puzzle, the electric rate base, and you say you don't have the operating income on an electric only?

A. I don't.

Q. Now you surely keep your books that way, you have a FERC Form 1 which is electric only, Form 2 gas only, so you certainly keep your books separate?

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A. We disaggregate the books to complete those FERC filings.

Q. Is this a number the -- could you break out this 12 month operating income on your workpapers into the gas and electric components so that we could calculate the electric rate of return before and after your rate increase?

A. I don't know that sitting here. I would tell you that, you know, the ability to finance is not split between the two types of companies. The ability to finance is the company overall, and so you have to look at it as it's run on an aggregated basis. The test is on an aggregated basis.

MR. KURTZ: Your Honor, I guess if I could make this a records requisition to simply take the October 2002 net operating income on a gas and electric combined basis and simply show it on an electric separation and a gas separation, and, of course, the two should add up to $203,884,000.

JUDGE MOSS: Is that something the company could furnish by tomorrow?

THE WITNESS: As I mentioned, I'm not sure if we can do that, but we can certainly try and do that.

JUDGE MOSS: Of course, we may finish this afternoon, although I'm beginning to be less optimistic

about that, but we do have tomorrow reserved, so I will make that Records Requisition Number 16 and ask for that to be returned as soon as possible, or if there's going to be a delay, let us know.

MR. QUEHRN: Yes, Your Honor, we will do it as quickly as we can, and as soon as we have a reliable turn around time on that, we will advise the Bench.

BY MR. KURTZ:

Q. I just have one more sort of area of questions, and that deals with I mean there's a number of ways to calculate how much rate relief the company should get. You have said the net power cost method $170,727,000. Staff did the Exhibit 414C sources and uses calculation. Mr. Hill did the two times interest coverage ratio and came up with $31 Million. You're familiar with all of these different concepts, right?

A. I'm familiar with the calculations. As we mentioned, they only do bits and pieces of the full standard.

Q. Now would it be appropriate for the Commission to consider something akin to a cost benefit analysis?

A. No, we have been through that before, and the flaw of that is, first of all, you could never get interim relief on that basis. But the big flaw is that,

one, doesn't fit with the PNB standard at all, two, it presumes an ability to repay the principal. I mean it presumes that you go out and borrow this capital somewhere to get the interest that you would incur in absence of relief and then that you have the ability to repay that capital. And in the inability to finance cases, you wouldn't have that. You can't make that assumption.

Q. Tell me what your definition of a cost benefit determination is.

A. Well, you ran me through the examples that other people provided, and my understanding of their calculations, because I wouldn't do one, I don't think it's appropriate to do one, is you compare the amount of rate relief being requested or the 107,727 as we have been discussing, with the amount of interest that you would pay or customers would pay if the company had borrowed $170,000,727. And unless you have an interest rate that's exceedingly high, probably 100%, the interest rate would never -- the interest would never come up to the rate relief, so it's sort of a contrived calculation.

Q. Let me define a different way of looking at cost benefit. You're asking the rate payers -- you're asking the rate payers to pay the company $170 Million

to preserve your financial integrity, and among other things, that would make it easier for the company to transact in the wholesale market without providing expensive letters of credit, it would prevent your bond ratings and borrowing costs from going up therefore making it more expensive to borrow, and a number of other things. But have you done a calculation that compares what the rate payers are buying for $170 Million, in other words, trying to quantify these negative aspects and seeing if they add up to $170 Million?

A. No, I have not.

Q. Just as an economic theory, wouldn't it only make sense to spend the $170 Million for the rate payers to spend it or the Commission to spend it for them really if the Commission were buying more than $170 Million worth of either benefits or avoided costs?

A. I don't see that anywhere in the PNB standard.

Q. Well, let me just ask it to you under the public interest standard of PNB, number 6, the catch all, not the catch all, but the public interest. Can you point anywhere -- you're asking the Commission to buy $170 Million worth of protection, but it's unclear how much -- what that's buying in dollars. Have you

tried to quantify these negative things that are going to happen?

A. They're not all quantifiable. They aren't at all. And what we're trying to do is collect an amount of money that enables us to finance on reasonable terms, avoid undue hardship, to be able to finance on reasonable terms, to be able to keep the utility healthy, all of which is in the public interest.

There's a misconception I think oftentimes in proceedings like this where people take the narrow definition of the public interest means low rates. That's not my understanding of the public interest. The public interest is balancing fair rates with the opportunity to earn a fair rate of return. I think that's -- if there's any public standard, that's what it is.

And when you look certainly at the bond ratings of the companies in this state that operate all under the same legal standard be they electric, investor owned, or publicly owned, there's a huge differential in ability to finance and in bond credit levels, and I think that's what we're tying to -- one part of this addresses certainly coverage ratios, bond rating, ability to finance on reasonable terms, as the cases that I have cited cover.

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Q. Now if we look at this, somebody earlier used it in the phrase insurance, if you're asking the Commission to spend -- to order rate payers to spend $170 Million on insurance which will then yield some benefits to the company's financial integrity, which do inure to the customers in part, and Staff thinks only $42 Million worth of financial cushion or insurance is the proper amount --

MR. QUEHRN: Objection, Your Honor, was it Mr. Gaines's testimony that spoke to insurance?

MR. KURTZ: No, it was probably the very first day. It might have been Ms. Steel. But no, you never -- I don't remember you using the word insurance. Well, let's just strike that portion of it.

BY MR. KURTZ:

Q. I wasn't referring to you, let's just think of it as insurance. You're asking -- you're asking for $170 Million to protect your financial integrity to prevent a number of bad things happening, yet you haven't been able to quantify monetarily that it's worth $170 Million.

A. Well, I think clearly having healthy utilities, which this does, solves the problem, stops the confiscation of equity. I think those are all things that are part of the public interest.

Q. Now you would certainly agree that a person, a consumer, a company could certainly buy too much insurance and it would not be cost effective, just as a general proposition?

A. I'm sure there's -- you could be overinsured and pay too much in premium, sure.

Q. Now --

A. I don't think of this as insurance in this case.

Q. An imperfect analogy.

MR. KURTZ: Sorry for the delay, I think I'm done.

JUDGE MOSS: It's all right, Mr. Kurtz, take your time.

MR. KURTZ: Thank you, Mr. Gaines.

THE WITNESS: Thank you.

JUDGE MOSS: All right, I believe that completes our list of those who had indicated they had cross-examination for Mr. Donald Gaines. That would bring us to the time for questions from the Bench. I wanted to ask if you wanted a brief recess.

I think we should take a recess then until approximately 5 after the hour, all right, 10 after the hour then.

(Recess taken.)

JUDGE MOSS: We have come to the point for questions from the Bench.

Chairwoman Showalter.

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. Maybe you could begin by turning to Exhibit 42, and my first questions really are not about the content of the exhibit. It's just a touchstone for my questions, and I want to know more about the rating agency process and the company's relationships with the rating agency. First of all, have you personally participated in discussions with either Moody's or Standard & Poor's?

A. I have been the company's primary contact with the agencies for over the last ten years.

Q. All right, that's good. There seem to be annual presentations in here; is that a custom?

A. Yes, the rating agencies have quite a bit of projected information that they like to receive from companies. The materials in this exhibit that you asked me to turn to are those projections. We do that in typically the April time frame for the full annual review. Clearly then they look at the actual results as they come out quarterly, and we talk with them always

two times during the year. Clearly we sit down and meet with them in their offices in the time periods that they go through these materials and then again in the fall, and then periodically throughout the year we have telephone conversations with them.

Q. So then for the April review, is one coming up?

A. Yes, there is.

Q. When you make those presentations, do you go back to New York?

A. Yes, we do.

Q. I'm going to speak of Moody's and Standard & Poor's collectively, and if there's a difference, just let me know.

A. Okay, sure.

Q. Typically how many people from the company would go back to make that kind of presentation?

A. It's usually either three or four. It's usually the CEO, the CFO, myself, and then our director of investor relations. And we time that -- the reason that there's as many people as there are is we typically since we're in New York, we time that with a presentation to equity analysts as well.

Q. So that would be you and Mr. Hawley?

A. And now Mr. Reynolds, yes.

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Q. And Mr. Reynolds. When you said CFO, I thought that was Mr. Hawley.

A. Yes, Mr. Reynolds, Mr. Hawley, myself, and then Ms. Williams, who is my director of investor relations.

Q. And for your annual meeting in April, over how many hours or days do you make your presentation?

A. Good question. It's we take this material, and we mail it out to them a week, two weeks in advance so they can really go through the details in advance of the meeting to sort of shorten up the meeting time. The meetings, they may have some clarifying questions in between receiving the information and when we meet, and then when we meet, it's typically an hour and a half to two and a half hour process.

Q. And who would be there on the part of say Moody's?

A. On the part of Moody's, do you want the type of individual or their names?

Q. The types.

A. Okay. It's the analyst who is assigned to following the company. Typically if the person is available, also the backup analyst. And then oftentimes other more senior people at the company, someone from the credit committee, someone from -- who may be the

managerial level over the analysts. Typically in Moody's, last time just, you know, trying to go by memory here, but it's three to five people. So in total, you may have a meeting of, you know, eight to ten people in total.

Q. On both sides?

A. Yes.

Q. Then is there any socializing that occurs; do you go out to lunch or dinner that night?

A. No, not there. We -- the time where we see them in the fall is at the Edison Electric Institute, the EEI financial conference. There's socializing there, but it tends to be more with investment bankers than rating agencies. Of course, you see them in the hall and you say hello.

Q. Then did you say that while you're back making your annual presentation to the ratings agencies you typically also meet with the investor analysts, do you do that with them as a group or with individual companies?

A. We have done it as both. Typically it's every other year we make a presentation to the what's called the splinter group of the New York Society of Security Analysts, and the splinter group are the analysts who are members of that society who

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specifically cover electric and gas utilities, so it's a subset of clearly the full group, if you would. That's every other year, and then most often we try and schedule one on one meetings with the buy side and sell side analysts, supply side, equity side analysts.

Q. Then you said you are the primary contact for the rating agencies. How often will you talk to people at either Moody's or Standard & Poor's, once a week or once a month?

A. It's probably -- it probably averages once a month I would guess, but it's bunched up. You may have three conversations in a week and then go two months without any. It just depends on the events going on, the issues, if they're planning a review of a certain aspect of the company maybe on liquidity or something like that, have a bunch of questions they want to ask you over the phone maybe about quarterly results, something like that.

Q. And then at the other end, on the Moody's end or the Standard & Poor's end, is there a primary person the analyst for your company?

A. Yes, there is.

Q. And why don't you tell me the names of the Moody's analyst and the Standard & Poor's.

A. The Moody's analyst is an individual named

Kevin Rose. You have probably seen his name on his
reports. He's been the primary analyst at Moody's for
many years now. On Standard & Poor's, the current
analyst is a woman named Kathy Mock I believe is her
name. She's just been following the company as the
primary analyst for about, oh, a month or so. Prior to
that, it was a man whose name as I sit here is escaping
me, and I can picture his face.

Q. Mr. Ferara?

A. Bill Ferara, thank you, yes. And then prior
to that it was -- and then Bill was the analyst there
for about two or three years. And then prior to that it
was a guy named Ray Leung who had covered us for maybe
four or five years. And prior to that Cheryl Richer,
who is now more of the policy pieces.

Q. All right. And then there's the formal April
meeting, the fall meeting that occurs in conjunction
with a big industry group meeting, and then there are
times when you actually face to face meet in between, or
generally it's just phone calls?

A. Generally it's just phone calls. I'm trying
-- actually, there was a -- I was trying to -- I was
going to say I don't recall another time of meeting them
other than those two instances, but I do know -- I

remember now that Kevin Rose and his backup analyst,

A.J. Sabatelle, came out and wanted to see one of our power plants, so I think we took them on a tour of Snoqualmie Falls.

Q. All right. Could you turn now to Exhibit 414C; that's Ms. Steel's exhibit.

A. I have it, thank you.

Q. All right. I just remembered I didn't want to leave Fitch out. Moody's, Standard & Poor's, do you also deal with the Fitch rating agency?

A. No, we don't. As a cost saving move when I first became the treasurer, we had -- it was before Fitch and Duff & Phelps merged, and I called up -- we had four agencies rating us. I called up every commercial banker and investment banker that we did business with at the time and asked them, why do I have, you know, as I'm new to this job, why do I have four rating agencies, do I need four, if I don't, how many do I need, and who should they be. And unanimously the response came back that you need at least two, they need to be Standard & Poor's and Moody's. It's sort of a first tier and then a second tier of agencies. So at that time, we discontinued being rated by Fitch and Duff & Phelps, and subsequently those two firms have merged, and so we only deal with Standard & Poor's and Moody's now.

Q. All right. I would like to know what your fees to them are. I don't know if that's confidential or not. If you can tell us now, please do, if not.

A. I would be happy to provide it as a Bench request. I can tell you roughly what I think they are. It depends on to some extent if you're doing financings, because sometimes they just have a coverage fee, which is approximately I think it's $50,000 a year, and I -- that's I'm guessing so -- but I think that's the neighborhood, and I would like to provide you the accurate number. Then again, like when we did the conservation financing, which is a fairly complex transaction, then you're asking them to rate that. They did a lot of work, and there's usually a separate fee for that. They do have, in the case of Standard & Poor's I know that they have a fee schedule that at one time I had a copy of. I don't recall seeing one for Moody's. I suspect they do. But these tend to be standard within an industry group.

Q. Also, do you know how many companies does a typical analyst in the electric industry have, so, for example, Mr. Rose, do you know if he follows 12 companies or 30 companies or 3 companies?

A. I don't. I would guess if I was guessing it's in the neighborhood of 8 to -- well, say 10 to 20 I

guess, that sort of a range, certainly more than 3 but not 50, you know.
Q. All right. I guess since I asked, why don't we make that a Bench Request to show us what the fees are, the fees to Moody's and Standard & Poor's, and I would like to know who it is from; is it from Puget Energy or Puget Sound Energy?
A. It would be from Puget Sound Energy, and just the time period, 2001 calendar year, say?
Q. That would be fine. I don't need to know special fees for special.
A. Just aggregate?
Q. Just the general range.
A. Oh, the sort of the standard review fee?
Q. Right.
A. Okay.
JUDGE MOSS: That will be 17B.
Q. All right, now I will wait until you're finished writing that.
A. Okay, thank you.
Q. Now looking at Exhibit 414, I understand that you and Ms. Steel have some differences as to what you would put down on this chart, but for purposes of this question, please assume that Ms. Steel is absolutely

correct in her calculations, and I will give you an

opportunity to explain why you disagree with some of that, but for right now I would just like you to assume that this 414C is the accurate report of the company as far as it goes in its scope. So, in fact, assume that Ms. Steel is with you in New York accompanying you to the rating agencies. First question is, is this portrayal of Puget Sound Energy significantly more positive than what the rating agencies have seen from the company?

A. When you say significantly more positive, you mean in terms of the financial result that they would be looking for, the coverage ratios, that sort of thing resulting --

Q. I guess I would say from what you have provided Moody's and Standard & Poor's, compared to what they -- compared to this document, would they have a different view of the company, and you can tell me whether that means Puget Energy or Puget Sound Energy, if they accepted this document versus what they have seen?

A. I think I -- there's just two questions, if I could.

Q. Okay.

A. If I were to take just this document, they wouldn't have enough information to make an assessment.

If you're saying -- if we put -- if we assumed that this was the amount of rate relief granted and then went through and put that into the book, included all the information that we would normally include, as in the exhibit that you had earlier referenced me to, the rating agency presentations, it would fall somewhere between those two.

We had given them, I believe, well, first of all, we gave them materials from this proceeding in, well, the whole financial committee, certain aspect of it in an 8-K, showed them results on some of the key measures that they look at, the quantitative ones, both with and without the full relief, you know, with and without 170, and this is 42, so it would proportionally be in between those numbers.

Q. And I think you may have answered the question, but supposing Ms. Steel had worked for Puget Sound Energy and you were asking us for $42 Million in interim rate relief and you had to -- and I'm sure you had conversations with the rating agencies, that is I assume you did, where you asked for the interim rate relief. It may -- supposing you had called them up and said, we just want you to know we're asking for $42 Million in interim rate relief, and here's why, and you laid out this analysis with all the workpapers behind

it. The question, I have two questions, and the first one is, would this presentation of the status, the financial status of the company, be more positive than what they have seen?

A. It would be far more negative.

Q. And why is that?

A. Well, it's -- that's why I say they have seen two things. They have seen with and without rate relief. It falls somewhere in between. They have seen all the ratios.

Q. Okay.

A. Maybe I don't understand the question.

Q. All right. Well, let's say compare it to a hypothetical conversation that you may or may not have had where you said, we're asking for $170 Million of rate relief, and here is why, and I presume the here is why would have been things like here are our power costs and here's our authorized rate of return, et cetera, et cetera. Compared to that scenario, wouldn't the -- wouldn't the scenario that Ms. Steel presents I mean be more positive in the sense that the company does not appear to be in as much distress from her analysis than from yours? That's all I'm asking is a comparison.

A. If we assume all the aspects of her

calculations are accurate and you flowed that through

all the schedules -- I'm struggling, because when you ask me is it more positive or less positive, as compared to what, and I'm assuming it's compared to what they have seen, and certainly the ratios aren't good compared to their standards. You know, in the case of Standard & Poor's, they have published benchmarks that you can compare coverage ratios against, and they would compare that against that and make their own independent assessment of whether or not from their view as what we presented them, how that fit within, in the case of Standard & Poor's, their quantitative criteria, they would make an assessment of the qualitative aspects of the company as well, and set that into there in the rating process.

Q.   I see where I may have confused you. Let's just take the amount of requested relief off the table. Suppose that you haven't told Moody's or Standard & Poor's yet what you're going to ask us for. You have simply gone because they have asked, and they said, well, how are you doing?

A.   Oh, okay, so maybe can we do it from the perspective of we're inside this rate stability period that we had a few years back and --

Q.   No, no, this is all these facts and figures today.

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A. Okay.

Q. Let's just say it's January, well, let's just say it's today.

A. Okay.

Q. You're back in New York, and the rating agencies are asking, how are you doing?

A. Yeah.

Q. And it seems to me that you have presented a picture on that question --

A. We presented --

Q. -- that's more negative than Ms. Steel would present. That she would say, well, they've kind of got enough to make ends meet, but not much more, and they're not prepared for contingencies, and so, you know, the company is coming in and asking for $42 Million. Whereas you would have said, well --

A. We're not doing too good.

Q. -- it's pretty bad.

A. It's pretty bad, we're not doing well, we're coming in and asking for $170 Million.

Q. All right, so just on that score, she would be presenting a more positive picture of the company's financial status than you would?

A. Where I'm getting really confused is the company has presented, you know, a with and without.

The company has a financial condition. Presenting $42 Million, presenting -- ignoring specific numbers, presenting an amount that results in worse coverage levels compared to another scenario would result in a worse condition.

Q. All right. Let's take two withouts, your presentation without that you have provided them.

A. I think I see where you're going.

Q. And her presentation without.

A. I'm sorry, I'm a little slow here.

Q. Which of those two withouts would be more positive for the company?

A. If you presumed her calculations were accurate --

Q. Yes.

A. -- and she has taken out some O&M and capital expenditures, and let's presume that there were no impacts on service quality, it's just the financial aspects, if you would, they would say, well, you have lower expenses given any level of rate relief, you have lower capital needs with respect to rate relief, so that would be viewed slightly more positive.

Q. All right. So she is there saying things aren't great, but they're not terrible, but I think $42

Million is needed. Now still on her scenario, on her

scenario, do you think $42 Million would satisfy Standard & Poor's and Moody's and say, I see, this ought to get you there?

A.   No, it would not.

Q.   And why not?

A.   Well, her analysis here covers -- it's trying to get into how much liquidity the company has. It's really limited to that. There's -- remember we had a, I don't know if it was a records requisition or a Bench request that said, can you take some of this proposal and compare it to some -- the other benchmarks that -- and the ratios that Standard & Poor's and Moody's look at, and I probably have forgotten the question now, but they would make their own assessment of that information.

Q.   The question was if she --

A.   I'm going to write it down.

Q.   The question was, accepting her analysis of the company's financial status and her recommendation of $42 Million, would Standard & Poor's and Moody's be satisfied? And if not, as you indicated, what would they be saying, you haven't provided for X, Y, Z, what would the X, Y, Z be?

A.   They would say that you haven't -- it's my personal view speaking for somebody else on this.

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Q. Yes, I'm asking you to -- yes.

A. They would look at that, and they would say, the coverages that you're projecting and as we look at them and calculate them do not meet the standard for the current rating. And they would say something like, we will review this with the credit committee. This is an analyst talking now because you're in the meeting. The analyst would say, my recommendation to the ratings committee will be to at least put the company on credit watch, if not downgrade all together. We will meet with the credit committee, tell you of our decision, how we get there, and then talk to you about when we plan to take the action.

Q. And so that they would be -- they would say, this isn't enough because you still haven't covered your financials?

A. You would be below the benchmark ranges for the current ratings class, yeah.

Q. All right. I recall in Ms. Steel's testimony somewhere her comment that even your requested amount would not cover that.

A. Yes, that's, in fact, in my calculation, my -- there's the four quantitative measures for which Standard & Poor's publishes a benchmark, and for the first one, funds from operations to total debt, with

rate relief, my number is 18.2%. The range for double B is 15% to 20%. My funds from operations to interest coverage is 3.3 times coverage. The range for a B, sorry, double B company is 2 to -- it's about the high end of that level, double B again. The pre-tax interest coverage, with full relief my number is 1.9 times coverage, the range for double B is 1.5 to 2.4.

Q. Are you reading from your testimony?

A. No, I -- well, these numbers are in my testimony. I pulled them together on a one page sheet. I can give you specific references.

Q. All right, let's keep going so it's all in one place.

A. They're all, just so you know, they're all in Mr. Hawley's workpapers, which, as I think Mr. Kurtz pointed out, is a couple of different exhibit numbers, 41C, if I remember right, 43 and 44, something like that, we'll get to it. The debt to capital ratio is 61.5%. The range for double B is 55 to 62 1/2. And the Commissioners as a Bench request asked for the comparison of how you do the two ratings methodologies. In my general rate case testimony, which I guess is not an exhibit in this case, is the one page sheet that has those ranges on it. If you wanted that so you could see, I would be happy to provide that.

Q. Well, just tell me, does the company's recommendation, do all of those numbers fall within a range, or do some of them fall outside of a range?

A. They all, without relief, they fall in the B range. With relief, they tend to fall in the double B range. The thing that had been holding our rating at the A minus level up until the recent downgrades was the qualitative aspects of the rating, their assessment of the economy, the company's management, the regulatory climate, and so forth.

Q. All right. So then what you're saying is either way, I think I heard you say, either way, these financial indicators are going to be below investment grade, or at least some of them will be?

A. Most all of them will be. What they will really be looking at is the qualitative aspect, because that's the thing that's really -- well, combined with not recovering the cost and therefore the quantitative, ratios dropping down, that's a big piece of their rating and their actions in the current proceedings.

Q. All right. But the qualitative aspect has a circular aspect to it, which is if they're looking at what we're going to do, well, if the only measure is what did the company ask for, what did they do, that's one thing if there's -- but we need something more

objective than that, and so if these financial indicators aren't really a pivotal issue, then here we are sitting saying, well, what is positive, what is negative, and what is justified.

A. Their analysis isn't based on what you get compared to what you ask for. I think it was in, and I don't recall if it was when you were on the conference call with the B of A people or the presentations of the regulatory research associated clients, but you made a statement to the effect of, and forgive me for paraphrasing you, but the rating agencies tend to look at the end result, we have a process that we work through. And that's a true statement.

They tend to say, okay, you got something, whatever the Commission orders. They look at that and say, was that set with an eye towards credit quality, was that set towards keeping a company financially healthy. And they do that by looking at numbers. They do that by comparison to others in the region. And that's, of course, just the one aspect.

I mean we're talking about one of the qualitative aspects, but it's not at all -- the company could have asked for say $500 Million and we would be totally asking for way too much, and they would think we were dumb and probably get marked down for bad

management, and it would be a big part that we didn't get, and what it would come down to is what did we earn, what's the result, what was the -- what did the order say, how was it written in terms of responsive to concerns over, you know, bond ratings and all of that.

Q. Okay. I did say I would give you a chance to disagree with 414, and I would like to begin with line 2.

A. Yes.

Q. Now this is Infrastrux, correct?

A. Yes, it is. Well --

Q. Can you first just tell me, what does Infrastrux do?

A. Yeah, I would be happy to. Starting with Puget Energy, a holding company has two subsidiaries, the regulated entity and Infrastrux. Infrastrux is a roll up strategy business. It was formed in May of 2000. It was formed with the initial equity deposits from Exhibit 81. There have been no additional equity investments in it at that time.

And what its business is is to acquire companies that do gas and electric construction and maintenance for other utilities. To some extent it has a limited amount of telecommunications business. It's similar, I don't know if you're familiar with this

company, there's a company called, and I will probably get the names mixed up, Quanta that acquires -- that owns Potelco and owns a whole bunch of operating companies. Infrastrux is a holding company. It has I believe eight operating companies now underneath it that it has acquired.

There was discussion of equity ratios. On day one it was 100% equity financed. It has a $150 Million line of credit that it uses to acquire additional businesses going forward. Those businesses provide a growth or are intended to provide a growth in excess of the growth that the utility provides. That retained earnings will come in and provide more equity to be able to finance, to pay the debt and be able to finance more acquisitions, and so their business plan is to do for other utilities the construction and operating, sorry, construction and maintenance services for other utilities as the utilities out source.

Q. Okay, my mind was distracted because I forgot to ask you one last question about Moody's.

A. Sure.

Q. So I apologize for jumping back to that.

A. No problem.

Q. I need to get this out of my head. Can you turn to Bench Request 1. This is the --

A.   Yes.

Q.   -- Moody's page 5 of 40.

A.   Okay.

Q.   And under cross-examination, you read this paragraph or the two paragraphs on this page.

A.   Yes.

Q.   And I thought -- I took this to be your grounds for saying that Moody's will downgrade if we do not grant relief in some measure.

A.   There's -- and I would -- I need to clarify. There's actually four grounds that I have in my testimony that -- four aspects that you would address that I addressed to make that statement. It's the quantitative measures, it's the qualitative measures, it's the liquidity aspects, which is one of the four that 414C is trying to get to, and then it's their actual statements. It's those things collectively that I based my assessment on.

I did a similar assessment in the earlier filing. Remember I said that if the company's request was denied, I thought that we would be placed on credit watch at a minimum if not downgraded all together. Both of those things happened based on similar review of information.

Q. Do you have any informal conversations with

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Moody's beyond what's in this piece of paper, and this possibly could be confidential, but do they call you up and say, hey, look you're in real trouble, and, you know, I'm just telling you now, if you don't get action, you're going to get downgraded, or are they very careful that this is the statement and the only statement?

A. They, as you have seen from the other report, they -- ratings are perspective, so they look at forecasted information. They also look at the historical numbers as well. They call us and ask questions about forecasts, how they change, you know. For example, the two year ago rating agency presentation, we showed them two scenarios, own or sell Colstrip. As we got close to that decision, they called and said, are there -- I see now that you have elected to continue owning that resource, are there material changes to that forecast. They asked those sorts of questions.

Q. But they don't predict informally to you?

A. You mean predict what an action would be?

Q. Mm-hm.

A. No, they do not at all.

Q. Okay. All right, I'm sorry for that, but let's go back to Infrastrux, and maybe we could turn to

Exhibit 81.

A. I have it.

Q. All right. I'm still confused about what was transferred from where to where. I see on this exhibit what looks like an acquisition in June of 2000 through the -- through October 2000. So who acquired what from whom?

A. Yeah, so you're just looking at the uses, you're not wanting to know the sources of the moneys and all that?

Q. Right now I just want to know where did Infrastrux come from and where was it transferred from and to whom?

A. Okay. Infrastrux, as I mentioned, was formed in May of 2000. And it was at that time we had yet to form the holding company Puget Energy. So it initially was a subsidiary of Puget Sound Energy much as Puget Western, the real estate subsidiary, is a subsidiary, unregulated subsidiary, of Puget Sound Energy. What happened there, and I would have to get this subject to check, I'm not sure if specifically if this money that went out to acquire Utilx in the firm example, if that went out to Infrastrux and Infrastrux sent it out or if we sent it out, Puget Sound Energy sent it out of its bank account to do the acquisition, but that's what it was used for was to acquire that business.

Q. All right. But it seems that Ms. Steel's essential dispute with you is that this was transferred from the utility to Puget Energy without a transfer of debt or debt ratio, that the company, that Infrastrux would have had at that time, so. And your answer seems to be, well, no, we used unregulated funds. And I --

A. And that is the principal difference. Her presumption, as I understand it, is that there was money in the utility that was then transferred over to do acquisition for or set up Infrastrux or whatever. And therefore because that was utility money, if you will, there should be some grab back of that equity. She said $25 Million in her recharacterization. She said maybe even the full $86 Million in the general rate case. She didn't provide a basis for her 25, that was a guesstimate I would call it.

What my exhibit is trying to show is that there were assets that date back actually to the Washington Energy holding company, assets that were acquired by Washington Energy selling stock, not moving that at all down into Washington Natural Gas, but putting it into a business that they set up to acquire exploration and production properties for gas back around the time of gas deregulation when a lot of LDCs were looking to get their own sources of supply. That

was an unregulated business separate from the utility. So sometime after that, and I don't know the dates, they sold or transferred that business to Cabot Oil and Gas and received in exchange for that investment common stock and preferred stock of those in Cabot Oil and Gas. So now you had this unregulated company that had common stock and preferred stock.

Q. Okay, but then her --

A. Then that money, we monetized the securities, kept that in a separate account so it wouldn't be at all tied into the utility, we could track dollars specifically not only on the books of account, but in a separate bank account to acquire these businesses. So this is the key difference is this money came from never anything related at all to a utility operation and has flowed through over time to another utility, non-utility aspect. And so this is where we disagree. There was no adjustment needed because there was never any debt acquired, never any debt put on the books. There was only equity that was from day one unregulated.

Q. So you're saying that the source was unregulated, the dollars were always tracked, and therefore it never really got into the regulated side, so it really never was -- had to -- was never pulled out of the regulated side?

A. And because of the holding company order that was granted, we are -- and the historical knowledge we know of when the gas business didn't track separately in the Commission's view appropriately the difference between regulated and unregulated business, we are very mindful of keeping separate in either/or the books of account or specific bank accounts the different moneys so that we never have this problem so that we can track and show the source of moneys.

And that is -- had we, you know, known that it wasn't a current maturities, it was this portion of reassigned debt equity, this would have been my exhibit to counter to rebut that point. I need to show clearly we are not at all taking money that ever had anything to do with the regulated business. There is no debt on the utility's books at all related to either the subsidiaries of Puget Sound Energy or Infrastrux, and I'm trying to make that clear.

And in this case, we assumed we would have difficulty convincing people of this, and so we actually set up a separate bank account at U.S. Bank separate from Bank of America where our core electric checking account is to track totally separate dollar for dollar. And you can see by the end there was $2 1/2 Million left over that we said, okay, we will give it up and put it

back to the utility. So if there's any adjustment that we were going to make to be truthfully honest, there should be $2 1/2 Million coming out of the utility and going to the non-regulated side, but that's not what we're proposing.

Q. Okay. Now I understand you have disagreements on lines 5 and 11 and maybe 7 as well, but I'm not going to ask about them either, because I might understand it or I might not understand it enough to ask a question, so.

A. They're in my exhibit anyway.

Q. All right. I think what I wanted -- well, let's see. I think what I would like to do now is just run straight through your testimony and ask a bunch of clarifying questions or other questions that are prompted by your testimony. And some of these are just trying to find out whether -- what the accurate information is as of today.

A. Is this the rebuttal testimony or the direct?

Q. No, I'm going to start with your direct testimony, so that's the Exhibit 21T.

A. Okay.

Q. And if you could turn to page 2.

A. All right.

Q. You use the term erosion of equity a lot, and

I understand that if your costs are more than you thought they would be, it's taken out of equity. But there can be erosion of equity from a fat account, or there can be erosion of equity from a thin account. And let me ask -- I'm not sure I can formulate a question. I guess one form of erosion of equity is your stock value; is that correct, or is that not a right way to put it?

A. I wouldn't put it that way, because what I was talking about here is, and there is an equips that said it well, when you buy pencils for ten cents and sell them for a nickle, you have this erosion. The stock value, and that's a book equity standpoint. As I understand when you say stock, I think of the value of the stock in the stock market, and so a price differential there, a price change, so they're different.

Q. And this may be my ignorance, because it seems like very often I think I understand equity and stock are sometimes used interchangeably, but that's not the sense in which you're using it here?

A. It's not the sense. Clearly what my testimony says here is I'm buying pencils for a dime and selling them for a nickle, and so I'm starting down this path of underrecovery. I also have in my testimony that

when you're not recovering, you're not going to have earnings at decent levels, the value of the stock goes down. I think I have a number of $300 Million or something later in my testimony that shows the erosion in the stock price that equity investors have experienced. And I have, I believe it's in my general rate case testimony, the impact on bond holders of the value of their bond investments dropping as a result of the downgrades as well.

Q. Okay. On line 10, you say:

> New equity will not be available to meet existing and increased needs for external capital.

You don't need to tell me what the increased needs are, but by increased, do you mean new unanticipated needs for capital or just what you're planning to do?

A. What we're planning to do.

Q. And that is an increase over some prior year?

A. When I say increased, it's the result of since we won't have the -- wouldn't have the internally generated funds as a source of financing, we have to -- we have an increased need now through the underrecovery of going to the capital markets to raise money, and those amounts are reflected in Mr. Hawley's workpapers

and projections.

Q. Okay. And this has probably been answered, but on lines 12 and 13, it says you will reach the two times coverage test by January 2002. Did that, in fact, happen?

A. I don't know that. I'm not sure if we have closed the books for January. I was looking for our financial reporting people. We can do the calculation if we have closed the books and provide those as a Bench request if you would like. I just don't know.

Q. Yes, I would like that, because it looks as if it either has or hasn't happened.

A. Right. You know, there's one other thing I should mention on that, because it came up, and what we're really talking about there is the ability to finance, and we had some earlier discussions today with respect to a registration statement. I wouldn't want anyone to think that just because you have a registration statement on file with the SEC that you're able to finance. I mean that's the difference is as much as you could register your car with the Department of Motor Vehicles to drive it, you may not have the money to put gas in it. It's that sort of a difference.

Q. Okay.

JUDGE MOSS: That will be Number 18.

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Q. All right, then you also make reference here and elsewhere to extractive rate, and I can't remember, but I think you said either 200 or 300 basis points would be extractive.

A. I think what we said was it's non-extractive if you would -- would be, you know, about 100 basis points over a comparable for the last time we did it, and that -- the 250 or 200 to 250 over was the extractive amount that we paid when we did the $40 Million, the last piece of that prior shelf.

Q. But on that question, all of these rates are below or either close to or below the authorized interest rate in your rates; is that correct?

A. That is correct, but that's not the proper comparison. The comparison is what am I -- what could I have gotten had I not had to pay a premium. So whereas we -- there was testimony earlier that we issued that 2 year bond at 6 1/4% and we compared that to a total embedded portfolio with a weighted coupon rate of 7.4%, which has a 13 1/2 year duration, so there's a big, you know, you pay more for farther you go in time, so there's a differences as well.

But the proper comparison is when I paid 350 over the treasury, had I not had this concern in the financial markets, what would I have paid. It would

have been substantially lower than 6 1/4, it would have been about 3 3/4.

Q. But isn't it the case that the rates that the rate payers are now paying assume a rate that you would now call extractive, and maybe you wish you didn't have to pay it, but --

A. No, I wouldn't --

Q. -- doesn't it include that?

A. I wouldn't -- no, because this is where we had testimony where Ms. Steel said a 10% rate is extractive. Well, in relation to what? If we're back in the early '80's where the cost of short-term debt is, you know, 20%, that's not particularly extractive. Extractive is there's a range, you know, the way securities are priced is you look at the risk free rate, which is the treasury rate for the duration or term that you're looking to do. So if I was looking to do a two year note, as I was in January, I would look at the two year treasury. And then there's a spread that you pay based on your credit rating, your credit quality over that treasury rate to sort of pick up the risk differential.

The extractive aspect -- and there's a range around that that you may -- all the companies that are A rated, for example, if they were to all issue the range

may deviate by 20 to 30 basis points for any point in time just because they all have their own unique aspects. When we talk about extractive, we're talking about relative to that normal range, anything substantially outside of that range above that is extractive. We're paying more than we should given our credit quality over the concerns specific to our company.

Q. But the word extractive aside, my question is --

A. Well, premium is the same thing.

Q. Well, the premium, but don't the current rates include an amount that assumes an interest rate up to that level?

A. Well --

Q. So you could call it it's extractive but it's "affordable" in the sense that your rates anticipate that amount?

A. Well, I think once you get outside the rate year, you have a tough time looking at the dollars and what costs they go for. As my testimony says, what's presently in rates is 7.91 on the electric side. What we expect those costs to be in the upcoming case is the 7.4. So there's a reduction there. Yet we have this erosion of equity, so, well, there's a big savings,

where does it go. Well, all of this comes into the complete financial picture of the company, which is picked up in a lot of the ratios that I used to compare to the PNB standard. So what I'm testifying to is, gee, you know, because of this problem that we have, I'm building in costs that customers will pay higher than what they need to be paying if we could address the problem in a timely manner. That's what the premium or whatever words you want to apply to it addresses.

Q. Okay. Could you turn to page 10?

A. Yes.

Q. This is as good a place as any to talk to -- to ask you for a comparison of the different recommendations, or I will call it contingent recommendations, of the different parties here. You have no relief, full relief, and revised relief, but in my mind anyway, I'm sticking in a few more columns there, which would be --

A. I'm sorry, you're in my rebuttal testimony?

Q. Yes.

A. Oh, I'm sorry.

Q. I'm sorry, that was my fault, Exhibit 25T.

A. Okay, and is that table 4?

Q. I'm looking at the bottom table, line 14.

A. Yeah, okay, table 4.

Q. All right. So you have no relief, and we could say that would be Public Counsel's position. And then in my mind, I am sticking in Staff relief of $42 Million, and, you know, $68 Million for what I will call a contingent relief. And then there I'm not sure full relief is really at issue anymore. I realize probably you've got this chart in your rebuttal later but -- oh, no, here it is, revised relief.

A. Revised relief.

Q. Right, revised. So you are making the case that only with the full amount of revised relief will you avoid I was about to say junk status, yeah, because triple B minus is --

A. The last notch of investment grade, yes.

Q. And I'm just wondering how you can -- how you're able to make that judgment. I mean obviously I think if we granted $160 Million instead of 170, I suspect that, you know, that would be tantamount in everyone's eyes to a full amount.

A. I suspect --

Q. But you go, you know, you go down the line, and why -- let's just take Mr. Schoenbeck's. I'm saying $68 Million, I Hope it was 68 and not 58, but.

MR. VAN CLEVE: I think it was 58.

Q. Okay, 58, make it 58, let's take that amount,

it could be on a theory that, yes, this was a deferred accounting mechanism, yes, it would continue, yes, the total amount would be the total amount of recovery of the deferred account throughout the interim period would be determined at the -- in the rate case, you know, but for now, $58 Million because a conservative estimate, i.e., Mr. Schoenbeck's, shows that probably that amount is justified. And in the meantime, our Staff has shown that this is ample for the emergency needs of the company. Now the question is, why wouldn't that be convincing to the rating agencies and to the company for that matter?

A. Well, because the ratios that would be resulting and the statements that have been made and the amount of liquidity that we would operate within simply don't meet the requirements to support the rating to enable us to finance. So just because somebody says, guess what, I have done these projections and I have determined that this number is enough, that would imply the agencies don't do their own assessment of the numbers.

They do what I would call a stress test. They make their own, calibrate, if you will, numbers we give them. We can't predict obviously a decision that a

Commission would make, so we give them with and without

scenarios. Two years ago we gave them own, sell Colstrip, and they can then do their own mathematics in between. And sometimes it's as easy as, well, if the Commission granted $85 Million, because that's halfway between zero and full, it's probably halfway the spread of the ratios between, and they can compare that to their benchmarks.

It's not at all I have said this is enough, so therefore it is, so therefore I'm good. It's whatever you say is fine, now that you have presented your numbers to me, I'm going to go through them and see whether or not I agree, and I'm going to come up with my own assessment as a rate agency.

Q.   But then we get back to this issue of the qualitative versus the quantitative, because on the numbers on the quantitative side, it seems that none of these is going to bring these financial indicators up. It seems to depend more on the qualitative judgment, not just the judgment of the rating agencies, but their judgment of our judgment and what our psychology is when we do this.

A.   What they will look at is your decision, and they will look at whether your decision enables the company to operate within -- or what they will do is they will say -- they will look at what level of

financial health does the decision result in. And they will make their own independent assessment of that, and they will set a rating or a ratings direction based on that.

It is, as their own documents describe, a combination of quantitative and qualitative assessments. And as their documents state, if you have strong qualitative aspects to your rating, you can be weaker on the quantitative side and visa versa. If you have weaker quantitative aspects, you need to be stronger, have better financials within the same -- to have the same rating, bond rating or credit rating.

And so there's -- and there's a bunch of things that are in my testimony that I have looked at, as I mentioned, the qualitative aspects, the quantitative aspects, the liquidity, ability to operate within our liquidity facility, the $375 Million, and then the statements of the agencies themselves. And it's those four items collectively that I have based my assessment on.

Q. Okay. Could you turn to page 18 of your rebuttal testimony.

A. Yes, I'm there.

Q. On lines 7 and 8, I just don't understand the sentence.

A. Okay.

Q. It says:

Increasing debt by increasing revenues will exacerbate the consequences of underrecovery.

Q. What does that mean? How do you increase debt by increasing revenues?

A. I think that is a typo.

Q. Okay, that's good.

A. I didn't catch that one, I'm sorry.

Q. What is it supposed to be?

A. Well, let me read it. What it's really trying to get at is increasing the debt, you know, by piling on more debt and without recovering your cost is going to continue to erode equity here.

Q. Does it mean increasing debt without increasing revenues?

A. Right.

Q. Okay.

A. Boy, that is a confusing one.

Q. Well, see, most people would recognize there was a typo and they would fix it, but I didn't know enough to fix it.

A. And I didn't recognize it, I apologize.

Q. All right. And then on lines 16 and 17, it

says:

Depriving the company needed revenues
thereby forcing the company to pursue
expensive short-term debt is not good
public policy.

Now what short-term debt would you be forced
to pursue?

A. Well, what I was really referring to there is
the fact that we have this credit facility, we are
projecting that we wouldn't be able to operate within
that, so while we had $40 Million left under that prior
shelf and while our ratio was -- enabled us to issue
bonds, we issued that, used the proceeds to pay down
short-term debt, so from a rating agency standpoint
there's no change in total debt, substituting two year
debt for overnight debt, if you will, and we had to pay,
you know, by not getting the revenues in the door to do
that, we had to pay 6 1/4 instead of 3 and a fraction.

Q. So back to that issue?

A. Yeah.

Q. All right. The next page, page 19, this gets
more to the theory of our interim case or the theories
maybe. But on lines 6 and 7, you say that:

What may or may not have caused

historical increases in debt is

irrelevant to the company's request for interim relief.

It seems to me you're asking us to simply look at the company today and where it stands in relation to the future, and I'm just wondering if that proves too much. Because supposing you were in terrible shape because somebody had recklessly gambled away $200 Million or more. Don't you agree that in order to understand where the company is today in its prospects for the future, we necessarily have to understand how you got here?

A.   I think it's important to look at that. I mean I think, you know, remember the standard, of course, is -- addresses symptoms, the PNB standards addresses symptoms, and as I mentioned earlier, the symptoms could be the result of many different diseases. And so I think -- and what we have tried to demonstrate, and I think we have resulted in confusing people, is the disease we have is the underrecovery of power costs.

So what I'm saying at this side of the line is regardless of where your capital structure is, how much debt or equity you have, if you're buying pencils for 10 cents and selling them for a nickle, you're going to erode your financial health from whatever the starting point is. The starting point in that sense is

irrelevant, that's why I use the word, to the erosion. It's just a matter of it's you're bleeding, and how long do you bleed before you bleed to death sort of a thing.

Q. Well, I mean medical, there's always an analogy in every case.

A. Well, I'm trying to put it, you know, I'm trying to make it understandable, it's financial.

Q. So I mean the period of time at this point is, you know, eight I think it was, I forget, was it eight months. I mean another analogy on the medical terms is somebody comes in, you seem sick, I think it's strep throat, I will give you some antibiotics, but we don't -- so this ought to do it, but I don't know.

A. Don't know whether it's viral or bacterial.

Q. But here's a lab test, when the lab tests come back, we'll figure it all out, we'll get you the right remedy. And then the analogy being, would be, an interim case can take the temperature, give the aspirin or the antibiotic, but the lab test is the full blown rate case, then we'll figure it all out. You are very confident that the reason is the power costs, and you believe you know where your starting point is. But it's not quite as clear to the other parties, especially where that starting point is.

A. The starting point is the financial condition

of the company. We structured our company to deal with power market conditions as they were and as we probably projected they would be. We didn't have credit facilities in place to deal with exorbitant increases in price and huge impacts on the company. No one foresaw that. We would have probably assumed that to pay that much for such a huge credit line would be imprudent or something could be made the case. No one predicted these power cost increases. So it's a matter of what's happening to you now, and surely the end result is the general rate case, and it's just a matter of can one finance on reasonable terms between now and then as that's the -- as I understand the --

Q. Okay.

A. -- the bases upon which prior Commission decisions have been set.

Q. But if you look at lines 14 and 15, you say:

It is incorrect to argue that had the company simply had more equity to erode, somehow interim relief would not be required.

But I pose the question, supposing you have a big fat bank account.

A. Well, that's --

Q. Doesn't the amount of equity you have have

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something to do with whether you are or aren't in emergency circumstances? That is, had you had this big fat account, I'm not saying you do, but had you had it and the very same erosion was occurring over the next eight months, it might not be a problem?

A. Well, it depends on the financing options available to you. Just because you have a bunch of equity doesn't mean you have cash in the bank obviously. I mean you could have 100% equity and it's just how you finance. All the assets are in plant rather than cash, so you still have all your expenses of maintaining that. As you don't recover your costs, as you start eroding this equity, you're going to come to a point, this is the death spiral I talked about, there comes to a point when the equity goes negative --

Q. Right.

A. -- and you're bankrupt.

Q. But doesn't that just prove the point that where your beginning point is is relevant?

A. It's you're bleeding to death and how long does it take you to die, going back to my --

Q. You could liken it to a very fat person going on a diet and losing, you know, 30 pounds versus a very skinny person losing 30 pounds and being deathly ill.

A. I don't think that's exactly where I'm going.

Q. All right.

A. But I could stand to lose a few pounds.

JUDGE MOSS: Mr. Gaines is relatively thin.

Q. All right, could you turn to page 20 of your rebuttal testimony.

A. Yes.

Q. You say at line 14:

> Cutting the dividend will further jeopardize the ability to issue equity.

And I think there's another place where you quote an old case. In fact, it's Exhibit 44, if you could just take a peek at it, but it's quoting a case of the Commission in which they said:

> Earnings would fall below the present levels of dividend of common stock and that the prospects are impaired if the dividend can not be earned from present rates.

My question is, doesn't it also matter where the dividend is? If your dividend is twice normal, continuing these terrible analogies, but isn't there some room to shrink the dividend without upsetting people too much because there's some cushion above normal?

A. Well, depends on what we're talking about

normal is. If normal is a dollar amount, a pay out ratio, a market to book ratio, or, I'm sorry, a dividend yield ratio. In this case --

Q. Let me ask, by any of those measures, are you at or below normal?

A. Well, yes and no. Someone's testimony said our dividend is too high, the dividend of course being $1.84. There are 16 utilities who have dividends greater than $1.84 per share. I think the one right above us if I remember right is Idaho Power. So in that sense, no.

Q. No what?

A. No, we're not outside the norm. In the sense of dividend yield, we are the highest dividend yielding stock at the present time, and that gets to a bit of a circular situation. Where in financial theory the value of the stock is typically the present value of expectations of future dividends. That's what the dividend growth model gets to. There is when you erode earnings, if people expect that to continue, the stock price is driven down, thus you have a high yield. And so people in proceedings have said, the earnings are down, let's -- or let's, as I would posit it, and other parties I'm sure wouldn't agree, we propose something less than what is needed, the earnings are therefore

down, therefore, oh, look at the dividend yield is too high, let's solve that problem by cutting the dividend.

Well, that's not the problem, you know, and so that's where I'm getting to. The problem where I'm getting here --

Q. That's because you say that the stock is too low, so the stock really isn't where it ought to be?

A. Yes.

Q. So the dividend, the yield is too high?

A. Yes.

Q. But where is -- isn't another measure of the stock the compared to book value?

A. Market to book value.

Q. And recently it seemed to be about 1.4, but do you know where it is yesterday or today?

A. Actually, the latest report that I saw, which I believe was AG Edwards, was either 1.4 to 1.6 range.

Q. Doesn't that indicate that the stock is not too low?

A. Well, you have to look at it with respect to everybody else, so what is everybody else's market to book, and how are you trading with respect to that. So it's not just one company in isolation. I don't think you can say because your stock is above or trading below book or above book that it's overvalued. I think you

have to look at, especially when you have a utility like ours that has or a company like ours that has a utility and another growth business, it's very, very difficult to separate the two aspects of the stock price.

Q. Okay.

A. So it's a relative -- it's a relative measure I guess is what I'm trying to get to. And on that measure, let me just do a quick calculation, if I may, on that measure, we're amongst the average, we're at 1.4 with a roughly $21 stock price and roughly $15 book value.

Q. You are among the what?

A. Among the average, 1.4 times.

Q. Just let me make sure I'm done here. I'm not quite done. Oh, I know, Exhibit 72. First you answered a question about the obligations of the two boards of Puget Energy and Puget Sound Energy and said that each board is responsible for its own -- for that company. Are there times when an action would be good for one company and bad for the other?

A. Certainly there are -- there are instances where that could be the case, sure.

Q. All right. And I'm just speaking abstractly.

A. Yeah, and I was answering to that.

Q. All right. If the board members of those two

companies are identical, then individually as well as collectively, how on earth does a board or both, each board, know what to do?

A. Well, of course, the board is elected by shareholders to be their representatives of overseeing the company since the true owners can't be managing the company, the nature of a corporation versus a sole proprietorship. So as I understand it, and we're getting into a bit of a legal area and I'm a lay person, but from my understanding, directors have a fiduciary responsibility to those who have elected them to look out for their interests.

And so there are times, I would imagine, and I have never been a board member of a corporation, where you're probably confronted with the situation that you have described where I have a fiduciary responsibility in this instance to this entity, I have a fiduciary responsibility in this instance to this entity, and sometimes they may work in tandem, and sometimes they may be opposed.

But if they are opposed or in any event, whether they're opposed or not, if the board does not act in a manner that is consistent with their fiduciary responsibility, they are subject to, I would imagine, shareholder lawsuits. Again, I'm not a legal person,

but so that's what governs their behavior as well as their own, you know, morals and ethics and so forth.

Q. But in the case of these two companies, Puget Energy answers to its shareholders, right?

A. Yes.

Q. Now the board of Puget Sound Energy answers to whom?

A. Its owner, Puget Energy.

Q. So doesn't that mean that Puget Sound Energy is going to do what's good for Puget Energy?

A. I don't necessarily think that that would always necessarily be the case. I think there could be lawsuits in that sense.

Q. All right. And then since we're on this page, I wanted to ask you about Mr. Hawley. Is he still the chief financial officer of both Puget Sound Energy and Puget Energy? Let me see if that was correct. He's the chief financial officer on this page of Puget Energy; is that correct?

A. I know he's the Vice President and Chief Financial Officer of Puget Sound Energy, and I believe, and I would be happy to have this subject to check, it looks like he is the same title at both.

Q. Okay.

A. Both places.

Q. And what is your relationship to him?

A. He is my boss.

Q. And you said he was out of the country?

A. That's correct.

Q. What is he doing out of the country?

A. I believe, I don't know for sure, but I believe that he had established or set up a trip to visit his son who is studying abroad, and he set that up when his son -- about the time he registered for that activity, which was quite a long time ago, and so he's -- that's why I say he's out of the country. That's my understanding.

Q. All right. You were asked a question about off system trading, and can you just define for me what off system means when you answered that question?

A. Well, if it's the one with the hypothetical that Mr. Kurtz was having me construct, it was what I interpreted that to mean was when we were trading in the wholesale power market.

Q. I think it was Mr. ffitch is my memory.

A. Okay. It would be the same answer. Bill Gaines can probably answer that better than I can.

Q. It leads to the question of, in my mind, of how much off system trading, if that's the right term, is appropriate. I think what I'm getting at, and you

tell me whether off system trading is the right term, is that it seems to me the utility needs to buy and sell enough power to serve its customers. It may well have a little extra, there may well be something around the margins, but that taking any kind of significant risk in trades that aren't necessary to achieve that obligation is probably unwise.

I don't know how much has been done here, and I don't know if that question got at this issue, but it's a question in my mind. It certainly could be, I think, that a lot of off system trading if it goes well and maybe it did go well for some period of time would end up benefiting the rate payers. But that's at a risk. If it doesn't work out, then the rate payers are asked to pick up that risk. We have had other companies get into that, and their reaction was, we better get out of that.

A. There's two, and again, Bill Gaines is the true expert, but there's -- I would like to give you my understanding and view on this. There's two types of companies with this regard. One is a trading company that looks for opportunistic activities within which to make money. Enron, for example, asset light trading, didn't have physicals to back up trades, huge trading entity, trading for the sake of picking up a margin

whether or not it was the result of, and in this case it wasn't, surplus energy. I view that as different from a company that has contractual or physical assets that produce power that has a load shape to it and has at times, you know, surplus and shortages of energy, be it gas or electricity.

One is purely in the business of trading. The other is trying to maximize the efficiency of its resource portfolio. So the one bets on prices to try and outsmart the market. The other simply uses hedges as a risk management tool to lock in price differentials as an insurance policy, I think. Those are dramatically different scenarios. We are the latter, Enron is the trading one, and that's about the extent of my knowledge of it.

Q. All right. Last question is on Exhibit 25, page 21.

A. 21 of 25?

Q. Mm-hm.

A. Being my testimony perhaps?

Q. I haven't got the right place. There is a place where you list a number of actions that other financial institutions have taken cutting back your credit. Do you know where that is?

A. I think it is 21 starting on line 17 or 18.

Q. Oh, I'm on the wrong page. Here we are, great. You have this list, and then on the next page, 22, line 7, you say:

And 7, as a result of the recent downgrades of the company's credit ratings, reputable firms --

A. Yes, this is referring back to selling the $40 Million.

Q. Okay. My question is the item 7 is as a result of recent downgrades. What about items 1 through 6, why have these things occurred as a result of these recent downgrades, are these recent, what's the time period here?

A. They're all recent with one exception. They're all as a result of underrecovery of power cost concerns. There is one aspect here that dates back earlier that was just confirmed again in the current time period. That would be item 3, First Union Bank and Fleet Bank, those two, and banks that are in a -- lend on an uncommitted basis come and go depending on their assessment of your credit volume. They went, if you will, originally around the time of the concern over recovery of the California receivables, early in 2001. I think the last lending was in 2000 or so.

We check with these folks periodically to see

if they will continue to lend. Shortly thereafter it was the concern over the FERC price caps. Now it's the concern over the existing underrecovery. So those folks are continuing not to lend. It's all -- even, you know, item 7 is a result of underrecovery. They're all related to that. They're all really last half of the year, mostly around probably close to fourth, beginning of fourth, end of third quarter, beginning of first quarter, that time frame, the October time frame.

Q. All right. Actually, I had one last question, which is really about the theory of the case. I've really been struggling with what the theory of this case is or what the different parties' theories are, and so far I have an analysis that runs like this. Staff and Public Counsel I think are looking at financial need. And Public Counsel's answer is there is no need. Staff's answer is there is a need for $42 Million. Mr. Schoenbeck is keying off the company's recommendation, but I think fundamentally he's looking at a deferred account that we did approve, but we didn't decide what to do with it.

A. Right.

Q. And he's not actually looking at the question of need, but he says, all right, if there's going to be a deferred account, if there's going to be recovery, I

can find my way to $58 Million, and let's postpone a full blown analysis until through the end of the rate case and then we will decide.

A. I think his --

Q. It -- sorry.

A. Go ahead.

Q. Well, then the company I think is fundamentally seeking action on a deferred accounting. And as a point of clarification, I do read the petition for interim relief as seeking extension of the deferred account through the interim period. And if you look at it that way, then you want, this is what I would call the ice storm theory, these big expenses that are beyond, outside your regular range, and you want recovery of them, and you really want recovery of them regardless, but you need it now, because at the same time, this is all producing a financial emergency. But simply getting some amount pending the rate case doesn't fully answer the question, because just as with an ice storm, if the costs are extraordinary, they ought to be recovered, and therefore the remedy that you're seeking extends beyond the interim period.

It would be if we followed Mr. Schoenbeck we would give $58 Million now but continue to ask the question and answer the question, how much of the

deferred account was justified and outside that range, and whatever it is, it gets piled on to the general rate case after that. And they really are -- they're different in that I think the impetus either way is financial need and maybe emergency need. But in one, we really answered the question, as soon as we figure out your need we're done, because you need it, whatever that is. That's the Staff and Public Counsel case. In the other, we haven't really answered the questions until we tell you, yes, you get to recover on your all of these months of deferred accounts, because A, they were prudently incurred, and B, they were truly extraordinary.

And I don't really know what my question is on that. It's just I'm just -- I think I'm just struggling with having a dual function here. Now I think that Staff may say the whole deferred accounting exercise, you shouldn't really even be thinking about it. You shouldn't have done it to begin with maybe.

A. I believe, and I would let the record speak for itself, but I believe Ms. Steel said that her number is a going forward number, and if I remember, this may have been her testimony rather than her cross, but that the amortization of the deferral, it should be amortized over the period in which it was accrued, which in other

words means you just expense it. And because there is no promise of relief as we do our internal accounting for January and February, we are expensing those costs, and then we're doing a little side account that says, okay, had we actually been deferring, it would be this amount.

And so when parties make proposals, and let's just pick a number that say somebody that had proposed $50 Million for a sake of argument, I believe the number if you went through the deferral period just through March was $89 Million. There's a difference in how it impacts the company as to whether that $50 Million is a collection of the deferral or you write off the deferral and you just get $50 Million going forward. That's an impact that has more to do with when you recognize earnings and so forth than, you know, obviously over the ten month period the impact would be the same in aggregate, but that's another sort of complicating factor.

So as we think about that, I think we have to address as we're contemplating proposals, is it what do we do with the deferral, as you mentioned, do we allow recovery of that, if it's $50 Million, is it $50 Million of deferral, is it $50 Million of other, is it half and half, is it, you know, that impacts the accounting for

it, so that is sort of a complicating factor to it.

CHAIRWOMAN SHOWALTER: All right, well, thank you, and thank you for allowing me all of this time.

JUDGE MOSS: All right, I'm going to preserve my perfect record for never predicting when a hearing was going to end. Given the late hour, it is a quarter to 5:00, and it is necessary that everyone clear their materials out of the room this evening in anticipation and preparation for our public comment hearing that will commence at 6:30 this evening in this same location, so I will have to ask you all to do that. And if you want to store your materials on site, I believe some rooms can be made available, and maybe you could talk to some of the Staff in the back, they could point you to those rooms.

We will reconvene, of course, at 6:30 for that public comment session, and then after that we will reconvene tomorrow morning at 9:30 to complete Mr. Gaines, Donald Gaines' examination, and also we have Mr. Swofford to go and whatever final business we have.

And so with that, is there anything else before we go off for the day?

MR. CEDARBAUM: Your Honor, I just have one question. Yesterday there was a Bench Request made of

Mr. William Gaines for information that he had learned

during yesterday afternoon's hearing session concerning access to power markets, and I was, I guess it's a question of the company, when can we expect to see that? It would be nice to see that before the record closes, the hearing closes so that we can take up any questions that might come up because of that.

JUDGE MOSS: That was some agreements or contracts that were going to be, is that what you're referring to?

MR. CEDARBAUM: I don't have my notes of what the Bench Request was exactly. When he was asked -- when he took the stand yesterday after we took an afternoon break, I don't know if he made some phone calls or talked to some people at the company, but he indicated that he would -- he had some information about this area that he was going to provide.

JUDGE MOSS: I think Ms. Dodge can help.

MS. DODGE: Your Honor, we have a number of -- there are a number of Records Requisitions and Bench Requests outstanding, and we have people at the company working on those today. We're making every effort to -- I think that a number of them we will be able to provide tomorrow. Some are going to come Fedex, and so it may be, of course, you know, that may be 10:00 a.m.

delivery, so we will have to juggle the logistics a

little bit, but we are trying to get as many of those as possible tomorrow. There is -- it's looking like it may take until Monday on a couple of them, but I guess I would suggest that we deal with where we are at the end of the testimony and hold the record open if we need to.

JUDGE MOSS: All right.

MS. DODGE: For anything like that.

JUDGE MOSS: Well, just get everything you can expedited, of course.

MR. KURTZ: Your Honor, along those lines, the one Records Requisition that I made earlier was simply to divide a gas and electric number into gas separate, electric separate. That surely is something that could be provided by tomorrow morning, I would hope.

THE WITNESS: Actually, it is not. I don't think that it is. I guess I will let the attorneys speak.

MS. DODGE: Actually, that is a significant concern, and I will address it now, although I think people are trying to gather just a little bit more information, but the difficulty is that the question came up with respect to, you know, well, doesn't the company issue -- have these FERC 1 and FERC 2 reports that are electric versus gas, so wouldn't it be a simple

matter to just provide that breakdown for the projection in October 2002. And.

The problem is that the FERC reports are based on historicals, and what you do is you have gas expenses, electric expenses, and common, and then you can go through and divide out. Once you see what the expenses actually were, you make your allocations based on allocation factors.

The problem is that the forward projection to October 2002 is a financial model that does not -- it's a consolidated company, they're not projecting finances based on electric versus gas. And so I mean first of all, they don't have the information. And second of all, you could go through and there are certain things that you could maybe say, okay, well, that's gas and that's electric, but there's a whole lot of common, and there's a whole lot of assumptions made and a whole lot of detail. It could take actually weeks to go through and produce that.

JUDGE MOSS: Mr. Kurtz, would an approximation based on the last time they broke it out for the FERC Form 1 and FERC Form 2 purposes and those factors applied to the current numbers be suitable to your purposes, or did you need something more precise?

MR. KURTZ: Well, I guess the only thing I

would say is that the allocation factors and the breakout, those used in the currently pending general rate case would be I think appropriate.

JUDGE MOSS: All right.

MS. DODGE: Well, it's done on a test year. I mean that's historical.

JUDGE MOSS: Historical, yeah, we don't use a future test year, we use a historic test year, as you probably learned today. That should be close.

MS. DODGE: The problem is that --

JUDGE MOSS: And, of course, that would have been -- it would be pro forma results in the general rate case as well, which would be forward looking.

MR. KURTZ: Well, my purpose for asking the question was to simply try to calculate what the rate of return would be on the electric assuming they got a $170 Million rate increase. It doesn't look like I will be able to get that information any time soon.

JUDGE MOSS: Well, we're trying.

MR. KURTZ: Yeah, I understand that, and certainly the Commission has to issue a ruling very quickly, so we will take the company at their word that they will get it as quickly as possible.

MS. DODGE: And again, that's why we do have people trying to figure out how you might do this or

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approximate it or -- so maybe we'll have something better tomorrow.

JUDGE MOSS: All right, then maybe you can give us your best whatever you can do on a short turn around basis tomorrow, and then explain further how it might have to be more -- take longer to do something more precise. And we will see, Mr. Kurtz, see how close we can get.

MR. KURTZ: Thank you, Your Honor.

JUDGE MOSS: Okay.

Anything else?

All right, thanks very much, we will see you either tonight or at 9:30 tomorrow morning depending on your intentions to participate.

(Hearing adjourned at 4:50 p.m.)