

EXHIBIT NO. \_\_\_ (KRK-1T)  
DOCKET NO. UG-040640, *et al.* (consolidated)  
2004 PSE GENERAL RATE CASE  
WITNESS: KARL R. KARZMAR

BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,  
  
Complainant,  
  
v.  
  
PUGET SOUND ENERGY, INC.,  
  
Respondent.

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

In the Matter of the Petition of  
  
PUGET SOUND ENERGY, INC.  
  
For an Order Regarding the Accounting  
Treatment for Certain Costs of the Company's  
Power Cost Only Rate Filing.

Docket No. UE-031471 (*consolidated*)

In the Matter of the Petition of  
  
PUGET SOUND ENERGY, INC.  
  
For an Accounting Order Authorizing  
Deferral and Recovery of the Investment  
and Costs Related to the White River  
Hydroelectric Project.

Docket No. UE-032043 (*consolidated*)

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

NOVEMBER 3, 2004

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**PUGET SOUND ENERGY, INC.**

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**PREFILED REBUTTAL TESTIMONY OF KARL R. KARZMAR**

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**PUGET SOUND ENERGY, INC.**

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**PREFILED REBUTTAL TESTIMONY OF KARL R. KARZMAR**

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**I. INTRODUCTION**

4

**Q. Please state your name, business address, and present position with Puget Sound Energy.**

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6

A. My name is Karl R. Karzmar. I am the Director of Regulatory Relations at Puget Sound Energy. My business address is 10885 N.E. Fourth Street, Bellevue, Washington, 98009.

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**Q. Would you please provide a brief description of your educational and business experience?**

10

11

A. Exhibit No. \_\_\_(KRK-2) describes my educational and professional experience.

12

**Q. What topics are you covering in your testimony?**

13

A. I will present rebuttal testimony on the treatment proposed for the gas water heater and conversion burner rental program by Commission Staff witness Michael P. Parvinen and Public Counsel witness Jim Lazar, and the associated adjustment proposed by Mr. Parvinen in Staff's direct case in this proceeding.

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1                   **II.     GAS WATER HEATER AND CONVERSION BURNER**

2                                   **RENTAL PROGRAM COSTS SHOULD NOT BE**

3   **EXCLUDED FROM THIS CASE**

4   **Q.     Do you agree with Adjustment 2.17 made by Mr. Parvinen in this case?**

5   A.     No. I disagree with Mr. Parvinen's adjustment. It incorrectly characterizes the  
6           terms of the settlement agreement related to water heater and conversion burner  
7           rentals that the Commission approved in Docket Numbers UE-011570/UG-  
8           011571 ("Settlement Agreement"), PSE's last general rate case prior to this  
9           proceeding.

10 **Q.     Are you familiar with the Settlement Agreement?**

11 A.     Yes, I was one of the principal participants engaged in developing the settlement  
12           terms for the natural gas elements of Docket Numbers UE-011570/UG-011571.

13 **Q.     How did the water heater and conversion burner rental program become an**  
14 **issue in UE-011570/UG-011571?**

15 A.     The Company filed a new depreciation study as a part of that case which showed  
16           that water heater and conversion burner rental equipment had been significantly  
17           under depreciated for a number of years. The Company should have been  
18           recovering more through depreciation from historical rental customers than it had  
19           been. Consequently, the Company was proposing new and significantly higher  
20           rental depreciation rates. Because of this and the resulting rate spread and rate

1 design implemented to begin recovering the new rates, a higher burden was  
2 proposed to be placed on both rental and non-rental customers than before. Since  
3 it would not be appropriate to put the entire burden of rental depreciation issues  
4 related to prior years on current rental customers, the Company was proposing to  
5 allocate only a portion of the increase caused by the under depreciation to current  
6 rental customers with the rest going to general ratepayers.

7 **Q. How did this impact the Settlement Agreement relevant to water heater and**  
8 **conversion burner rentals?**

9 A. In order to ensure that the rental program did not impose an even greater burden  
10 on other customers before the impact of the new depreciation rates had time to  
11 reduce that likelihood, the parties agreed to two principals to settle this issue.  
12 First, the Company agreed that it would not request an increase in the revenue  
13 requirement associated with the gas rental business until September 1, 2005.  
14 Second, in order to make sure rental retirements would not reduce the amount of  
15 depreciation being charged to expense, the Company agreed to hold depreciation  
16 expense at a minimum of test year plant levels utilizing the new depreciation rates  
17 until September 1, 2005. These two principals are characterized in paragraphs  
18 numbered 5 and 6 in the Settlement Agreement.

19 Paragraph No. 5 in the Settlement Agreement addresses the first principal and  
20 reads as follows:

21 5. The Executing Parties agree that the Company shall not request an  
22 increase in the revenue requirement associated with the Gas Water Heater

1 and Conversion Burner Rental Program until at least September 1, 2005.  
2 In the event that the Company requests general rate relief prior to this date,  
3 it shall compute the request for rate relief without inclusion of the  
4 revenues, operating expenses, or rate base related to rentals.

5 The first sentence, and what was agreed to in principal, means that the Company  
6 will not seek recovery in rates -- before September 1, 2005 -- of any additional  
7 costs for the rental program beyond those built into rates based on the test year for  
8 the UE-011571/UG-011570 case. The second sentence enforces the restriction of  
9 the first sentence by requiring removal of the gas water heater program costs,  
10 expenses and revenues from a general rate case if the Company violates the  
11 agreement by requesting an increase in revenue requirement for the rental  
12 program.

13 The second principal is addressed in Paragraph No. 6 in the Settlement Agreement  
14 and reads as follows:

15 6. Depreciation: Depreciation rates incorporated for natural gas plant in  
16 service are adjusted and accepted in accordance with the depreciation study  
17 provided by the Company in its original filing in this proceeding, Exhibit  
18 No. \_\_\_\_ (JB-1T) (Julius Breitling), which was entered into the record as  
19 Exhibit No. 527 during the hearing on the Electric and Common  
20 Settlement. Depreciation expense for rentals shall continue at an annual  
21 rate of not less than \$8,284,422 until September 1, 2005.

22 This paragraph reflects the agreement to adopt the new depreciation rates and  
23 establishes the minimum depreciation expense for rentals until September 1, 2005.

24 These provisions of the Settlement Agreement were further described in the Joint  
25 Testimony Re: Natural Gas Rate Spread and Rate Design Settlement, Docket

1 Nos. UE-011570/UG011571 at 6-7 (excerpts provided as Exhibit  
2 No. \_\_\_(KRK-3).

3 **Q. Is there any dispute in this case over the Company's implementation of**  
4 **Paragraph No. 6 of the Settlement Agreement?**

5 A. No. There is no dispute as to paragraph No. 6 in the Settlement Agreement. The  
6 Company evaluates rental depreciation monthly to ensure that the minimum annual  
7 depreciation of \$8,284,422 is recorded.

8 **Q. Turning to Paragraph No. 5 of the Settlement Agreement, has the Company**  
9 **requested in this case an increase in the revenue requirement associated with**  
10 **its gas water heater rental program?**

11 A. No. This can be shown by comparing the revenues, operating expenses and rate  
12 base related to rentals in the current test year to those in the test year for Docket  
13 Nos. UE-011571/UG-011570.

14 **Q. Has the Company made this comparison?**

15 A. Yes. Attached as Exhibit No. \_\_\_(KRK-4) is the Company's response to WUTC  
16 Staff Data Request No. 193 in this proceeding. The referenced schedule in this  
17 response is an analysis that shows this comparison. The first column in this exhibit  
18 shows the revenues, operating expenses and rate base related to rentals in the test  
19 year ended June 30, 2001 from Docket Nos. UE-011570/UG-011571. The second  
20 column shows the comparable amounts in the test year ending September 30, 2003

1 for this rate case. As can be seen in this column, the Revenue Requirement of  
2 \$13,463,801, shown on Line No. 15, has declined \$974,831 from the \$14,438,632  
3 shown on Line No. 15 in the test year for the prior rate case. Accordingly, the  
4 Company has not requested an increase in its revenue requirement associated with  
5 this program.

6 **Q. What about the second sentence in Paragraph No. 5 of the Settlement**  
7 **Agreement?**

8 A. Since the Company did not violate the restriction against requesting an increase in  
9 revenue requirement associated with the rental program, the penalty of removing  
10 the program from the case does not apply.

11 **Q. How do you respond to the testimony by Mr. Parvinen and Mr. Lazar on the**  
12 **gas water heater rental program?**

13 A. Mr. Parvinen's interpretation of the Settlement Agreement is incorrect and out of  
14 context. He cites only the second sentence of Paragraph No. 5 of the Settlement  
15 Agreement and has completely ignored the first sentence. See Exhibit  
16 No. \_\_\_(MPP-1T) at 16. Mr. Lazar does not cite the language of the Settlement  
17 Agreement at all, and merely claims that the Company agreed it would remove  
18 rental rate base and expense from future rate case filings. See Exhibit No. \_\_\_(JL-  
19 1T) at 38.

20 **Q. Was Mr. Parvinen a participant in the discussions leading to the Settlement**  
21 **Agreement for water heaters?**



1 A. No.

2 **Q. Was Mr. Lazar a participant in those discussion?**

3 A. Yes, he was. In fact, he required insertion of the second sentence of Paragraph  
4 No. 5 as the final revision to the Settlement Agreement prior to execution.

5 **Q. Did Mr. Lazar indicate at the time that he interpreted Paragraph No. 5 of**  
6 **the Settlement Agreement in the manner he advocates in this case?**

7 A. No, he did not. The Company did not agree in any section of its settlement of the  
8 last general rate case to any stay out period with respect to potential future rate  
9 relief. It would have been entirely counter to that position to have accepted a  
10 provision that required an automatic \$5.3 million disallowance based on removal  
11 of the rental program if the Company needed to come in for rate relief prior to  
12 September 1, 2005 because of earnings deficiencies caused by factors wholly  
13 unrelated to the gas rental program.

14 **Q. Is the Company's proposal in this case with respect to rentals consistent with**  
15 **the spirit of the Settlement Agreement in other respects?**

16 A. Yes. The Company's proposal is to move rentals closer to parity and raise rental  
17 rates by \$2,410,258. This would reduce the amount being recovered in general  
18 rates even further from its current levels. This proposed treatment is consistent  
19 with and further addresses the fundamental purpose of Paragraph No. 5, which is  
20 that general ratepayers should not have any greater burden placed on them by the

1 gas rental program due to the historical depreciation issue.

2 **Q. Are there other reasons why PSE's treatment of the rental program should**  
3 **be approved?**

4 A. Yes. PSE's proposed treatment should also be approved because it is fair and  
5 reasonable. The simple facts are that the Company under recovered rental  
6 depreciation expense for a protracted period of time and it is only reasonable that  
7 the Company be allowed recovery of these costs now. It is the nature of  
8 depreciation rates that they are never perfect and may require adjustment over  
9 time.

10 The elimination of the water heater and conversion burner rental program  
11 investment and expenses is arbitrary and harmful to the Company's financial  
12 condition. The logic of removing an element of the Company's ratebase and  
13 associated expenses because the Company needs rate relief for other cost pressures  
14 is without any regulatory foundation or precedent. It would set poor precedent as  
15 a policy matter and impose further financial drag on PSE to suddenly and  
16 temporarily disallow recovery of costs related to a program that has been in  
17 existence and included in PSE's rates for over forty years.

18 **Q. Does that conclude your testimony?**

19 A. Yes, it does.

20 [BA043050.014 / 07771-0089]