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1 P R O C E E D I N G S

2 JUDGE MOSS: Good morning, everyone.

3 Mr. Gaines, welcome back.

4 THE WITNESS: Thank you.

5 JUDGE MOSS: We will resume your
6 cross-examination this morning, and, of course, you do
7 remain under oath. I believe we were in the midst of
8 questions from the Bench. And, Chairwoman Showalter, I
9 believe you had completed your questions, initial
10 questions, and that we were to you, Commissioner
11 Hemstad.

12

13 Whereupon,

14 DONALD E. GAINES,
15 having been previously duly sworn, was called as a
16 witness herein and was examined and testified as
17 follows:

18 E X A M I N A T I O N

19 BY COMMISSIONER HEMSTAD:

20 Q. Good morning, Mr. Gaines.

21 A. Good morning, Commissioner.

22 Q. First, just a couple of questions from your
23 answers to questions from others. I take it from your
24 response to the questions from Mr. ffitch that it's your
25 view that the dividend policy of the company is entirely

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1 a matter for the board of directors and what, that it is
2 not a matter of any interest to the Commission?

3 A. I wouldn't say that it's not a matter of
4 interest of the Commission. I think it -- I think
5 setting the dividend policy or determining that and
6 declaring dividends is the responsibility of the board.
7 Clearly I would think the commissioners and the
8 Commission itself would be interested in that, but what
9 I was trying to point out is that it's not part of the
10 rate setting process.

11 Q. Well, just as a pure hypothetical, assuming a
12 company earning its authorized rate of return, rates of
13 return, has a dividend policy whereby very large amounts
14 of cash of the company are distributed via dividends
15 well above that level or well above the earning of the
16 company and that goes on for some years, wouldn't that
17 have the result of substantially weakening the company's
18 ability to respond to either emergency environments, or
19 it would then have the result of increasing the debt
20 ratio in relationship to equity?

21 A. Yes, clearly if a company paid out a dividend
22 in excess of its earnings for many years, as you
23 posited, it would weaken the equity ratio, and therefore
24 it would erode equity, and that would be a situation
25 that would be of consider -- something that I would

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1 think would be of concern to the Commission, and they
2 would have to look at it. If they viewed that as
3 imprudent, then I would think that in setting rates,
4 they would look at the capital structure and try and
5 determine an appropriate one.

6 What I was trying to get at is in the
7 instance where, and jumping ahead to a general rate
8 proceeding where the Commission authorizes a rate of
9 return, you know, that rate of return and, excuse me,
10 specifically the return on equity components of the rate
11 of return, how -- my point was how that gets carved up
12 between what's retained and what's paid out to
13 shareholders is the dividend policy of the board. Now
14 if a board was paying out a dividend well in excess of
15 that, it would in essence be putting out money well in
16 excess of its ROE, I think that would be of concern.

17 But my point is there's no case law that I'm
18 aware of in the state where the Commission has
19 authorized or ordered anything related to the dividend.
20 We asked that of other witnesses. No one could provide
21 anything historic, history in this state. When we asked
22 the question, we were -- the response we got from Staff
23 was that we misunderstood their proposal, it wasn't that
24 they were proposing a dividend cut, they were making
25 their rate relief suggestion contingent upon the company

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1 accepting to reduce its dividend. I think they even
2 recognized that it's outside the purview of the
3 commissioners themselves to determine the carve up
4 between the retention and the payout.

5 Q. I want to turn to a matter that perhaps has
6 been belabored a bit, and again, that's the company's
7 theory for its case.

8 A. Yeah.

9 Q. And I understand that has been explored now
10 already considerably. First, it's the company's
11 position that it needs a rate increase, it has a need
12 for a rate increase in order to have the ability to
13 finance, so in other words, they need more cash?

14 A. Well, I wasn't sure if you were not through
15 with your question, I don't -- I didn't mean to cut you
16 off, but if you're not, then it's more than cash. You
17 have to look at the or I believe in looking at the PNB
18 standard, it covers more than just cash. It covers more
19 than just the ability to issue first mortgage bonds.
20 Staff's analysis is a simplistic cash flow analysis
21 addressing that one item. Public Counsel's, Mr. Hill's
22 exhibit, is one that addresses first mortgage bond
23 coverage or attempts to, so it's limited to that aspect.

24 But to look at the whole financial health of
25 the company, the company needs both earnings and cash,

1 as those two things impact credit worthiness from a bond
2 rating, credit rating perspective. It also impacts the
3 ability to finance, because the earnings impact the
4 first mortgage bond ratio, the ratio that has to be two
5 times whether the bonds are electric or gas being
6 issued. And certainly it needs the cash, because if you
7 run out of money, you're -- you don't get to spend
8 earnings, you spend cash.

9 So it's really -- it's really both that are
10 needed, and that's some of the limitations I think that
11 we have seen today, that my testimony tries to get at
12 both the measures, and the PNB standards address both.

13 Q. All right. And the company's remedy for that
14 is to seek recovery of, your phrase, the power costs,
15 current power costs under recovery?

16 A. What we did is we looked at the parameters
17 that we have in this proceeding. We saw those
18 declining, and as we looked out over time, we saw them
19 continuing to decline. And so we looked at the root
20 cause of that problem, and we found that the root cause
21 was the amount that we were paying for power on a net
22 power cost basis was less than the sum of the moneys we
23 were collecting from wholesale sales and from retail
24 customers, and that is the driver of the need for the
25 relief being requested in this proceeding.

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1 So that then became, you know, I think if we
2 just said we need X, whatever X may be, I think the
3 first question certainly that I would have were I
4 sitting in one of the other chairs would be, well, but
5 what is the cause of the need for X, is it something
6 that was outside your control, is it something that was
7 inside your control, and that's sort of why we
8 approached it the way that we did.

9 Q. Are you familiar with the merger order?

10 A. Somewhat, yes, I mean I have -- it's been a
11 while, I was here before and after the merger, but yeah,
12 in general terms, certainly.

13 Q. I assume you are aware that the issue of the
14 escalating power costs were one of the issues that were
15 -- that was addressed in that proceeding?

16 A. Very much so.

17 Q. And as I recall, there were two explicitly
18 identified remedies for it. One was the annual rate
19 increase that was built into the system for residential
20 customers. I believe it was 1 1/2% a year for four
21 years.

22 A. That's correct.

23 Q. And that was explicitly tied, was it not, to
24 the issue of the escalating power costs?

25 A. That agreement was a stipulation, and I -- my

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1 recollection of hearing the negotiations, which I didn't
2 participate in, was that that was the main driver of
3 those increases. I do know that the intent was to
4 separate so that they would cover all costs and the
5 increases granted in that order and through the
6 stipulation. Remember there was a drop, a reduction in
7 rates reflecting the discontinuation of the PRAM and
8 then these periodic increases, as you mentioned.

9 Q. That's right.

10 A. And then those increases were smaller in
11 percent than the increases in the PURPA contracts that
12 we had at the time. And so we as a company agreed to
13 live with that. I mean so the customers were getting
14 their, in my view, customers were getting their share of
15 any merger benefits, because the company would have to
16 get enough not only to make up the difference between
17 the escalation in power costs and the rate increases,
18 but then also produce enough to generate the level of
19 earnings that the board had contemplated when the merger
20 -- when they signed the merger agreement. In fact, the
21 order, as I recall, I don't recall the exact words, but
22 I believe the Commission at that time encouraged the
23 company to vigorously go after those savings, because it
24 recognized the need for that.

25 Q. And there was a second point, the opportunity

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1 for merger savings was identified again as a way for the
2 company to manage its power costs?

3 A. Yes.

4 Q. And it's clear that there have been now, when
5 I say clear, at least the company is asserting that
6 there have been substantial merger savings; isn't that
7 true?

8 A. That is true.

9 Q. I believe in Mr. Weaver's testimony, he cites
10 the figure of \$156 Million in merger savings over a
11 three year period.

12 A. And I don't know the number specifically, but
13 I do know that it's addressed fairly fully by
14 Mr. Sherman's testimony in the general rate proceeding.

15 Q. And substantially greater savings were
16 projected over a ten year period?

17 A. The way that I recall those projections being
18 made and the merger savings were prepared with -- by the
19 company and with help from a consulting company were
20 that you take a savings, and then with inflation it
21 grows out over time, and they projected that over a ten
22 year period. And that merger period, as we call it, the
23 period of rate stability, stable rates of increase as we
24 think of it, covered the period of I think '97 through
25 2001.

1 And it is one of the reasons, there was a
2 question asked earlier, why now when you filed in
3 December, why now are you only requesting for the
4 recovery of these costs from January on. And that was
5 in our own thinking the thought was we filed in essence
6 the first day of December. We could have requested
7 December, but we thought, no, let's just start with the
8 conclusion of the rate stability period, not trying to
9 reach back into that period, although in our view
10 certainly the extraordinary power costs, extraordinary
11 conditions that caused the run up in net power costs,
12 were ones that in our view did allow for the filing of
13 an interim relief under the conditions of the merger.
14 We elected not to reach back.

15 Q. All right. When you said the extraordinary
16 conditions that caused the run up in power costs, to
17 what are you now referring?

18 A. Well, Mr. Gaines is probably the best, my
19 brother Mr. Gaines, is probably the best person to ask
20 that, but I can tell you my understanding of it, because
21 our situation is different than most of the surrounding
22 utilities. In our case, the volatility and the impacts
23 that started hitting us happened in I believe his
24 testimony says it's sort of in the time period of late
25 spring, early summer, and it's when prices in the

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1 wholesale market dropped, and so the margins from the
2 wholesale sales were no longer sufficient.

3 Q. But now that's where I'm having some real
4 trouble. The underlying PURPA contracts with their
5 escalating costs were a clearly known fact. None of
6 that was a surprise.

7 A. Absolutely not.

8 Q. The merger agreement builds in at least for
9 residential customers a 1 1/2% increase per year for
10 four years and also identifies the merger savings as a
11 way to manage those costs.

12 A. Yes, during the five year period.

13 Q. Mr. Weaver testifies that there has been \$156
14 Million in merger savings.

15 A. In the five year period.

16 Q. That's right, well, over a three year period.

17 A. Okay.

18 Q. But your case is built on the underrecovery
19 of the power costs in the PURPA contracts, but you don't
20 net out either the 1 1/2% increase per year or the
21 merger savings. Now why not?

22 A. Well, I think we do net out those impacts,
23 and I will explain to you why I believe that. Clearly
24 there have been savings inside the company. There's the
25 savings that I think of that Mr. Swofford and Mr. Weaver

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1 and Mr. Sherman testified to that are merger related.
2 There are also savings with respect and we have had a
3 lot of questions about the reduction in the equity
4 ratio. The company restructured two of its PURPA
5 contracts, its two largest PURPA contracts, Tenaska and
6 Encogen. To do that, there were up front buyout
7 payments made that were funded with debt, and that added
8 debt to the books, effectively reducing the equity
9 component by percentage, not necessarily by dollar
10 amount. And that reduced the cost of those contracts.
11 Also included in those calculations is a reliance upon
12 selling any surplus that we have to the extent our firm
13 load is less than the total.

14 Q. But that wasn't contemplated in the merger
15 settlement, was it?

16 A. Yes, it was, the merger settlement for the
17 board to agree to and for the officers of the company
18 looked at all of the costs.

19 Q. I understand, but at the time, power costs
20 were low, not high, and isn't it your point that the
21 company was able to make profits when the wholesale
22 prices were high?

23 A. Right.

24 Q. But they weren't high at the time the merger
25 settlement was entered into.

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1 A. Well, the company's load resource balance was
2 different then than it is today as well. And you asked
3 me, how is it that we addressed that in this case, how
4 did the savings get taken into consideration, how did
5 the rate increases get taken into consideration, and
6 this is why in my analysis we don't, you know, the test
7 as to whether or not our request is meeting the PNB
8 standard, you don't see anywhere in that test anything
9 related to power costs. It's measures of financial
10 health that address the overall impact of the company
11 where all costs and all savings would be netted
12 together, things like the rate of return, things like
13 the first mortgage bond coverage, pre-tax interest
14 coverage, the funds from operations.

15 Q. Well, is it your position that the \$170
16 Million represents a netting of all the pluses and
17 minuses in your books?

18 A. Our case is really split into two parts, if
19 you will. My brother and I, we joke about it as the
20 Gaines' boys case, because his part is what's the impact
21 of power costs, and then my part is let's take an amount
22 that is in essence an amount like that and determine the
23 impact.

24 CHAIRWOMAN SHOWALTER: What did you mean like
25 that?

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1 A. Well, \$170 Million.

2 CHAIRWOMAN SHOWALTER: Oh, okay.

3 A. And see would that amount fit within the PNB
4 standard, and it does when you look at all the measures.
5 And it's more than cash flow, it's a combination of cash
6 flow and earnings, and the ratios and statistics and
7 indicia that we used to compare against that standard
8 pick up everything. I mean when you think about the
9 rate of return, it really incorporates everything. Even
10 with the company's full request, we're earning less than
11 the allowed, last allowed return.

12 Q. Well, what I'm struggling with and trying to
13 get a handle on is the nexus between the company's
14 asserted need, and I emphasize need, and then
15 identifying the underrecovery of power costs as the
16 solution, and I don't get a nexus between those two.
17 For example, well, I have mentioned the merger savings,
18 that's a net benefit, very substantial. Rate increases,
19 not insignificant. Another one is I believe the
20 embedded debt of the company is I have a figure of 7.4%,
21 but you're currently financing at 6.25%. That's a
22 benefit, clearly so. Are all of those things taken into
23 account when you come up with a figure of \$170 Million?

24 A. They are when you look at the --

25 Q. Then is the \$170 Million a proxy, or is it

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1 just a pure coincidence?

2 A. I would look at it as two steps. One is of
3 an amount, say it's 170, how does that amount fit within
4 the PNB standard. In our case, 170 fits within the
5 definition of need under that criteria. And then when
6 you go and look at the root cause, you say, gee, you
7 know, there's a huge underrecovery of power costs. The
8 number reached back to the time period, as I mentioned,
9 sort of end of spring, early summer of last year is over
10 a quarter of a billion dollars. We're just looking at a
11 piece of that in this proceeding because it's only a
12 portion of the time period.

13 But when we look at the savings, we also have
14 to look at the other costs that went up as well beyond
15 net power costs, and these are included in there, and
16 along with our costs, they get netted out against these
17 measures. For example, we have put in place a network
18 inside our company, a computer network. We have put in
19 place a large PEM program that you heard a lot of
20 testimony on last night that whether people liked or
21 didn't like the rate increase, they seemed to like that
22 PEM program. That we have never come and asked for
23 money to pay for that program. That program is paid for
24 by netting out cost increases and savings of the
25 company.

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1 Q. But those are ongoing operational costs.

2 A. They are, and they erode -- they erode
3 earnings and they erode cash flow to the extent they
4 aren't covered.

5 Q. Now Chairwoman Showalter in her questioning
6 yesterday referenced, and I think it has come up
7 elsewhere, that analogizing or at least posing of this
8 situation of whether your circumstances are analogous to
9 an ice storm or a fire storm, but the underlying power
10 costs and your description of the PEM program, those
11 don't constitute fire storms, do you think, or ice
12 storms?

13 A. No, they don't, and it's where, while the
14 analogy in part is a good one, in another part it's not
15 a full correlation to the situation. Because in an ice
16 storm, you incur costs of putting back the system or
17 rebuilding after the fire. But in this case, we have an
18 ongoing continuing erosion that doesn't and hasn't
19 stopped.

20 Q. But I think isn't the difference the one is a
21 surprise, I mean beyond that which is reasonably
22 predictable?

23 A. And as was the conditions in the power
24 markets were a surprise.

25 Q. But that's -- why? At the time of the

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1 merger, prices were low, now the prices are low, I think
2 William Gaines testified that, in fact, the spike had no
3 measurable impact on your underlying problem, maybe
4 provided a short-term help to your arguable problem.

5 A. Correct. I think --

6 Q. But you can't look at the price spikes of the
7 last 18 months as the basis for your problem, and if
8 anything, it was a benefit.

9 A. I think -- and that's not certainly in my
10 testimony. What I'm saying is I think that your
11 statement there is representative of the fact that when
12 you net everything together, costs increases, savings,
13 rate increases that we have had to date, those in
14 aggregate are insufficient. And when you look at all
15 the bits and pieces --

16 Q. All right. Then is it the company's position
17 that the deal, if that's the way to put it, cut in the
18 form of the stipulation approved by the Commission from
19 the merger hasn't worked out?

20 A. I wouldn't -- I wouldn't say that, I wouldn't
21 say that, because I think it has worked out. I think I
22 remember looking at the scenarios at the time that
23 agreement was entered into, and there were two
24 scenarios. One that had sort of traditional unmerged
25 impacts and what the impact on customers would be in

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1 that scenario. The other was the impact on customers
2 and shareholders as well under the scenario where you
3 merge. And the impact to customers and the financial
4 health of the company was more attractive in the merger
5 situation. The rate increases needed to provide the
6 same level of result, financial health, if you will,
7 would have been much greater absent the merger because
8 of the potential for the savings that come from
9 combining the two entities. And so --

10 Q. Well, was it the expectation of the company
11 at the time that the built-in rate increases and the
12 like would ultimately not be sufficient to meet the
13 problem of the escalating PURPA contract clause?

14 A. Of course, the agreement was based on
15 projections over the five year period. The company
16 looked at its projections and felt that it had a big
17 challenge, but it was one that it was ready to accept to
18 try and get the savings and live within those levels of
19 relief. It was not anticipated one way or another as to
20 whether that would be able to be continued beyond the
21 end of the rate stability period, and we are now beyond
22 the end of that period.

23 I do have to say, Commissioner Hemstad, it's
24 only with great reluctance that we come down and request
25 relief. This is obviously a process that while good and

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1 fair takes a lot of time and resources, and we would
2 much rather take that time and resources and apply them
3 to running our business. But when you just have done
4 all you can on getting savings, becoming efficient,
5 winning awards for innovative programs and so forth,
6 there comes a time where the rates just aren't
7 sufficient, and unfortunately, we have reached that
8 time.

9 Q. I may make the comment, I'm not asking these
10 questions critically, I'm merely asking them to try to
11 understand --

12 A. I didn't take them that way.

13 Q. -- the nature of the company's case.

14 Will you turn to Exhibit 426.

15 A. I'm not sure I have that in front of me.

16 Q. I think that was part of Ms. Steel's.

17 A. Oh, I have it now, thank you.

18 Q. And I believe at least indirectly, this
19 relates to her Exhibit 414. This is a Puget Sound
20 Energy consolidated balance sheet showing March 31,
21 2001, and December 31, 2000. First, what does it mean,
22 a consolidated balance sheet?

23 A. What that means is the -- all of the
24 subsidiaries of Puget Sound Energy. For example, the
25 real estate subsidiary, Puget Western, Hydroelectric

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1 Development Corp., HEDC, which I have referred to, and
2 all the other ones that were on the list that was passed
3 out in another exhibit are all aggregated together into
4 this sheet.

5 Q. Okay. And what I'm looking at is the
6 caption, additional paid in capital, March 31, 2001,
7 \$382,584,000, and then on December 31, 2000, it was
8 \$470,179,000, and this came up in discussion earlier,
9 for a difference of \$87,595,000. Could you tell me
10 again, what caused that drop in paid in capital?

11 A. Yeah, and I can show you specifically the
12 components of that amount. They are depicted in Exhibit
13 81. Remember it was January 1 of 2001 that the holding
14 company, Puget Energy, was formed. So what were
15 subsidiaries of Puget Sound Energy, for example
16 Infrastrux, we went through yesterday, I'm not planning
17 to do it again, but we went through the source of funds
18 for that, that was now once consolidated underneath
19 Puget Sound Energy unregulated activity. And then with
20 the creation of the holding company, the holding company
21 was up on top, and then this was transferred over to
22 being separate. So in aggregate, those dollars are
23 there, we're just recognizing now that what was once
24 unregulated \$87 Million that on a consolidated balance
25 sheet was included with the PSE numbers is now

1 separately.

2 Q. But with that change, at least the balance
3 sheet of Puget Sound Energy is measurably weakened; is
4 it not?

5 A. Well, on a consolidated basis, sure, but
6 that's not the measure that we should use in looking at
7 the regulated business, because it consolidates the
8 non-regulated activities with the regulated business,
9 so --

10 Q. Well --

11 A. -- and always historically when we have
12 looked at equity, we backed out, and we do this always
13 in the cost of money exhibits, the capital structure
14 exhibits, the equities related to those non-regulated
15 activities.

16 Q. Well, for a third party looking at the
17 company, say a Merrill Lynch broker or a Wall Street
18 credit rating agency, aren't they going to look to the
19 Puget Sound Energy balance sheet to have a sense of how
20 strong or how weak the company is?

21 A. A Merrill Lynch analyst, no, because he would
22 be looking at equity, which is at the holding company
23 level, so he would be looking at PE, Puget Energy's
24 balance sheet. A credit rating agency would look,
25 because the bonds and the preferred stock, the

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1 securities that they rate are at the Puget Sound Energy
2 level, they would look at that balance sheet. But for
3 regulation, we need to strip out all of the unregulated
4 activities and just look at Puget Sound Energy, the
5 regulated piece.

6 Q. Well, if I'm a party considering buying some
7 debt, whether secured or unsecured of PSE, why wouldn't
8 I look at the balance sheet to see --

9 A. Well, you would, you would look at the
10 balance sheet, but you would recognize that the balance
11 sheet is comprised of regulated as well as unregulated
12 assets and liabilities.

13 Q. But how would I know what's regulated and
14 unregulated?

15 A. Well, there are in the back of the financial
16 statements the segment information that breaks that out,
17 not in a lot of detail, but that's where you would get
18 it.

19 Q. But wouldn't that come as a surprise to me?

20 A. I wouldn't think so. It's part of the
21 company's 10-K.

22 Q. And I would know or at least I would be --
23 your position would be I would be put on notice at least
24 that if I'm considering buying debt of PSE that that
25 category of paid in capital could all of a sudden

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1 plummet?

2 A. Well, I wouldn't say that it would all of a
3 sudden plummet, because all we're doing is moving a part
4 that was always unregulated into another piece that
5 remains always unregulated. It was always separate from
6 regulated capital structure. I mean going through the
7 history of the numbers in Exhibit 81, they were never
8 part of the regulated capital structure, so sure.

9 Q. But I just want to get this as clear as
10 possible, that that third party would be on notice that
11 that's the case, that they could not rely on that
12 caption to really know how much paid in capital was
13 available to back up and secure the debt of PSE?

14 A. Well, again, I'm not sure that put on notice
15 would be the term that I would use, but some of that I
16 just mentioned, the segment information is disclosed in
17 the 10-K, it's disclosed that it contains both regulated
18 and unregulated businesses. In this proceeding, my
19 direct testimony I believe at page 8 talks about how
20 these projections that we have been looking at are just
21 the regulated businesses. And I think as we have always
22 done for coming up with a capital structure for
23 regulated activities, we exclude the equity from the
24 capital structure. And to the extent those documents
25 are part of the public record, investors would have

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1 access to those as well.

2 Q. All right. And the \$87.5 Million reduction
3 is then what, reflected or what happened to it is
4 reflected in your Exhibit 81?

5 A. The source of it, yes, right, where those
6 moneys came from and what they were used for happened
7 there, and then it doesn't depict the creation of the
8 holding company and the disaggregation.

9 Q. I understand. I note at the very bottom of
10 your Exhibit 81, the total there is 87.115.

11 A. Yeah, in fact, the moneys that went to the
12 unregulated businesses is really 85, 84 something, it's
13 the 87 less the \$2 1/2 Million transferred to the
14 utility. And clearly those businesses had earnings, and
15 so at the time of the transfer, that would go as well.

16 Q. So that's the connection, the two 87's
17 approximate one another?

18 A. Correct, the difference being earnings.

19 Q. And so you can look at Exhibit 426 and then
20 look at Exhibit 81 and see what happened to the money?

21 A. Yeah, its source, and see that it always was
22 unregulated, and that it's just a matter of
23 disaggregating financial statements to have a clearer
24 separation between those regulated and unregulated
25 businesses.

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1 Q. Where did the \$87 Million originally come
2 from?

3 A. It originally came from, there's three
4 pieces, but the bulk of it came from years ago
5 pre-merger. The gas business acquired exploration and
6 production properties when it was -- around the time as
7 I understand it of gas deregulation, when a lot of gas
8 distribution companies were looking for their own
9 sources of natural gas. It then sold those assets, or I
10 think merged is what happened technically, with Cabot
11 Oil and Gas, a firm out of Houston if I remember right.
12 And what it got in exchange for that was common stock of
13 Cabot Oil and Gas as well as \$50 Million of preferred
14 stock, and those are the two pieces here. And so that
15 was securities held outside of Washington Natural Gas,
16 the regulated business.

17 Q. So the original dollars came from earnings of
18 the old Washington Natural Gas?

19 A. No.

20 Q. As additional capital in that company?

21 A. The origin of the money to build the electric
22 or the exploration of production properties as I
23 understand it came from stock, if you would like,
24 Washington Energy Company, the holding company, that
25 instead of putting down into Washington Natural Gas it

1 put down into this unregulated business to acquire those
2 properties. Those properties were merged, got the
3 securities, and so the original source was shareholder
4 money outside of regulation.

5 For example, Puget Energy should it want to
6 grow Infrastrux and add additional equity, Puget Energy
7 could sell stock and put it into Infrastrux, or it could
8 bring in outside equity investors. That would have
9 nothing to do with the activities of the regulated
10 business. And that was the source, Washington Energy
11 sold common stock, went over here to the unregulated.
12 This never hit Washington Natural Gas. That was
13 segregated on the books of accounts.

14 When PSE was created, that was monetized into
15 cash. That cash continued to be tracked and invested in
16 unregulated, and now we just have the disaggregation of
17 what were once fully consolidated statements now into
18 PSE and Infrastrux.

19 Q. In one of the exhibits, I don't remember the
20 number now, I asked William Gaines about this, there was
21 a projection of rate of return for a period of 2001
22 through 2005, I believe, that was substantially above
23 the authorized rate of return, and which now is not the
24 case, and I asked him, was that projection of relatively
25 handsome earnings solely estimated to be as a result of

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1 activity in the wholesale market?

2 A. I believe the Exhibit was 42C, as I have it
3 here, and it's the rating agency presentations,
4 specifically the one that was dated April 23 and 24 of
5 2001.

6 Q. Let's see, looking at my notes, I see a
7 reference to Exhibit 275, page 85. I hope that's right,
8 maybe not.

9 A. It looks to be the same. I have that now in
10 front of me, and I'm trying to find that particular
11 page. Page 85 of 138, and I won't address specific
12 numbers because it's confidential numbers, but we can
13 talk conceptually certainly about it.

14 Q. And I question those relatively attractive
15 rates of return. Were they projected at the time as
16 resulting from your activities in the, positive
17 activities in the wholesale markets in contrast to where
18 you are now?

19 A. Yes, they did, they were based on -- yes,
20 they were. That forecast was prepared around the March
21 2001 time period at a time when before this crisis in
22 power markets happened, which we said was late spring,
23 early summer of the same year, so that certainly was
24 part of it. I would again, because we had the earlier
25 discussion, remind people that the line there that we're

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1 looking at is consolidated regulated and unregulated in
2 terms of Puget Western and so forth.

3 In my testimony, I mentioned page 8 of my
4 direct as talking about that separation, and on that
5 page, I say that in 2002 the non-regulated consolidated
6 operations are projected to generate approximately \$12
7 Million of net earnings, so there would be that impact
8 going forward as well, the impact of non-regulated
9 activities in those returns. But clearly, remember that
10 was based on a forecast pre-unexpected surprise in
11 unexpected ice storms so to speak in power markets.

12 Q. Just one last question. In your figure of
13 \$170 Million, I take it that includes the cost of the
14 gas hedges?

15 A. Yes, it does.

16 COMMISSIONER HEMSTAD: That's all I have,
17 thank you.

18 THE WITNESS: Thank you.

19 CHAIRWOMAN SHOWALTER: I have a follow up
20 just to the discussion you just had.

21 THE WITNESS: Certainly.

22

23 E X A M I N A T I O N

24 BY CHAIRWOMAN SHOWALTER:

25 Q. And I will describe to you a scenario or

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1 what's coming to me from the company's case, and then we
2 can go over the elements of it.

3 A. All right.

4 Q. What I am hearing is that there's a kind of a
5 three part dynamic. There is first the pre-crisis
6 merger mode, second, the power crisis/good, and then
7 there's the power part C is the power drops/bad. Now am
8 I correct that in part A, the pre-crisis merger mode,
9 you're going along, you've got the merger agreement, but
10 that in point of fact if the power crisis had not
11 occurred, the company would be hurting as it headed into
12 the home stretch of the merger period?

13 A. And when you say --

14 Q. Actually, please just let me keep going, and
15 then we will go back over it.

16 A. Okay.

17 Q. I just want to let you know what I'm thinking
18 so you can correct me if I'm not correct.

19 A. Certainly.

20 Q. So that had this power crisis not occurred,
21 the company might have come in prior to the merger term
22 end, that would have been a choice that you might have
23 made, but that had you not been "bailed out" by the
24 power crisis, your financial condition would not have
25 been good. But then B.

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1 A. Yeah, okay.

2 Q. The power crisis comes along, and actually
3 it's good for this company in spades. It essentially
4 not only masked the earlier dynamic, the merger mode,
5 but went beyond masking and would have, had it
6 continued, put the company in pretty good shape. But
7 then part C, the power drop comes along, and it's bad
8 for the company in spades. And so there's this dynamic
9 of things looking quite good and being good, but then
10 you come down through a kind of a neutral moment, and
11 looking forward to certain projections, things don't
12 look good. But this sort of good period and bad period
13 in spades has a fairly wide amplitude, and that is
14 because of the very high prices that when you were on
15 the receiving end of them were very good, and when
16 you're suddenly in effect paying for them in the sense
17 that you hedged against them, it looks very bad. Is
18 that sort of the dynamic, and then we can go through
19 these three parts?

20 A. Yeah, I believe it is, I think your pieces
21 with your three parts are accurate. I think your
22 description of the impacts of the three parts is
23 accurate. I would -- I wasn't sure exactly the point
24 with respect to the hedges, because when we were talking
25 yesterday, we talked about differentiating the use of

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1 derivative and hedges in a trading company, which is
2 what we do not do, versus managing core, you know,
3 trading around your surplus, and so it's our hedges are
4 the latter. But yes, I mean I think you summarized it
5 certainly.

6 Q. Well, let's go back to part A then.

7 A. Okay.

8 Q. The merger mode pre-crisis.

9 A. Okay.

10 Q. From the sounds of things, you may or may not
11 have made it to the end of the merger period, but if you
12 did, you would be making it into the end of the merger
13 period with a request for an increase post merger
14 period. Is that accurate, had all this West Coast power
15 crisis not occurred?

16 A. I haven't run those numbers, so I don't know
17 for sure, but clearly the part B power crisis/good
18 helped out.

19 Q. Right.

20 A. Now remember in 2000, just looking at
21 aggregate earnings per share, in 2000, our earnings per
22 share were \$2.16, and clearly that was in part benefited
23 by part B.

24 Q. All right. But that what it also implies is
25 that despite savings the company may have achieved or

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1 interest rates that have come down and annual rate
2 increases that went up a little for one reason or
3 another, which may be the subject of a rate case later,
4 but for one reason or another, it brought the company to
5 a neutral or negative position relative to its rates and
6 rate of return.

7 A. Neutral to negative I would think would be
8 fair.

9 Q. Okay.

10 A. Then, you know, then we have good period,
11 then we have bad period.

12 Q. Right. So why you got to the neutral to
13 negative, excluding the power good, power bad dynamic, I
14 don't know, and it may or may not be relevant to this
15 proceeding, it's probably something that will become
16 more evident in the general rate case. But in any
17 event, here we are in the interim proceeding, you have
18 asked for the rate increase.

19 A. Yes, we have.

20 Q. We will get to that later.

21 A. Right.

22 Q. But meanwhile, I think what you're saying is
23 that the good parts have now at this point been
24 outweighed by the bad dynamic, especially as time goes
25 on.

1296

1 A. Correct.

2 Q. And isn't part of the exercise that we're
3 engaged in here is to decide where in that dynamic we
4 are. That is, had you come in in July, you might be
5 able to predict that things were going to be bad, but
6 you wouldn't have been in terrible shape and maybe not
7 bad enough shape pending the end of a rate case.

8 A. You mean July of this year?

9 Q. No, of last year, no, I mean had you come in
10 earlier. I'm not saying you should have, I'm just
11 saying --

12 A. And again, remember we filed in August I
13 remember our initial request.

14 Q. Not the general rate case.

15 A. No, I'm sorry, I misunderstood.

16 Q. And I will, it probably doesn't need to be
17 said, but I just do want to remind the record if no one
18 else, that we did not rule on the merits in that case.

19 A. Right.

20 Q. But isn't part of what we're struggling with
21 here is where in the plus side of the dynamic moving
22 down to the negative side of the dynamic are we, and how
23 much can the company withstand pending the rate case
24 versus, maybe not even withstand, but how it's doing
25 just fine depending on these financials?

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1 A. I think that's right, and I think it's one
2 reason certainly that in our rebuttal revised proposal,
3 if you will, that we said, let's include a true up,
4 because this amplitude can be large, and clearly if the
5 amplitude is such that it's to the benefit of customers,
6 we have another benefit where net power costs are low,
7 we're not asking for that. We would want to give that
8 back. Again, the company can't deal with, as I think a
9 lot of witnesses recognized, another negative amplitude,
10 and so this would, the tracking deferral aspect with
11 respect to those costs, would address that as well.

12 And then I think with respect to the PNB
13 standard, we have to look at and the forecast in that
14 case is based on power costs being fully covered,
15 because perfect future knowledge, you know, you have
16 rates at that level, so the earnings would be the same
17 be power costs up or down if you went that route of
18 tracking it, you still then say, well, is there a need,
19 and that's when you take this broader look at the
20 overall financial health, earnings and cash flow.

21 CHAIRWOMAN SHOWALTER: All right, thank you.

22 JUDGE MOSS: Thank you. I think it might be
23 well advised to take a break, and then we will finish
24 up, so why don't we take our morning recess for 15
25 minutes, and then we will be right back.

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1 (Recess taken.)

2 JUDGE MOSS: Commissioner Oshie.

3 COMMISSIONER OSHIE: Thank you, Judge Moss.

4

5 E X A M I N A T I O N

6 BY COMMISSIONER OSHIE:

7 Q. Good morning, Mr. Gaines.

8 A. Good morning.

9 Q. I don't often get to say that to witnesses.

10 A. I guess that's right.

11 Q. I'm going to ask you questions on a few
12 subjects, but they're going to jump around a little bit,
13 and I guess that comes as a result I suppose of being
14 last.

15 A. That's fine.

16 Q. Of people with cross-examination questions.
17 Let's start with maybe just a clarification. Help me
18 understand better the merger between the gas and
19 electric companies. Because from what I heard you say
20 is that the asset, the non-regulated asset of was it
21 Cascade or Washington --

22 A. It was Washington Energy Company, the holding
23 company that also owned the regulated gas business.

24 Q. And so they were -- and so they held an
25 unregulated asset in the exploration and development

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1 company, which was then converted into the Cabot Oil and
2 Gas stock?

3 A. That's correct.

4 Q. And held by Washington Energy. And I guess,
5 you know, my question is, was the -- at the time of the
6 merger, was the regulated and unregulated asset
7 segregated in that way, or did Puget Sound acquire the
8 company as a whole, not in pieces, so to speak?

9 A. Yeah, much as Chairwoman Showalter was having
10 me step through three parts of the power situation,
11 there were you can think of three parts to this
12 situation. We had pre-merger holding company with
13 respect to the gas business, then we have PSE period
14 sort of pre -- and then you have holding company of PE.

15 And at the time of the merger that created
16 Puget Sound Energy, what happened was we merged the gas
17 regulated business into Puget Sound Energy, also merged
18 in Washington Energy Company, but kept on the books of
19 account, you know, records related to unregulated so we
20 could do something with that later.

21 Then created the first of '01 Puget Energy
22 itself and sort of then disaggregated what had been
23 aggregated. So the starting point, remember we had a --
24 you can think of an unregulated, and I will ignore the
25 Puget Western for a minute, the real estate subsidiary,

1300

1 because it's not the one in question, but we had
2 regulated gas business, unregulated holding company with
3 some unregulated activities, and unregulated electric
4 business. All of that came into one. Trying to track
5 to the extent books of accounts allow those differences
6 and certainly as cash monetized assets tracking in
7 separate bank accounts in certain circumstances those
8 flows of dollars, so that we could utilize them for
9 their intended purpose all along, unregulated
10 investment.

11 Q. I guess how is that done at PSE's level? I
12 guess that you would have acquired the whole company,
13 the shareholders would have, and it would have been
14 their investment.

15 A. You mean when PSE was formed?

16 Q. No, when PSE acquired Washington Energy.

17 A. Well, I would have to double check to be 100%
18 certain, but I'm about 90% certain that the creation of
19 the merger of, in fact, I am 99% certain the merger of
20 those exploration and production properties that
21 resulted in the Cabot common and preferred happened
22 pre-merger, so they would have had on their books that
23 the holding company, this investment in either sub that
24 held this stock or investment in that stock. I don't
25 recall if the unregulated sub had been collapsed into

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1 the holding company. But that then became an asset
2 investment in those securities when the whole PSE merger
3 was formed, so that's tracked separately. And then it
4 was post merger that those assets were monetized,
5 converted to cash, and then tracked separately in a bank
6 account. You obviously can't track a non-cash
7 investment through a bank account. And that's really
8 the way it was done.

9 Q. Jump around a little bit as I said I would
10 to, oh, in yesterday's discussions about the rating
11 agencies, Moody's and S&P, and probably I will get them
12 somewhat mixed up, but you mentioned qualitative factors
13 as being a significant influence in the decision of the
14 rating agencies.

15 A. Yes.

16 Q. And of the qualitative factors, you talked
17 about management, and you also discussed the regulatory
18 environment.

19 A. I had a third one, the economy as well.

20 Q. Now I'm assuming that Moody's or S&P when
21 they look at or they try to analyze, if you will, PSE's
22 relationship with the UTC, they look at our decisions
23 only?

24 A. No, I don't think they look at decisions
25 only. I think they look at the process in part as well.

1302

1 As Chairwoman Showalter --

2 Q. What do you mean by process?

3 A. Well, they look at time period, how although
4 there is allowed an 11 month period, does it always take
5 11 months. They look at do they read in the newspapers
6 argumentative things going back and forth, or do they
7 see not that, you know, do they get an implication that
8 there is a good working relationship. Some companies
9 have good relationships with their commissioners, as I
10 believe PSE has. Other companies in other states are
11 probably less so. And so they try and pick up that.
12 And these are things that, of course, aren't
13 quantifiable, and thus they fall under their heading of
14 the qualitative aspect of the rating.

15 Q. Do you think it would be a benefit to the
16 analysts to have a relationship with the Commission or
17 its Staff?

18 A. I do. In fact, I think not only would it be
19 good for as was done where the Chairwoman spoke to
20 regulatory research and had conference calls with the
21 Bank of America that were, in the case of the Bank of
22 America, available for replay. And I know there were
23 rating agency analysts listening in on some of those
24 from conversations I have had. I think the more
25 information that is had by agencies, be it from Staff,

1303

1 Public Counsel, the company, commissioners, I think
2 that's good. I actually think it would be good to
3 outside of rate proceedings have more frequent
4 conversations among those same parties as well.

5 Q. And I'm assuming that in your meetings with
6 the ratings agencies that they want to talk to you about
7 your relationship with the Commission?

8 A. They do.

9 Q. And so in effect you become our voice with
10 the rating agencies then?

11 A. I think --

12 Q. If they're not talking to us.

13 A. I think I become -- I think I am my voice of
14 my opinion of that relationship. And as I mentioned
15 earlier, I think we have a good one.

16 Q. Okay. Help me understand a little bit, I'm
17 going to move into the development of the holding
18 company and the relationship between PSE and Puget
19 Energy, and I may call it PSD and maybe it will --

20 A. Per the ticker symbol certainly.

21 Q. I don't think the court reporter will
22 appreciate it, but. As I understand it, of course and
23 there has been a lot of discussion throughout this
24 proceeding, that PSE is a subsidiary of Puget Energy.

25 A. Yes.

1304

1 Q. And this is my understanding, that Puget
2 Energy is the sole shareholder of PSE.

3 A. That is correct.

4 Q. And is there 1 share or 1 billion shares, or
5 perhaps it doesn't matter?

6 A. I don't know the number of shares, but I
7 don't think that it does matter.

8 Q. So now when you talked about shareholders in
9 your testimony, you're really talking about the
10 shareholders of Puget Energy?

11 A. Correct.

12 Q. Because there's only one shareholder of PSE?

13 A. In most instances unless we were talking
14 about the holding company relationship, I was referring
15 to the ultimate owners of the entity, yes.

16 Q. Now there was some discussion yesterday about
17 the board of directors and that they're identical
18 between PSE and also Puget Energy. And I think it was
19 your testimony that the board, each board has a
20 responsibility and does act independently of one another
21 in making decisions for each corporation.

22 A. They have a fiduciary responsibility to their
23 role in either situation.

24 Q. And I think you stated as well, and I will
25 generalize, that the interests of PSE may differ from

1305

1 the interests of Puget Energy.

2 A. I think that can be the case at times, yes.

3 Q. And so the board of directors would have to
4 make decisions again independent of one another even
5 though they're one and the same.

6 A. I believe that's correct.

7 Q. And so, for example, as far as the stock
8 price, at least in a theoretical sense, the shareholder,
9 or excuse me, the board of directors of PSE in a
10 theoretical sense would be thinking more of the
11 interests of PSE than the interests of the shareholders
12 of Puget Energy?

13 A. I would believe that that would be right.
14 I'm not a board member, but I would think that would be
15 true.

16 Q. Now again, based on the testimony, and of
17 course both written and oral, we do not regulate Puget
18 Energy?

19 A. Correct.

20 Q. And Puget Energy is made up of different
21 subsidiaries including Infrastrux and PSE, and I believe
22 you mentioned a real estate --

23 A. Actually, just to correct, we have Puget
24 Energy the holding company, it has two subsidiaries,
25 Puget Sound Energy and Infrastrux. And then underneath

1306

1 Puget Sound Energy is the subsidiary Puget Western, PWI,
2 and HEDC and some others that are very, very small.

3 Q. And I think just in general terms, there are
4 both the risks that are foreseeable, if you will, or
5 understood by the shareholders of Puget Energy from both
6 the regulated and unregulated environments are
7 reflected, if you will, in the stock price?

8 A. Absolutely.

9 Q. And I guess those risks are also reflected in
10 the decisions made by rating agencies?

11 A. No, not 100%, because the rating agencies --
12 they are when the rating agencies are rating the issuer
13 rating of the holding company, then they would be
14 identical. But when the rating agencies are rating the
15 securities issued by Puget Sound Energy, then they would
16 just consider the items with respect to that entity.

17 Q. And I guess that's why there are certain
18 securities of PSE that are ranked higher than those of
19 Puget Energy?

20 A. That is -- the ones that are ranked higher,
21 for example, the company's first mortgage bonds have a
22 higher rating than the issuer rating, the corporate
23 credit rating, because they have the protection of the
24 pipes and wires, the assets of the company, whereas the
25 corporate credit rating, the one that really a power

1307

1 marketer would look at, is really just the general
2 creditor standpoint or credit worthiness of the company
3 without a claim in a bankruptcy proceeding towards the
4 assets, the physical assets.

5 Q. Now Puget Sound Energy issues a dividend, and
6 maybe I will use the term upstream, if you will, to
7 Puget Energy.

8 A. Correct.

9 Q. And the decision to issue a dividend would be
10 made by the board of directors of Puget Sound Energy.

11 A. That's correct.

12 Q. Now was the dividend paid in the third
13 quarter of 2000, it is my understanding, would be for
14 earnings in the second -- of 2001 would be for earnings
15 in the second quarter of 2001; is that right?

16 A. Yes.

17 Q. And so it would follow then that the fourth
18 quarter dividend of 2001 would have been for earnings in
19 the third quarter?

20 A. With one minor modification, Commissioner
21 Oshie, the dividends aren't paid at calendar quarters.
22 They are paid sort of middle of the quarter. So when
23 the board would look at the dividend for what you would
24 probably refer to as the fourth quarter one that's being
25 paid November 15th, and the financials that they look at

1308

1 are the actuals through the end of October, so it's not,
2 you know, a clean calendar.

3 Q. Right.

4 A. But I just wanted to clarify that.

5 Q. Because I think that your fourth quarter
6 actuals for 2001 resulted in a dividend payment in the
7 middle of January if I'm not mistaken; is that right?

8 A. No, there would have been a dividend -- the
9 actual -- the dividend that was declared in January was
10 paid February 15th, so it would be looked at through --
11 I don't -- I can't remember the minutes, but the minutes
12 of the board meetings, the representative board meetings
13 of Puget Sound Energy and Puget Energy, would reflect
14 the date of those financials.

15 Q. Now, Mr. Gaines, just help me to get a
16 picture, because to me at least, it folds into the
17 financial situation of the company. You know, did the
18 dividend that was upstreamed to Puget Energy by PSE for
19 the third quarter of 2001, did that exceed the earnings
20 for the third quarter of 2001?

21 A. I don't know for a fact, but I would suspect
22 that it would have, and the reason in part would be, you
23 know, typically because of the seasonality of our
24 business where, you know, the gas business, the bulk of
25 its revenues are in the first and the fourth quarter,

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1 the bulk of the margin is the first and fourth quarter,
2 because that business doesn't have the more stable
3 lights and appliance load. And even to the extent of
4 the heating load of the electric, it too has the bulk of
5 the margin in the first and fourth quarters. Typically
6 on a quarterly basis, it is such that we would pay out
7 more in the third quarter in dividends at the PE level
8 than what PE's earnings would be. And the corollary, of
9 course, is in the first and fourth quarters, typically
10 you would pay out much less than what the earnings are.

11 Q. Was that true for this fourth quarter, 2001?

12 A. Not with the underrecovery of the power
13 costs. And I would like to point out while we're on the
14 dividend that the dividend paid by Puget Energy to its
15 shareholders is on a quarterly basis 46, currently or
16 last time, was 46 cents per share. That in aggregate
17 was roughly \$40 Million to \$42 Million. It's not -- I
18 don't have the exact numbers, it's in one of these
19 exhibits. The dividend paid from Puget Sound Energy to
20 Puget Energy is about \$30 Million to \$33 Million. The
21 difference of \$6 Million or so roughly on a quarterly
22 basis or \$24 Million or \$25 Million a year reflects the
23 dividends that the shareholders of Puget Energy elect to
24 reinvest in the business, and we have been retaining the
25 cash at the utility and having, you know, issuing new

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1 equity, if you will, to meet that rather than buying
2 equity in the open market to rebuild the equity ratio of
3 the utility, and that has been happening since November
4 of 1999.

5 Q. In the first quarter of 2002, do you
6 anticipate that -- I guess the board hasn't made a
7 decision to issue any dividends for first quarter, but
8 they're built into your projections, aren't they?

9 A. We may be thinking of different time periods.
10 I think of the first quarter one as the one paid during
11 the first calendar quarter, so the February 15th
12 dividend, that was declared and was paid at 46 cents.
13 They have not declared the May dividend.

14 Q. And that's what I'm thinking.

15 A. Okay.

16 Q. I'm trying to get a relationship between the
17 earnings within a particular quarter and the dividend
18 that would be issued by the board of Puget Sound Energy
19 for that quarter's earnings. And it's I guess from --
20 and I don't want to really point to any exhibit, but
21 just in a general way that the earnings of the company
22 for at least the first couple of quarters of 2002 if you
23 were paid out a dividend of \$30 Million to \$33 Million
24 to Puget Energy, your earnings, your dividend payment
25 would exceed the earnings for those periods.

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1 A. Well, clearly in periods of, example, poor
2 hydro conditions, there were years in the past where we
3 -- the dividend exceeded the earnings. In the year of
4 the merger where we had \$55 Million of merger related
5 costs that for financial reporting purposes were
6 expensed, the dividend exceeded the earnings. But in
7 other years inside the merger period where we had
8 favorable hydro conditions, earnings well exceeded the
9 dividend, and, in fact, on average over the period, the
10 earnings have exceeded the dividend.

11 Q. But for the first two quarters of -- let's go
12 back to my question I guess.

13 A. Sure.

14 Q. If you were to pay out the dividend as
15 projected for the first quarter and second quarter of
16 2002, is it your testimony that the dividend payment to
17 Puget Energy would exceed the earnings for those
18 periods?

19 A. Just to be certain, I want to check a number.

20 Q. Okay, sure.

21 A. If the board declared a 46 cent dividend, it
22 is, and I'm looking at Mr. Hawley's workpapers which
23 were supplied in response to Public Counsel Data Request
24 62, which has a couple of different exhibit numbers
25 related to it, and trying to add in my head without

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1 numbers in front of me the revenues and earnings from
2 Puget Western and from Infrastrux, I think it is highly
3 likely that the dividend would exceed the earnings.

4 Q. Now my question really was focused on Puget
5 Sound Energy, Mr. Gaines, and I --

6 A. Oh, okay, sorry.

7 Q. Because I'm really interested in what the
8 income, if you will, or the revenues of the utility, the
9 earnings of the utility are in relationship to --

10 A. Of the utility --

11 Q. -- that would be upstream to Puget Energy.

12 A. Of the utility itself, clearly the dividend
13 would exceed the earnings.

14 Q. And I appreciate the clarification on the
15 dividend, because there's been a lot of discussion
16 throughout the hearing about the dividend, and I guess
17 it was focused on the dividend of Puget Energy --

18 A. Well, because --

19 Q. -- as opposed to what flows from Puget Sound
20 Energy to the parent company.

21 A. I think that's right, because the dividend
22 that the shareholder looks at is the one from Puget
23 Energy, and I think it's important to note that
24 investors of utilities look for stability in a dividend
25 payment. You don't decrease it in short bad times. You

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1 don't increase it in short good times. You really, it's
2 my understanding not being a board member, is that
3 boards look to the long run financial viability of the
4 company and set a policy with respect to that. And
5 clearly it's typical in my mind that when a company is
6 in for an increase in general rates that it would be
7 having a period where its earnings could exceed, or
8 sorry, its dividends could exceed its earnings. Were
9 that not the case, it probably wouldn't be needing to be
10 filing for general rate relief.

11 Q. All right. My interest here is really the
12 decisions that are made at Puget Sound Energy's level in
13 dividending earnings upstream to Puget Energy, and I
14 guess in order to say it straight out, in a time of
15 financial crisis, it seems as if the board of directors
16 of Puget Sound Energy would be more concerned about
17 maintaining the financial viability of that corporation
18 than of dividending moneys upstream to benefit the
19 shareholders of the parent company. I mean their
20 concern is Puget Sound Energy.

21 A. Correct.

22 Q. It's not, even though they're one and the
23 same board, their concern isn't for the shareholders of
24 PE.

25 A. Right, that's right.

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1 Q. Do you think that it's in the best interests
2 of Puget Sound Energy to dividend \$30 Million to \$33
3 Million upstream to Puget Energy in the first quarter of
4 2000 for the first quarter earnings of 2002?

5 A. I believe that it's critical that they
6 continue, the board continues to do that. And were they
7 to ask my opinion, I would give them that opinion.

8 And the reason why is because this company,
9 Puget Sound Energy, needs to rebuild its equity, and the
10 only way that it is going to be able to do that at the
11 level to the degree to which it needs to do, as is
12 included in my general rate case testimony, is to have
13 public issues of common stock, and sizable public
14 issues. I can't say the number, because that aspect of
15 the testimony is confidential, but a lot of money, more
16 than -- what we plan to issue is more than what the
17 reduction proposed in the dividend would be.

18 And sure, cutting the dividend is a source of
19 money in the short run. But to get capital, to attract
20 the equity investor in the long run so that Puget Energy
21 can issue stock and invest that in Puget Sound Energy,
22 it is absolutely imperative that stability in return to
23 shareholders be maintained, and that would be my
24 recommendation. I don't know how, you know, you have
25 reduced the dividend down, there has been testimony, now

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1 this is my testimony, I'm not relying on excluded
2 exhibits, if you were to cut the dividend, the stock
3 could drop below book value, and that would be a
4 horrible situation to have at a time when you're trying
5 to issue public stock in the public markets at the level
6 to which we need to do.

7 Q. Another way of building the equity would be
8 to retain the earnings; is that right?

9 A. Certainly.

10 Q. It's another mechanism?

11 A. It's another mechanism that would not address
12 the long-term problem, would be detrimental to the
13 long-term problem.

14 Q. So I guess your testimony then is that it
15 would be -- it's in the company's -- it's in PSE's best
16 interest to dividend its \$30 Million to \$33 Million even
17 though it hadn't earned that for the first quarter of
18 2002 to the parent company?

19 A. It would be, much as it would be my
20 recommendation not to increase the dividend were we
21 still in period B, power crisis/good, right.

22 Q. Now I guess there's probably a couple of
23 assumptions built into your opinion, and I guess one
24 would be that there would be some relief that the
25 Commission would afford the company?

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1 A. That would be correct.

2 Q. And just assuming that there would be no
3 relief, your answer would be different?

4 A. No, I think because I'm thinking beyond this
5 period as well and thinking about what's needed in the
6 general rate setting process, that's when you address
7 capital structure and when you address issues such as
8 this. That's the time in my testimony, you know, post
9 interim, post decision on general when there is clarity
10 on long-run earnings capability of the company that we
11 would sell common stock.

12 And this short-term period that we're really
13 talking, I guess there's two quarters of dividend
14 between now and the end of the decision period in this
15 proceeding, at \$30 Million to \$33 Million, that's \$60
16 Million to \$66 Million of dividends if you absolutely
17 eliminated the dividend, and there have been five firms
18 in the last five years, five utilities in the last five
19 years who have omitted the dividends. That \$60 Million
20 to \$63 Million is a very small fraction of the equity
21 needed by the utility to rebuild its capital structure
22 after rates are set in the general rate making process.
23 It would be being penny wise and pound foolish, to use
24 an expression my English grandmother would use.

25 Q. If you had to, this is just an assumption, if

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1 there were no rate relief afforded or at least in your
2 opinion insufficient rate relief afforded by the
3 Commission, how would PSE, at least in your opinion,
4 make its dividend payment to the parent company?

5 A. Well, as we saw, there are cash flows that
6 come in. Earnings are positive, not negative. And it
7 would be out of those cash flows that we would do that.
8 Dividends, although we look at them as with respect to
9 earnings, are in the case of utility stocks typically
10 paid in cash. And so you look more to cash flow,
11 especially on a short-term area.

12 Q. Would the company consider borrowing money to
13 make the dividend payment?

14 A. I can't speak for the board. I do know that
15 that has happened historically years ago in the period
16 of big construction time when it was critical to issue
17 equity to fund power plant construction.

18 Q. I guess there's, at least from the testimony,
19 there's an expectation of the shareholders of Puget
20 Energy that the parent company will -- that the dividend
21 will remain constant.

22 A. I wasn't sure if that was the end of your
23 statement, but I would agree with that.

24 Q. And how long has the dividend remained in the
25 46 cents a share a quarter range?

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1 A. I believe the last increase was during the
2 year of 1993. We could certainly get you a date
3 specifically as a Bench Request if you would like, but I
4 think it was then.

5 Q. So at least nine years?

6 A. Yes.

7 Q. And I guess based on your testimony, I would
8 assume that it would at least be your opinion that for a
9 number of years going forward that that dividend should
10 remain the same?

11 A. Well, again, you reminded me that when I made
12 my earlier statements, it was premised on some
13 assumptions. My assumptions if I were to make that
14 statement would be that we would have the long run
15 earnings capability to support that dividend.

16 Q. And so I guess your testimony is, as long as
17 you were able to earn the money to pay the dividend,
18 then you would pay it, or there would be -- if you had
19 an opinion that you could give to the board, it would be
20 to pay the dividend because you had the earnings to
21 support it?

22 A. It's a little bit more complex than that. I
23 believe the shareholders of Puget Energy look for two
24 things. They look for -- and they only get two things.
25 They get a dividend as current income, and they get

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1 change in the stock price up or down. I believe
2 investors, and I have this belief from speaking with
3 equity analysts as well as some shareholders, that
4 shareholders in our company, and we are primarily about
5 70% to 75% of our stock is owned by individuals as
6 compared with, you know, institutions, many of whom are
7 Washington residents, it is my belief from talking to
8 them and talking to analysts that they look for two
9 parts. They look to the stability from the utility,
10 from the regulated business, to support the dividend,
11 and they look to the growth in their stock price to the
12 unregulated activities of the company.

13 The utility has customer growth of less than
14 2% on the electric side, 1% to 1 1/2%, 3% or so on the
15 gas side, so aggregate not a lot of growth to look
16 forward to. There were questions asked of the growth
17 plans for Infrastrux, and clearly they have substantial
18 growth plans. Those were expressed in terms of
19 revenues, but there would be earnings that would be
20 expected to flow from that as well over time as this
21 company expands and gets from its infancy to more closer
22 to teen age years or maturity I guess.

23 And so I believe that investors are looking
24 at that. They look to the utility for stability of the
25 dividend, and they look to unregulated businesses for

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1 the growth aspect of the stock.

2 Q. At least during this period where there is,
3 and I, well, maybe, during the period in which of the
4 infancy of the unregulated subsidiaries, then the
5 dividend is primarily being supported by the utility?

6 A. Correct.

7 Q. Is the, at least in your opinion, and it's --
8 does the dividend artificially, if you will, prop up the
9 stock price? I mean maybe I can put a little background
10 on that, because it's my understanding that your -- the
11 percentage of the dividend in relation to the stock
12 price is -- is it the highest in the nation?

13 A. In terms of dividend yield at present time.

14 Q. Dividend yield, yes.

15 A. It is the highest of the utilities that I
16 have tracked of the combination companies, and there's
17 about 30 to 35 of those.

18 Q. All right, so but back to my question, is
19 that, I mean that high dividend yield, the highest in
20 the nation, is that artificially propping up the stock
21 price?

22 A. No, I think it's a function of the stock
23 price being beaten down. I don't think the problem is
24 the numerator in that equation. I think the reason the
25 ratio is where it is is concern over erosion of equity

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1 and low earnings, and I think that -- I mean when we
2 look at the period prior to this unexpected run up in
3 net power costs, the stock price was higher, the
4 dividend yield was lower.

5 Q. What's the average, the three year average of
6 the stock price at PSE or Puget Energy since its
7 formation? Do you have a running average in your head
8 or an approximation?

9 A. I can -- an approximation, I would guess \$23
10 to \$26, somewhere in there. Those numbers are in the
11 back of our annual reports, which is a public document.
12 I don't have them handy to refer to, but.

13 Q. Well, if the dividend -- I guess if the stock
14 price is reduced and people have an expectation of a
15 certain percentage of dividend, in other words, if the
16 stock price goes down, if your -- and I don't know what
17 the percentages may be, but if your yield would have
18 been 6% for example at \$28, why wouldn't they expect 6%
19 at \$20 just in --

20 A. Well, the yield is simply a mathematical
21 calculation. It's the current dividend per share
22 divided by the price per share. And if there are
23 situations, and ignoring the cause, if there are
24 symptoms that are of concern to investors, that will
25 make the stock price go down. And as a result, you

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1 know, clearly if you have a calculation where the
2 denominator is depressed, the resulting quotient I guess
3 is increased. The way to address that is not mess with
4 the numerator, it's do things to address the depression
5 in the denominator, in my view.

6 Q. Well, if the -- that may be -- just in a
7 general sense, if the stock buyers, if your investors
8 are concerned about the health of the company, I guess
9 there's a tension between their wanting to reinvest the
10 moneys that they could receive in dividends back into
11 the company to I guess increase or make the company
12 healthier and the desire to put more money in their
13 pocket. Is that a fair statement?

14 A. I would ask you to repeat the question.

15 Q. Well, if the stock price has been driven down
16 by investors' view on the health of the company, isn't
17 there a natural tension then that exists between their
18 wanting to improve the financial health of the company
19 perhaps by reinvesting what they could receive in
20 dividends and, of course, their personal interest in
21 receiving the highest dividend possible within the board
22 of directors' judgment for any given period?

23 A. First of all, I would disagree that it's the
24 highest dividend possible. It's the highest present
25 dividend yield. I would also think that the investors

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1 are -- and the depression in the stock price is a short
2 lived phenomenon, because I believe that investors
3 believe in the regulatory process, and they know now
4 that there's an interim period. Looking beyond that,
5 they're probably more concerned with the general period,
6 and it will be that that will determine the long run
7 earnings capability of the company. And that's why I
8 think it makes sense to wait and sell the stock after
9 there is that clarity. I don't know how I would -- the
10 scenario that I would describe to an investor not
11 knowing the outcome and not able to predict and never
12 trying to predict the outcome of regulatory decisions to
13 investors or rating agencies.

14 Q. Do you see the growth in the Puget Energy
15 stock price, at least your projected -- your opinion of
16 its projected growth, is that a function really of the
17 activities, the financial activities of the unregulated
18 subsidiaries or more of that than of the regulated
19 utility?

20 A. I think so, and I think I can give you a
21 quick example of the mathematics that would show that,
22 and let's just go back to the period when rates were
23 last set and the ROE was last set at 10.5, and we'll
24 ignore for the moment the fact that the gas was some
25 negotiated number that may or may not have been higher

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1 than that, let's just assume it was 10.5 for the
2 consolidated entity. I think historically over the
3 let's call it a mid term, five, six years, normalized
4 levels, payout ratio, dividend payout ratio of the
5 company is probably 85% let's say. If you're paying out
6 85% of your 10.5 return, that means you're retaining
7 15%. And if you can continue earning the 10.5, you
8 would expect -- and you're reinvesting that 15% of 10.5,
9 one of the simplistic, if you will, ratios of finance is
10 retention ratio times ROE is earnings growth. So if we
11 say we had a 10.5% return on equity and we were
12 retaining 15% of that, paying out 85, which is by
13 industrial standards a high percentage, that's a growth
14 rate of 1 1/2%.

15 That's not enough of a growth rate to be
16 attractive to investors, so investors would be looking
17 to Infrastrux, for example, for that additional growth.
18 And I think with the plans that I think it was
19 Mr. ffitch who asked me about their plan to have \$1
20 Billion in revenue over a five year period, and
21 earnings, you know, growing up from that level, that
22 provides a lot more earnings growth than the 1.5%. And
23 I believe if even just to go to Yahoo Finance, for
24 example, and look at their research section there where
25 there is a number from the IBES system that has cell

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1 side analysts' growth expectations in earnings, we would
2 see a number that's at least double that 1.5.

3 Q. I guess it's maybe a generalization, but
4 growth stocks or growth companies as a general rule will
5 use its retained earnings to acquire new businesses or
6 to develop the business that it has or to put in R&D
7 than will -- and will not use those moneys to pay
8 dividends?

9 A. Well, in some part. Clearly you have just
10 hit the nail on the head with respect to Infrastrux in
11 its infancy stage. And certainly going back to my
12 mathematics, the company that had no dividend and earned
13 10.5, you would expect its earnings to grow by 10 1/2%
14 because 100% retention times 10.5. That is a company
15 like Microsoft that pays no dividend, people are buying
16 that purely for growth.

17 I think in our company, and now I speak of
18 Puget Energy because we're talking about the
19 shareholder, again, they look to this business in its
20 infancy going through adolescence and retaining and
21 doing the growth scenario much like Microsoft, not
22 paying a dividend, and they look to the earning
23 stability of the utility, which over the long run has
24 paid out less than its earnings. Certainly earnings
25 have been much higher and much lower in other years, but

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1 I think they look to that for the current income piece.

2 COMMISSIONER OSHIE: I don't have any other
3 questions. Thank you, Mr. Gaines.

4 THE WITNESS: Thank you.

5 CHAIRWOMAN SHOWALTER: No questions.

6 JUDGE MOSS: I have a few questions to keep
7 our record clear, Mr. Gaines, before we go on to other
8 parties or back to the parties.

9

10 E X A M I N A T I O N

11 BY JUDGE MOSS:

12 Q. I will refer you to page, well, first your
13 Exhibit 25T, your rebuttal testimony. If you look at
14 page 4, line 17, you make reference there to a figure of
15 \$625,000 a day, and I think that actually may appear in
16 several other places in your testimony and perhaps in
17 Mr. Swofford's as well.

18 A. Yes.

19 Q. I wanted to know what is the source, the
20 derivation, if you will, of that number?

21 A. The source of that number, let me just check
22 real quickly, the source of that number is the page 15
23 of DEG-4 in the company's general rate proceeding, and
24 although I think that page was marked confidential, the
25 underlying -- because of the monthly shape of the

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1 derivation of that, the underlying number itself is not.
2 It's the final page of DEG-4 in that proceeding, and I
3 have a copy if you want to do a request somehow with it.

4 Q. Yes, I think we probably would want to just
5 have that page as an exhibit so we understand the --

6 A. It would need to be marked confidential if
7 that's acceptable.

8 JUDGE MOSS: We're going to get some
9 interesting exhibit numbers here, but that will be 19BC.

10 THE WITNESS: An odd year.

11 MR. CEDARBAUM: Can you just repeat,
12 Mr. Gaines, what that exhibit will be then?

13 THE WITNESS: 19BC. Oh, what the source of
14 it is?

15 MR. CEDARBAUM: The source, yes.

16 THE WITNESS: I'm sorry, Mr. Cedarbaum, yes,
17 I believe it's page 15, which is the final page of
18 DEG-4, my exhibit in the company's general rate case,
19 and we can produce that today on the lunch break.

20 MR. CEDARBAUM: I have a copy of it. I can
21 just make a copy for myself.

22 JUDGE MOSS: We will need copies though
23 because we don't have it up here, so appreciate that.

24 BY JUDGE MOSS:

25 Q. In the same Exhibit 25T, your rebuttal, and

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1 indeed on the next page, page 5, line 9, and again
2 perhaps in several other places, there's a figure there
3 of \$13 Million per month, and again, I would like to
4 know what the derivation of that is.

5 A. That one is actually in the record already.
6 It is the source of that can be seen on page 1 of the
7 exhibit that contains Mr. Hawley's workpapers, which I
8 think someone said was 425, and then it's line 18,
9 column B, it actually shows as \$12.7 Million and it's
10 rounded in the testimony to be 13.

11 Q. Okay, I think we're going to need to check
12 that exhibit number, because my 425 is --

13 A. It's the one that I refer to from this
14 exhibit list as 32C on your earlier --

15 Q. Yeah, 32C does seem to be Mr. Hawley's
16 workpapers.

17 A. Yeah, page 1.

18 Q. And then in connection with that \$13 Million
19 figure, you use the term or the phrase, confiscates huge
20 amounts of our equity investors' existing investment in
21 the company, and the term confiscation of equity is one
22 that appears in several places in the testimony. I want
23 to be clear about what that means. We have used the
24 word equity in several senses throughout the case, and I
25 wonder if you could simply explain what it means in this

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1 connection.

2 A. Yes, I can. The derivation of those two
3 numbers, Judge Moss, the 625 and the 13 Million, are
4 really the same. They're the underrecovery of net power
5 costs. One is a pre-tax, and one is an after tax
6 number, I believe, but of over different time periods.
7 And the confiscation of equity that I'm referring to is
8 synonymous to when we say the erosion in equity. It's
9 the fact that when, using the analogy of buying pencils
10 for 10 cents and selling them for a nickle, it erodes
11 the equity in the company. That's what I'm referring
12 to, and that erosion is depicted on page 1 of the
13 exhibit we were discussing.

14 Q. And this is in line with the discussion of
15 erosion of equity you had with Chairwoman Showalter
16 yesterday?

17 A. That's correct, yes, it's the same.

18 Q. We have had a good bit of discussion
19 throughout the case in terms of the various coverage
20 ratios, and specifically I want to talk about the first
21 mortgage bond two times coverage ratio. And I believe
22 it's in your testimony here in 25T at page 3 that
23 without interim relief, the company will not maintain
24 its two times coverage ratio for its first mortgage
25 bonds. I guess I should stop and ask you if I have that

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1 piece right?

2 A. That is correct. And, Judge Moss, there was
3 a Bench request to produce the actual number for
4 January, which we should have today.

5 Q. Do we have that now?

6 A. I don't believe we do. I think it's being
7 calculated up in Bellevue.

8 Q. All right. Let me ask you if you know what
9 level of relief the company would require just focusing
10 on this one measure, what level of relief would be
11 sufficient to maintain that through the period October
12 2002?

13 A. I do, and it's a number that Ms. Steel has
14 calculated, Mr. Hill has calculated in a data request
15 and I believe there's an exhibit to that, and I have
16 done mathematically although it's nowhere in any of my
17 exhibits. It's roughly \$70 Million, and that would be
18 keeping that ratio at two times but not allowing for the
19 issuance of any securities, because that ratio when
20 calculated, you have to include the interest on the
21 currently contemplated issue in making that calculation.

22 Q. And if you made that allowance, what would it
23 be?

24 A. It would depend on the --

25 Q. Well --

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1 A. Yeah, on the amount of interest. But, for
2 example, let's say the company was doing \$100 Million
3 bond offering and the interest on that at say 8% would
4 be obviously \$8 Million, so it would be \$8 Million
5 higher.

6 Q. So \$78 Million in the example?

7 A. Yes.

8 Q. Or if it was 6.25%, \$6,250,000?

9 A. Correct, yes.

10 Q. That simple?

11 A. Yes, that simple.

12 Q. Appeals to my sense of mathematics.

13 JUDGE MOSS: One other thing that I would
14 like to have for a clear record, and I think I will just
15 put this in the form of a Bench request for counsel to
16 jot down, and other counsel may wish to provide a
17 response as well, but what I would like to see in one
18 place, and I think that the data is in the record, is
19 the company's current actual capital structure in the
20 form of the usual table that we see that lists on the
21 left-hand side, for example, long-term debt, equity, and
22 so forth, and then the ratios and the percentage, the
23 cost, and if we could have that actual figure.

24 THE WITNESS: December 31, 2001?

25 JUDGE MOSS: That would be agreeable, yes.

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1 THE WITNESS: Okay, great. Judge Moss, just
2 a clarification on that, is that for Puget Energy, Puget
3 Sound Energy, or just the regulated aspect of Puget
4 Sound Energy? And we can produce all three if you would
5 like. I would be happy to do --

6 JUDGE MOSS: Let's just do all three.

7 THE WITNESS: Okay.

8 JUDGE MOSS: So we make sure we have
9 everything that we need.

10 THE WITNESS: Great, no problem.

11 JUDGE MOSS: Thank you, appreciate that
12 clarifying point.

13 BY JUDGE MOSS:

14 Q. Just a couple more. With respect to we have
15 had a good bit of discussion or you had a good bit of
16 discussion with Commissioner Oshie this morning about
17 the holding company structure and earnings and so forth,
18 what is the primary source of Puget Energy's earnings?

19 A. Well, the primary source is Puget Sound
20 Energy. I think in 2001 I know Puget Energy reported
21 \$1.14, if I remember, per share, if my memory serves me.
22 I think roughly, and this would be subject to check, 3
23 cents of that came from Infrastrux, and there was a
24 sizable amount that came from Puget Energy because it
25 had sold a property, but the bulk of the number would

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1 have come from, clearly \$1 or so I would guess, would
2 have come from the utility.

3 Q. And those earnings that Puget Energy receives
4 through the dividend payments I suppose from Puget Sound
5 Energy, that's the source of funds or the source of
6 dollars to pay out the Puget Energy dividend to the
7 shareholders; is that how that works?

8 A. Again dividends are paid in cash.

9 Q. Yes.

10 A. And so the source of that \$30 Million that
11 has gone out on a quarterly basis historically from
12 Puget Sound Energy to Puget Energy is the operating cash
13 flow of the company.

14 Q. And that money is the money that would be
15 used to pay the many shareholders of Puget Energy?

16 A. Correct.

17 Q. And I think you testified in connection with
18 Commissioner Oshie's questions that in terms of
19 adjusting dividends that you don't do that, it's not a
20 good corporate strategy or policy to make adjustments to
21 that for short-term problems or short-term benefits?

22 A. That is my testimony and my belief.

23 Q. I wonder if it follows from that that Puget
24 Sound Energy facing certain financial exigencies if the
25 company decided to cut its dividend payment to Puget

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1 Energy, if the board of Puget Sound Energy made that
2 decision as one means of helping its financial
3 situation, that wouldn't necessarily affect what Puget
4 Energy's board would decide to do in terms of paying
5 that dividend to the many individual shareholders, would
6 it?

7 A. Well, Puget Energy's board would have to look
8 at what cash it would have from all available sources,
9 either the utility or Infrastrux or a borrowing
10 arrangement or something in making its decision.

11 Q. But it could still -- it could maintain the
12 was it 46 cent dividend payment even if the earnings
13 were insufficient to cover that? As I understood the
14 testimony, that that's something that sometimes occurs.

15 A. Well, it would look to do that. I don't
16 believe that it would have in the short term the cash
17 flow to do that. It has, Puget Energy as the holding
18 company has no borrowing arrangements established in
19 place. We have talked about the Puget Sound Energy
20 credit agreement, we have talked about the Infrastrux
21 credit agreement, but Puget Energy itself has no source
22 of capital other than its two subsidiaries.

23 Q. Is that something that would be --

24 A. At the present time.

25 Q. It could make such arrangements, couldn't it?

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1 A. It could if investors and lenders were
2 receptive to lending to it.

3 Q. And that would depend on those lending
4 institutions' or investors' view of the overall company
5 and its potential for the future, including the
6 regulated and unregulated activities?

7 A. It would.

8 Q. Just one final point. If Puget Energy issues
9 stock, as I understand it, Puget Sound Energy just has
10 the one shareholder, Puget Energy, so if we're talking
11 about an issuance of stock to raise capital, that would
12 be by Puget Energy?

13 A. That's correct.

14 Q. And my question is, does that necessarily
15 improve Puget Sound Energy's capital structure?

16 A. I think it depends on -- it clearly depends
17 on what Puget Energy does with the proceeds from the
18 common stock sale. It could, when it sells stock, it
19 could invest that in Puget Energy, make an equity
20 investment in Puget Energy, make an equity investment in
21 Infrastrux, or make an equity investment in some new yet
22 to be determined business.

23 Q. Just to be clear, you said make an equity
24 investment in Puget Energy.

25 A. I'm sorry.

1336

1 Q. Did you mean Puget Sound Energy?

2 A. Thank you for correcting me, yes, I did.

3 Q. And it would have to make that equity
4 investment in Puget Sound Energy in order to have any
5 impact on the capital structure of Puget Sound Energy?

6 A. That is correct, and that is the present
7 plan, Judge Moss.

8 JUDGE MOSS: All right, I think that's all I
9 had.

10 Anything else from the Bench before we turn
11 to see if there's further cross based on the Bench's
12 questions?

13 Okay, then we will do that, and I guess,
14 Mr. Cedarbaum, you will go first.

15 MR. CEDARBAUM: Thank you, Your Honor. I
16 have three exhibits that I would like marked if I could
17 just pass those up.

18 JUDGE MOSS: All right, have you provided
19 these to counsel?

20 MR. CEDARBAUM: No, I will do that right now.

21 JUDGE MOSS: Okay.

22 Oh, and while we're passing out paper,
23 Mr. Cedarbaum, I neglected to mention earlier, it looks
24 like the Bench may have a few questions for Ms. Steel,
25 and so we would be looking to call her back to the stand

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1 after Mr. Swofford's testimony, so you might alert her.
2 Actually, I see her sitting in the back of the room, so
3 I suppose I am alerting her that that eventuality is
4 likely, and therefore she should hold herself available
5 this afternoon.

6 MR. CEDARBAUM: And that would follow
7 Mr. Swofford, you said?

8 JUDGE MOSS: I think that's logical.
9 Let's be off the record for a few minutes.

10 (Discussion off the record.)

11 JUDGE MOSS: During the brief recess I have
12 marked PSE's response to Staff Data Request 276-G as
13 Exhibit 84C for identification. PSE's response to Staff
14 Data Request 275-I I marked as 85C for identification.
15 And PSE's response to Staff Data Request 61 I marked as
16 86 for identification.

17 MR. CEDARBAUM: Thank you, Your Honor.

18

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

20 BY MR. CEDARBAUM:

21 Q. Mr. Gaines, you were asked some questions
22 from Commissioner Hemstad about the general proposition
23 that if dividends exceed earnings, I think you agreed
24 with him and using your words I think you said over time
25 that over -- if dividends were to exceed earnings over

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1 time, that would have the effect of weakening the
2 financial status of the company and also increasing its
3 debt capitalization. And my question was, if I heard
4 you correctly when you said over time or years or I
5 can't really remember, what period of time were you
6 talking about?

7 A. What I was talking about, Mr. Cedarbaum, was
8 a period after a general rate case when sort of the
9 long-term earnings capacity of a business has been
10 determined, not, you know, a period where there's good
11 or bad hydro or something like that, but a longer term
12 period, so a period of maybe five or six years looking
13 out.

14 Q. So if for a period of five or six years after
15 the last general rate case was decided, let's say a
16 company, hypothetical company, has a general rate case
17 that's decided in 1993, 1994, if it were then to have
18 five or six years of dividends exceeding earnings, that
19 would meet your testimony?

20 A. It would, and that didn't happen in our case.

21 Q. While we were off the record, I had asked or
22 notified Mr. Quehrn that I had a few questions for you
23 on Exhibit 155. I don't know if that has been provided
24 to you.

25 A. It has.

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1 Q. And that for the record, and actually, I'm
2 sorry, I misspoke when I said 155, I meant 153, and I'm
3 looking at part 2 of 3, page 1 of that exhibit, it's
4 entitled also called spreadsheet A. Do you have that?

5 A. I do, Mr. Cedarbaum.

6 Q. And I understand you didn't calculate this,
7 I'm not going to ask you questions about the
8 calculation.

9 A. Thank you.

10 Q. This was your brother's responsibility?

11 A. Yes, it was.

12 Q. But this does show the calculation of the
13 deferred power costs beginning January that the company
14 would seek, seeks to recover, and the projected power
15 costs beginning March that the company seeks to recover
16 in this interim rate case; is that right?

17 A. Expressed in a revenue level grossed up for
18 taxes, yes.

19 Q. This is the \$170.7 Million calculation?

20 A. That's right.

21 Q. Is it correct that looking on this exhibit
22 that merger savings and best practices savings are not
23 included?

24 A. That would be correct, because this is simply
25 the power cost calculation and not one of the overall

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1 financial health of the company, which is in my
2 testimony.

3 Q. And I'm done with that exhibit. You were
4 asked some questions by Chairwoman Showalter about this
5 three part dynamic, and the first part of the dynamic
6 involved post merger but pre-power crisis; do you recall
7 that.

8 A. I do. In fact, I jotted the periods down, so
9 I have them in front of me, all three.

10 Q. And I think there was some discussion as to
11 whether or not the company at that time believed itself
12 to be in a healthy or unhealthy financial situation. If
13 you could turn to what's been marked for identification
14 as Exhibit 84C; do you have that?

15 A. Yes, I do.

16 Q. And do you recognize this as the company's
17 response to Staff Data Request 276-G, which would be a
18 general rate case data request?

19 A. I do.

20 Q. And these include board minutes for the
21 January 5th, 2000, board meeting; is that right?

22 A. Just to clarify, Mr. Cedarbaum, minutes
23 typically are paragraphs of words, and at least the
24 pages as I'm thumbing through look like a numeric
25 presentation, so I suspect that this is a subset of a

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1 presentation that probably doesn't actually include the
2 minutes itself, unless this was just a partial response.

3 Q. You're right, I should be more specific. Do
4 you recognize the attachment to Exhibit 84C as the 2000
5 and 2004 forecast that was presented at that January 5th
6 meeting?

7 A. Yes, I do.

8 Q. And if you could look to it's the fourth page
9 of the exhibit, but it's paged itself page 2 at the
10 bottom; do you have that?

11 A. Yes, I do.

12 Q. And there's a line just up from the bottom in
13 bold called earnings per share, and then across that
14 line are earnings per share for the years 2000, for
15 2004.

16 A. I see that.

17 Q. So can we agree that January 2000 was a
18 pre-power crisis, post merger time certainly as opposed
19 to merger time?

20 A. Let's see, this was the January 2000, so yes,
21 it was certainly -- I think it fits within Chairwoman
22 Showalter's first time period pre-crisis and I guess
23 merger mode since we were -- the thing was prepared in
24 2000.

25 Q. Now recognizing that these are projections on

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1 the page that I'm looking at for earnings per share,
2 would you characterize those projections, and you don't
3 need to speak to numbers unless these are now
4 non-confidential, but would you characterize those as
5 being healthy, normal, average, unhealthy, what?

6 A. Well, first of all, they are confidential, so
7 I won't speak to the numbers. Those terms are relative,
8 and so when you say healthy, I don't know what you mean,
9 with respect to what?

10 Q. Well, I --

11 A. There's more indicia of financial health than
12 simply earnings per share.

13 Q. I guess I'm asking you for Puget Sound Energy
14 with those earnings per share whether you would consider
15 that to be indicative of a company that projects itself
16 to be in a healthy or unhealthy situation?

17 A. Well, those earnings appear to be Puget
18 Energy earnings.

19 Q. Okay.

20 A. And page 3 of the following page of that
21 exhibit appears to have those split between regulated
22 and non-regulated activities. And I don't know how to
23 answer the question with respect to health. There's
24 more information needed to answer that question.

25 Q. Looking at page 3, how do I -- I'm just

1343

1 having trouble understanding how I differentiate between
2 Puget Energy and Puget Sound Energy.

3 A. I'm sorry, go ahead.

4 Q. I just wanted to make sure I'm on the right
5 page, it's paged itself as page 3, but it would be the
6 fifth page of the exhibit actually.

7 A. Yes, and it's the one that starts absent the
8 heading current earnings forecast and then before
9 initiatives and then the initiatives and then regulated
10 EPS, non-regulated EPS, and so forth.

11 Q. Okay, so the regulated EPS is Puget Sound
12 Energy, non-regulated EPS is Puget Energy?

13 A. Regulated EPS I believe from this would be
14 just the regulated piece of Puget Sound Energy, not
15 Puget Western and so forth, sort of unconsolidated, if
16 you would.

17 Q. I'm sorry, but where is Puget Energy then on
18 this page?

19 A. Puget, well, Puget Energy would be the total
20 line, and Infrastrux and the unregulated subs of Puget
21 Sound Energy would be in the line called non-regulated
22 EPS.

23 Q. So looking at that page 3, the internal
24 reference for page 3, the regulated EPS is the regulated
25 aspect of Puget Sound Energy?

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1 A. Yes.

2 Q. And the total column is Puget, the total line
3 is Puget Energy?

4 A. That's right.

5 MR. CEDARBAUM: Your Honor, I would offer
6 Exhibit 84C.

7 JUDGE MOSS: Hearing no objection, it will be
8 entered as marked.

9 BY MR. CEDARBAUM:

10 Q. You had some discussion with Commissioner
11 Hemstad about the merger order and whether or not the
12 increases that were set up in the rate plan were related
13 to power costs or not. Would you accept subject to your
14 check that on page 7 of the stipulation attached to the
15 Commission's merger order at line 7, it says that:

16 The rate plan is based upon the recovery
17 of the power cost components for 1997 to
18 2001 as set forth in Exhibit D attached
19 hereto and Exhibit Number 240.

20 A. I would accept that.

21 MR. QUEHRN: Excuse me, Your Honor, do we
22 need a copy of the merger order and the stipulation
23 submitted to the record, or can we refer to it just
24 as --

25 JUDGE MOSS: It's a Commission order, we can

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1 refer to it without it being part of the record.

2 MR. CEDARBAUM: That was my understanding, I
3 just wanted to get some context here.

4 JUDGE MOSS: That's correct.

5 BY MR. CEDARBAUM:

6 Q. And referring to Exhibit D to the stipulation
7 that was referenced in the language I just recited, do
8 you recall or can you accept subject to your check that
9 that's a table of power costs, forecasts, that have
10 various categories of power costs that then carries
11 forward is the Exhibit D that I referenced before?

12 A. Could you just show it to me, Mr. Cedarbaum.
13 I don't have it, and I don't recall it at all.

14 JUDGE MOSS: And while you're walking around,
15 Mr. Cedarbaum, I neglected to note the hour, how much do
16 you have?

17 MR. CEDARBAUM: I would guess 10 minutes.

18 (Discussion on the Bench.)

19 JUDGE MOSS: I apologize, Mr. Cedarbaum, I
20 probably shouldn't have let you get started, but I do
21 think we need to take our luncheon recess. We don't
22 want our blood sugar content falling too much here on
23 the excitement of the last day.

24 MR. CEDARBAUM: That was the last question I
25 had on that subject. If Mr. Gaines can just --

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1 JUDGE MOSS: Okay, go ahead with your last
2 question on this subject matter, and then we will take
3 our recess.

4 A. Mr. Cedarbaum was kind enough to show me the
5 exhibit, so I will accept that it is as he stated.

6 MR. CEDARBAUM: Thank you, I'm at a good
7 breaking point.

8 CHAIRWOMAN SHOWALTER: You know, I think we
9 should clarify the record that these various references
10 to the brothers Gaines and my brother are made in jest.

11 THE WITNESS: Yes, they are.

12 CHAIRWOMAN SHOWALTER: And that the two
13 Mr. Gaines are not actually brothers, so that if someone
14 is reading this transcript who is not familiar with all
15 the parties, they will understand that.

16 THE WITNESS: They are actually brothers, so
17 the record should reflect that, in fact, they are.

18 CHAIRWOMAN SHOWALTER: I didn't know that.
19 You are actually brothers?

20 THE WITNESS: We are.

21 CHAIRWOMAN SHOWALTER: See, you learn
22 something every day.

23 THE WITNESS: But they are made in jest.

24 JUDGE MOSS: All right, we will be in recess
25 until 1:30.

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1 (Luncheon recess taken at 12:05 p.m.)

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

4 (1:35 p.m.)

5 JUDGE MOSS: During the recess, somebody
6 pointed out to me that, actually I believe it was
7 Ms. Kinn who kindly pointed out to me that I neglected
8 to give a number to the Bench request concerning the
9 company's actual cost of capital and cost structure, and
10 that should be 20B. And I also will note for the record
11 that during the recess, another forest fell, and the
12 parties produced responses to a number of Bench
13 requests, and for the time being, I will not distribute
14 those. We will do that a little later so we can get
15 through the testimony and work into the evening.

16 To be perfectly honest, I have lost track of
17 where we are. Mr. Cedarbaum, did you have some more
18 questions?

19 MR. CEDARBAUM: I do have some more
20 questions, but Mr. Quehrn asked me while we were off the
21 record if Mr. Gaines could be allowed to correct a
22 question that you asked, and I am willing to oblige that
23 request.

24 JUDGE MOSS: I assume he's going to correct
25 his answer and not my question. Well, maybe I shouldn't

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1 be assuming that.

2

3

E X A M I N A T I O N

4 BY JUDGE MOSS:

5 Q. Mr. Gaines, what did you have for us?

6 A. It was my response, certainly not your
7 question. My rule is it's good to never question a
8 judge.

9 Judge Moss, when you had asked me about
10 including the impact of interest in the first mortgage
11 bond indenture ratio, I had said that it was in essence
12 a one for one consideration. So in other words, if
13 there was another dollar of interest, you would only add
14 another dollar to the amount of relief required. And I
15 neglected to think about the fact that it was a two
16 times coverage, so we would have to multiply the
17 additional dollar of interest by two to ensure that the
18 ratio was still two times. So it's still simple math,
19 it's just two times the amount of interest instead of
20 one time.

21 Q. You're still within my mathematical ability,
22 thank you, Mr. Gaines.

23 A. Thanks for allowing the correction.

24 JUDGE MOSS: No problem.

25 Okay, Mr. Cedarbaum.

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

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BY MR. CEDARBAUM:

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Q. Mr. Gaines, I guess just picking up on that point, we have been talking about the two times interest coverage test for first mortgage bonds, which I understand to be electric utility mortgage bonds; is that right?

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A. The requirement is in the electric mortgage indenture, but the opinions that I have gotten from our securities attorneys when they look at when the merger came together, in the reach of the various mortgages, which of course were written without a merger in mind, it is their view that the reach of the electric covers the gas plant to some extent as well, and so regardless of the type of property backing the bond, it still has to be the two times interest coverage.

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20

Q. Okay.

A. As well as the 1.75 that you mentioned on the funded debt requirement.

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Q. You anticipated my next question, which is, did your answer just mean that the company does not have the ability to issue first mortgage bonds -- well, let me back up.

25

There's a 1.75 interest coverage test for gas

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1 mortgage bonds; is that right?

2 A. Technically funded debt, but yes.

3 Q. And did your answer to my prior question mean
4 that the company is not able to issue first mortgage
5 bonds using that interest coverage test as opposed to
6 the two times interest coverage test?

7 A. That is correct, yeah. I mean if we, for
8 example, if we wanted to issue bonds, let's say our
9 interest coverage within the respective allowed time
10 periods was 1.9 times and so you were below the 2 times
11 in the electric indenture but above the 1.75 times
12 funded debt, you would be precluded from issuing either
13 electric or gas bonds.

14 Q. Thank you for that clarification.

15 A. Certainly.

16 Q. I had a question for you about the rating
17 agencies, and you have discussed yesterday and I think
18 this morning your relationship with these analysts. And
19 my question is, when the Commission issues an order with
20 respect to Puget Sound Energy, do you discuss those
21 orders with the rating agency analysts, or do they just
22 get a copy of it and read it for themselves and make
23 whatever conclusions they want to make from it?

24 A. We send the order to the agencies, and then
25 oftentimes they call and ask, what does that mean, you

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1 know, to the impact on the company, because we have
2 provided them forecasts, and so they're wanting to know.
3 Sometimes, as we probably all recall, the -- it's
4 there's things in orders that need clarification, and so
5 even in final orders, I mean absent a legal
6 clarification, so we explain to them our interpretation
7 of just how it would work.

8 Q. And so the specific question I guess I have
9 for you is, when the Commission issued its order last
10 October in the prior interim case and basically
11 dismissed the company's request, what type of
12 discussions did you have with the rating agencies about
13 that?

14 A. A couple. The main one is remember that the
15 facts in the case were most all the material was
16 confidential. We didn't do as we have done subsequently
17 putting information in 8-K's and so forth. And because
18 of the nature in which that request was dismissed, the
19 comments from both rating agency people and equity
20 analysts was, well, gee, you said you put on a good
21 case, the implication was that maybe it was incomplete,
22 which is it, you know. And that was the bulk, a piece
23 of the conversation. The other piece of the
24 conversation was, does that mean that you're precluded
25 from requesting relief again. That was a piece which,

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1 of course, we told them no. Let's see, those are the
2 two big pieces, Mr. Cedarbaum, that I recall.

3 Q. The first piece where they had some,
4 apparently had some confusion between the Commission
5 dismissing a case and you saying, well, we had, I think
6 I heard you say, we had all this information but it's
7 confidential, so the analysts can't see it?

8 A. Well, we had not provided that to them that I
9 recall. I should say that's subject to check. I don't
10 believe that we had given it to the rating agencies. My
11 response was covering both equity analysts and rating
12 agency analysts, and certainly that was true with
13 respect to equity analysts.

14 Q. And so did you explain to them that the
15 Commission had held that the company had not carried its
16 burden of proof in that case, or did you tell them that,
17 we put on a good enough case to clear that hurdle?

18 A. What I told them was what the Commission's
19 view was and that my view was that we had put on a good
20 case and that we weren't afforded the opportunity for a
21 hearing to really see if the information was there. But
22 the record spoke for itself in that regard.

23 Q. Switching topics, I think it was this morning
24 you, I think it was, that you referred to PURPA contract
25 buyouts.

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1 A. Yes.

2 Q. Which contracts were you talking about?

3 A. Two, and I think I talked about -- I may have
4 said buyouts, I probably should have said restructuring,
5 but same intent. The first one was the Tenaska project,
6 and the second one is Encogen. As I number them,
7 Mr. Cedarbaum, I may have the timing backwards as to
8 which one went first, but those were the two.

9 Q. Do you know what the timing was for both of
10 them?

11 A. I don't, but if you have a date, I would
12 accept it subject to check, or we could respond to that
13 with a Bench request, I mean a records requisition.

14 Q. Do you know the general time frame?

15 A. I think one of them was towards the end of
16 1999, and I just can't remember the other. Mr. Bill
17 Gaines would certainly know the answers to those.

18 Q. He seems to have escaped the hearing room.

19 A. As I mentioned, I would be happy to provide
20 it as a records requisition.

21 Q. Why don't we go ahead and do that.

22 JUDGE MOSS: All right, not being prescient,
23 I failed to reserve enough numbers in the early series,
24 so I decided to jump ahead. This will be Exhibit 460,
25 the records requisition, and this will be the timing on

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1 the Encogen and Tenaska restructuring.

2 THE WITNESS: Yes.

3 JUDGE MOSS: Okay.

4 BY MR. CEDARBAUM:

5 Q. You had some discussions this morning with
6 Commissioner Oshie in particular and perhaps others
7 about consolidated and unconsolidated, all of that
8 stuff. Is it correct that Puget Sound Energy has debt
9 on a consolidated basis?

10 A. Well, on the consolidated -- I want to make
11 sure I understand your question, Mr. Cedarbaum. On the
12 consolidated books of Puget Sound Energy, there is debt.
13 The vast majority of that debt, in fact, I would have to
14 double check, but I'm pretty sure it's all the debt is
15 related to the utility business. I don't believe
16 there's debt outstanding other than maybe some mortgage
17 notes or something with the real estate subsidiary.
18 There's certainly no long-term debt.

19 Q. And I'm going to be bouncing around here.

20 A. That's okay.

21 Q. And hopefully you will be able to keep track.
22 You had some discussion as well about the level of cash
23 dividend that Puget Energy pays its shareholders versus
24 the level of dividend that Puget Sound Energy pays to
25 Puget Energy, and I think you said that those two were

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1 different, different amounts?

2 A. I don't believe in the case of Puget Energy I
3 was necessarily saying the cash dividend. The dividend
4 declared is, you know, 46 cents times the number of
5 shares, which at 87 Million shares approximately on a
6 quarterly basis is roughly \$40 Million. And what I was
7 saying is that's the dividend that PE pays. Some
8 investors choose to have their dividends reinvested, and
9 that amount is roughly \$6 Million, and so the cash
10 dividend that Puget Sound Energy using Commissioner
11 Oshie's term upstreams to Puget Energy is the net of the
12 two or the \$30 Million to \$33 Million.

13 Q. I guess my question is, have there been
14 quarters in which the cash dividend that Puget Sound
15 Energy pays to Puget Energy is equal to the amount of
16 cash dividend that Puget Energy pays to its
17 shareholders?

18 A. I would have to double check, but I -- well,
19 no, I would say no, because we only have had that
20 situation since the creation of the holding company,
21 which was January of 2001, and we started the issuing
22 new shares with response to the dividend revision
23 program in November of 1999, so I don't believe that
24 that has been the case. The accounting may have been
25 different at points where you pay in and it gets funded

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1 back, I would have to double check, but I'm pretty sure
2 that it's been that way.

3 MR. CEDARBAUM: Your Honor, may I approach
4 the witness with a document?

5 JUDGE MOSS: Sure.

6 BY MR. CEDARBAUM:

7 Q. Mr. Gaines, I'm going to hand you a document
8 that was contained within the company's response to
9 Public Counsel Data Request 73.

10 A. I have that exhibit.

11 Q. At least the copy I received was not on blue
12 paper, and I don't see any confidential stamp on it,
13 so --

14 A. It's not.

15 Q. Can you just read, I think you probably know,
16 I don't have it now in front of me because I gave you my
17 copy.

18 A. I would be happy to read it, and then explain
19 it as well. This is a recommendation, and I'm assuming
20 it's the first part, Mr. Cedarbaum, under the category
21 of recommendation that you're wanting me to read from
22 Puget Sound Energy, and it states:

23 Approve a cash dividend to its parent,
24 Puget Energy, equal in amount to cash
25 dividends Puget Energy will pay to

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1 shareholders on November 15, 2001.

2 And then this says, anticipated dividend, the
3 amount is the \$33 Million that I have been talking about
4 before.

5 Q. Okay. So why don't you explain why I'm
6 confused.

7 A. Okay, I would be happy to. It's because, as
8 I was mentioning, my mention of dividends that the Puget
9 Energy pays is inclusive of those dividends reinvested.
10 So if we were to take the number of shares outstanding
11 at the end of August 2001 and multiply that by the 46
12 cents a share, you would get a number much closer to
13 that \$40 million that I was talking about, the aggregate
14 amount of dividends. And so in this instance, as I
15 mentioned, there would be times when it would be netted
16 out. This is a time where the reinvested dividends,
17 that's approximately 6 1/4, has been netted out. And so
18 rather than showing it separately as we have done
19 subsequently, I believe, this was done on sort of a net
20 basis and talks about the net dividend, cash dividend
21 that Puget Energy pays as contrasted to the total
22 dividend that Puget Energy pays, which would be greater.

23 Q. Okay.

24 A. Do you need this back?

25 Q. I can get it from you later, that's fine,

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1 thanks.

2 I have one question about the \$375 Million
3 line of credit. Is it correct that the borrower on that
4 line is Puget Sound Energy?

5 A. Yes, interpreted to mean the utility. It's
6 never been used for non-utility purposes.

7 Q. Just a couple more areas. If you could turn
8 to what's been marked for identification as Exhibit 85C,
9 and that was one of the exhibits that I distributed this
10 morning.

11 JUDGE MOSS: It's the response to WUTC Staff
12 Data Request Number 275-I.

13 Q. Do you recognize this as the company's
14 response to Staff Data Request 275 as just indicated by
15 the Bench?

16 A. I do, yes.

17 Q. And these are at least a portion of board
18 minutes from a board meeting of January 4, 2001?

19 A. Yes, that's --I can't tell if it's -- which
20 board from this, if it's Puget Energy, Puget Sound
21 Energy. It deals with Infrastrux, so I'm not sure if
22 it's an Infrastrux board. I would take a subject to
23 check here clarification of that. Oh, I'm sorry, a few
24 pages in, Mr. Cedarbaum, it says at the top, Puget
25 Energy.

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1 Q. Thank you.

2 MR. CEDARBAUM: I would offer Exhibit 85C.

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

5 MR. CEDARBAUM: And for the record, Your
6 Honor, there was in our complete copy of the response to
7 275 a legal memorandum at the end, which we took off,
8 because we assumed it was privileged. If the company
9 wants to include it, that's fine with us.

10 THE WITNESS: Is this the request here, the
11 exhibit we were just talking about?

12 MR. CEDARBAUM: The exhibit is 85C. If
13 you're looking at the request, you might have a document
14 that has more pages to it.

15 THE WITNESS: I'm just looking at the
16 confidential material that was discussed. It looks like
17 it's minutes of Puget Sound Energy and Puget Energy.

18 MR. CEDARBAUM: And I'm sorry to belabor the
19 point, I just wanted to put the company on notice that
20 we didn't include the complete response to 275, because
21 there was a legal memo to the company included, which we
22 didn't want to violate, get into the privilege issue,
23 quite frankly.

24 MS. DODGE: If a privileged document has been
25 inadvertently produced, we would like it back.

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1 MR. CEDARBAUM: Okay.

2 MS. DODGE: And the company --

3 MR. CEDARBAUM: I don't know if it was
4 inadvertent or not.

5 MS. DODGE: I will say for now that the
6 company doesn't waive any privilege and that we'll take
7 the position it was inadvertent. I would be happy to
8 look at it, and then we'll see.

9 MR. CEDARBAUM: Your Honor, has 85C been
10 admitted?

11 JUDGE MOSS: Yes.

12 BY MR. CEDARBAUM:

13 Q. Referring you, Mr. Gaines, to Exhibit 86 for
14 identification, do you recognize this as the company's
15 response to Staff Data Request 61-I?

16 A. It's described as that, Mr. Cedarbaum.
17 There's a line across the page which I have not seen on
18 other data responses that has me wondering if it was a
19 cut and paste of something, so I don't know for sure. I
20 didn't prepare this particular data request. It was one
21 that I adopted, and so I don't know for sure. I would
22 certainly take subject to check your request that I do
23 so.

24 Q. That was the way we received it.

25 A. Okay.

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1 Q. There was nothing missing.

2 A. I'm assuming that this could be just a copier
3 problem.

4 MR. CEDARBAUM: Your Honor, I would move the
5 admission of Exhibit 86.

6 JUDGE MOSS: Being no objection, it's to be
7 admitted as marked.

8 BY MR. CEDARBAUM:

9 Q. One final topic, Mr. Gaines, you indicated
10 this morning in response to a question from one of the
11 commissioners that you believe shareholders have an
12 interest in dividend stability. Do you recall that
13 general area?

14 A. The general discussion, yeah, not that
15 specific comment.

16 Q. My question is, do you believe that rate
17 payers have an interest in rate stability?

18 A. That's a very good question, Mr. Cedarbaum.
19 I think rate payers, and I prefer to refer to them as
20 customers, a rate payer to me is just simply a person
21 who pays a rate. Every one of our customers who pays a
22 rate receives something in exchange, so to me that makes
23 them customers. But I believe that their interests are
24 broader than probably what some people may assume. I
25 think their interests are more than just rate levels. I

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1 think that -- and not necessarily stability. I think --
2 and it depends how we define stability. I was
3 interpreting stability to mean constant level.

4 I don't think customers are necessarily
5 interested in that, and I base that comment in part on
6 the popularity of the PEM program, which has different
7 blocks of rates during the day. So it's a stable -- the
8 structure is stable over time, but the rate level isn't
9 stable during the course of the day. I think they also
10 are interested in the health of the company who provides
11 them their service. There has been instances in
12 telecommunications companies where people who bought
13 long distance service from a resaler have had to switch
14 as the resaler maybe went out of business, and so I
15 think that that's an aspect of their interest, but I
16 think that it's much broader than that.

17 Q. So do I take it from that answer then or
18 should I take it from that answer that you believe that
19 customers should be entirely responsible for the
20 financial health of the company?

21 A. Well, subject to prudence, I would say yes.

22 MR. CEDARBAUM: Thank you, those are all my
23 questions.

24 THE WITNESS: You're welcome.

25 JUDGE MOSS: We have some follow up on that

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1 from the Bench before we turn to you, Mr. ffitch.

2 CHAIRWOMAN SHOWALTER: Oh, well, sorry,
3 they're just quick follow ups.

4 MR. CEDARBAUM: I was finished with my
5 questions.

6 JUDGE MOSS: I thought you were.

7

8 E X A M I N A T I O N

9 BY CHAIRWOMAN SHOWALTER:

10 Q. Regarding the information that you can
11 provide the rating agencies as opposed to the stock
12 analysts, is there any prohibition against the company
13 sharing what would otherwise be confidential information
14 with the rating agencies?

15 A. There's no prohibition. The rating agencies
16 to perform their task need access to material,
17 non-public information like the forecasts since ratings
18 are prospective, and it is certainly a policy of our
19 company not to make that available to others. But other
20 than maybe information that was subject to a specific
21 confidentiality agreement say between the company and
22 others, for example, the materials with respect to the
23 Schedule 48 settlement, I believe that type of
24 information we wouldn't share with the rating agencies.

25 Q. But as far as information the rating agencies

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1 would like to see or information you would like them to
2 see, barring other restrictions, you will show that to
3 them?

4 A. We show them everything that we can not, you
5 know, that we're -- that we can show them where we
6 wouldn't be violating a legal agreement or something,
7 and that really is just about everything. It is -- they
8 do have to make sure in writing their reports that they
9 do not include any of that, and that's oftentimes why
10 they will discuss those reports with us.

11 Q. And then if you could turn to Exhibit 414C,
12 which was one of Ms. Steel's.

13 A. I have it.

14 Q. And it's page 6 of 7. This actually does
15 relate to the questions Mr. Cedarbaum asked, because it
16 actually relates to the board minutes that were just
17 distributed.

18 A. Okay.

19 Q. Am I correct first that Infrastrux was
20 transferred from Puget Sound Energy to Puget Energy as
21 of or on January 1st, 2001?

22 A. Yes, and I believe that the last exhibit that
23 Mr. Cedarbaum showed me had that as the date.

24 Q. Yes, it does. Now this may be a what happens
25 at that witching hour between the 31st and the 1st of

1365

1 January, but I just want to make sure I understand it.

2 On the line that says current assets, which is four bold
3 points down, four bold lines, this is on page 6 of 7.

4 A. I have that, yes.

5 Q. All right. There was some discussion of
6 these amounts.

7 A. Yes.

8 Q. Going from \$36,000 plus on the 31st of the
9 year 2000 to \$82,708, \$82 Million, I'm sorry, on the
10 31st, December 31st of 2001, and then there are
11 Ms. Steel's handwritten notes showing 82.7.

12 A. Yes, I see that.

13 Q. There was discussion around that as
14 reflecting or not reflecting cash due to Infrastrux, and
15 I just wonder if you can tell me first, is that
16 accurate, and how does the -- how is it reflected in
17 that line vis-a-vis the transfer date of the 31st, of
18 the 1st of January 2001?

19 A. This is not one of the things that happens in
20 that bewitching time between the two, because they're
21 really instantaneous. This is by coincidence a similar
22 number to the 86 or 87 that we were talking about, but
23 is unrelated to that.

24 Q. Okay.

25 A. This information, and remember we're

1366

1 comparing just to be clear it's the cash line of the
2 component of current assets from the end of 2000 to the
3 end of 2001. In there would be temporary investments
4 and so forth, and it would include cash of Puget
5 Western, that entity. And there was discussion earlier
6 of, and her adjustment for working capital compares this
7 statement to our financial forecasts included in
8 Mr. Hawley's workpapers, and there was discussion that
9 that projection ended the year with an \$8 Million
10 balance, and this shows ten times that amount, so the
11 forecast must be off. That's an apples to oranges
12 comparison.

13 As this states at the bottom, it includes all
14 subsidiary results, so it would include Puget Western,
15 and that entity has about \$60 Million of cash in it, and
16 a large portion of that was derived during 2001 by Puget
17 Western selling the Mercer properties that were synergy
18 properties that it had. That was disclosed to Staff in
19 response to Staff Data Request I believe 146-I, and
20 that's really why that difference is.

21 A better comparison for the accuracy of the
22 forecast is to take this amount of short-term debt,
23 again we said there's no debt related to Puget Western
24 here other than maybe some notes, real estate mortgage
25 notes, which wouldn't be in this line, we can compare

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1 that number of \$338 Million down roughly ten lines up
2 from the bottom to the models forecast or financial
3 forecast as shown on I believe it's page 4 of
4 Mr. Hawley's workpapers. And allow me to double check.
5 The number on whatever the source is for the end of the
6 year is \$339 Million, so in my view, that forecast was
7 quite close when you're off by \$1 Million with respect
8 to that kind of a number. And if I will find my page
9 quickly, that reference is not page 4, it is page 7, and
10 it is column D, line 4, 339.013 contrasted to 338.168.

11 Q. You were just reading from workpapers, and
12 this is not an exhibit?

13 JUDGE MOSS: Yes, it is an exhibit, it's 32C.

14 A. It's 32C.

15 Q. All right, I started to get lost there, but
16 in effect then on the cash line, it isn't the same
17 thing, or is it, that there are -- there were pluses and
18 minuses during the year, and it ended up at -- it
19 happened to end up at 82,708?

20 A. It happened to end up at that. It's
21 comprised of there were -- certainly there was --
22 remember on Exhibit 81, I believe, we showed that the
23 money had been spent by the end of the year on two
24 acquisitions from the what I would call the Infrastrux
25 cash. That left in there the cash at Puget Western in

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1 its bank account, which is \$60 Million, and then there
2 was another roughly \$15 Million, and I say roughly
3 because it's plus or minus \$3 Million, with respect to a
4 sale of, and I can't remember the asset, but that's
5 really what the two pieces were.

6 CHAIRWOMAN SHOWALTER: Okay, thank you.

7

8 E X A M I N A T I O N

9 BY JUDGE MOSS:

10 Q. Just to clarify the record, you referred to,
11 I think you were actually referring to a company,
12 Cynergy, is that C-Y? You weren't using the term
13 synergy?

14 A. No, and I -- if we could have the court
15 reporter read back, because I don't recall.

16 JUDGE MOSS: That's what I'm -- let's be off
17 the record for a minute.

18 (Discussion off the record.)

19 JUDGE MOSS: Let's see now, Mr. Cedarbaum,
20 you were finished.

21 And did that conclude your follow up,
22 Chairwoman Showalter?

23 CHAIRWOMAN SHOWALTER: Yes.

24 JUDGE MOSS: And I just had one quick follow
25 up to Mr. Cedarbaum's as well before we go back to you,

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1 Mr. ffitch.

2 BY JUDGE MOSS:

3 Q. Mr. Gaines, you mentioned in response to some
4 questions, or maybe this is just a single question, from
5 Mr. Cedarbaum with respect to the exhibits in
6 Mr. William Gaines' testimony regarding the \$170 Million
7 amount that we have heard so much about, that in his
8 exhibits, that reflected power costs and did not reflect
9 any of the sort of savings, merger savings and things we
10 talked about. And you said that by contrast, your
11 exhibits, the exhibits of Donald Gaines, did reflect the
12 analysis of the company's financial position arriving at
13 the same \$170 Million figure reflecting that sort of
14 thing. And what I wanted to ask you was whether there
15 was a particular exhibit that you had in mind to show
16 that, to show your analysis in that respect, or whether
17 you were speaking more generally in terms of theories
18 and principles consistent with the PNB criteria?

19 A. What I was talking about is more generic, and
20 the number -- I don't have a schedule that derives 170.
21 I take the 170 number, which is comprised of \$163
22 Million of power costs and other miscellaneous revenue
23 related items, and run that, the impact of that number,
24 through a series of indicia, coverage ratios, for
25 coverage ratios, the cash flow analysis similar in some

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1 respects to the one Ms. Steel did, the four -- the two
2 times interest coverage for the indenture, the rate of
3 return calculation. And then other people do other
4 things with it as well. But really those I believe
5 seven items that I used to compare and stand up against
6 the PNB standard.

7 Q. Are those seven criteria or standards all
8 reflected in an exhibit, or is it a series of exhibits?

9 A. They're all in my testimony, which is Exhibit
10 25.

11 Q. Your direct is 21, your rebuttal is 25.

12 A. My rebuttal, thank you, and they're
13 unfortunately not necessarily all on one page.
14 Actually, there's a couple of tables that contain them
15 towards the back. Where I discuss the PNB standards,
16 they are mentioned. And all of them, all of the numbers
17 and their derivation are included in 42C, Mr. Hawley's
18 workpapers.

19 JUDGE MOSS: All right, thanks very much.

20 THE WITNESS: Certainly.

21 JUDGE MOSS: All right, Mr. ffitch.

22 MR. FFITCH: Thank you, Your Honor.

23

24

25

1371

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

2 BY MR. FFITCH:

3 Q. Hello again, Mr. Gaines.

4 A. Hello, Mr. ffitch.

5 Q. Just one or two more questions. So did you
6 or Mr. Hawley conduct this analysis that you were just
7 discussing with the Judge where you took the \$170
8 Million and then sort of ran it through all the
9 coverages and performed the analysis that you just
10 described, was that you or Mr. Hawley?

11 A. I did that at the request of Mr. Hawley.

12 Q. All right. Following up on a question that
13 Commissioner Hemstad had, you had just I think discussed
14 the merger savings that have been identified so far. I
15 believe that number is \$156 Million over a three year
16 period.

17 A. I think that was a number included, if I
18 recall, in Mr. Weaver's testimony, and I believe I
19 accepted that subject to check.

20 Q. Correct. And then you were asked whether
21 there were substantially greater projections over a ten
22 year period, and I didn't hear a yes or no answer to
23 that question. Are there substantially greater
24 projections over a ten year period for those savings?

25 A. I don't know the answer to that question.

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1 Q. Last area.

2 A. Mr. Ffitch, just to be clear, I do know there
3 were projections at the time of the merger that went out
4 ten years, and I do know, well, subject to check, there
5 is a number for savings which I believe may be to date,
6 I don't know if it's a ten year number, in Mr. Weaver's
7 testimony and in Mr. Sherman's. I just don't know if
8 they're -- if one is actual, one is -- one is certainly
9 projected, if they cover similar time periods, if
10 they're addressing the same items or what, and that's my
11 reluctance or hesitation in having an ability to answer.

12 Q. And those projections you say just run up to
13 the present time?

14 A. I don't know that, that's one of the things
15 I'm wondering about.

16 Q. Okay.

17 A. I know in the merger the projections were ten
18 years and I believe began in '96.

19 Q. Right. So I guess what I'm asking is whether
20 there are current projections going forward regarding
21 the expected continuing flow of merger savings?

22 A. There are none that I'm aware of.

23 Q. Do you know if there is any expectation on
24 the company's part, on Puget Sound Energy's part, of
25 continued savings from the merger?

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1 A. There is, and I'm glad you let me have the
2 question, because I want to clarify why I believe that
3 there are no savings calculations. The savings, trying
4 to measure the actual savings is somewhat difficult
5 because you're taking the results of the merger and
6 trying to compare them to something that would have been
7 had the companies not merged, and we don't know the
8 numbers for that. There are different ways of trying to
9 get to that number, and I believe that's what
10 Mr. Sherman's testimony does in the general rate case.
11 I don't know if that helps clarify your question or not,
12 Mr. ffitich.

13 Q. Well, we have testimony, you have
14 acknowledged that the merger savings that have been
15 identified are at least \$156 Million over a period of
16 three years, and there's also I think it's fair to say
17 general testimony from company witnesses in this case
18 that the company has done very well, very, very well in
19 achieving the merger savings that were expected. Isn't
20 that true?

21 A. I don't know the exact adjective, but I would
22 agree that the company has performed admirably with
23 respect to the forecast of earnings put together in the
24 merger proceeding.

25 Q. And what about --

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1 A. And I do know --

2 Q. Excuse me, I'm happy to have your answer with
3 regard to earnings, but I asked about merger savings.

4 A. Okay, I'm sorry. Yeah, merger savings only
5 show up in the company's overall result. Again, the
6 savings themselves are calculated or at the time the
7 projections were made by taking projections of stand
8 alone entities unmerged and comparing them to a merged
9 entity forecast. So since there is no unmerged entity
10 going forward, it's difficult to calculate the savings.
11 Clearly any benefit from such savings flows through the
12 financial forecast upon which all of these financial
13 indicia were calculated. So clearly to become the
14 second lowest cost combination company in the nation, we
15 achieved savings. Those are reflected in these
16 forecasts and in the financial results that I have held
17 up against the PNB standard.

18 Q. All right. And I guess what I'm trying to
19 get to is specific company discussions of merger savings
20 as such. I realize that all of these things blend
21 together on the balance sheets.

22 A. And income statements, yes.

23 Q. But we have company testimony in this case
24 with regard to specific merger savings achieved and to
25 the general level of merger savings. I'm asking if,

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1 first of all, if the company expects the current level
2 of merger savings to continue?

3 A. I don't know the answer to that question.

4 Q. And you have already testified that there are
5 no projections of continued merger savings?

6 A. Correct, the merger savings and all other
7 items are reflected in the forecasts we have provided.

8 Q. Do you know if the company expects the merger
9 savings to go down?

10 A. I don't know either way, Mr. ffitch.

11 Q. All right.

12 A. And I do know there are no line items in any
13 of those forecasts with respect to merger savings. The
14 forecasts contain the costs at whatever levels they're
15 projected to be of the combined entity, and to calculate
16 the savings, one would compare those costs with costs of
17 an unmerged or the unmerged entity, you know, had the
18 two companies not combined, and I just don't have that
19 other piece that I would need to do such a calculation.

20 Q. I just want to make sure I'm understanding
21 your testimony. Are you testifying there are no
22 projections, no current projections, or are you
23 testifying you don't know if there are any current
24 projections?

25 A. I'm testifying that the company has made no

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1 such projections since around the time, well, no current
2 projections say within the last year that I'm aware of.
3 And I would be aware of a lot of projections since the
4 financial forecasting area is the area, one area of my
5 responsibility. I do know that there are savings
6 calculations in Mr. Sherman's testimony in the general
7 rate proceeding, and just as I sit here today, I don't
8 know if those are projected or if those are historical.
9 They would be Mr. Sherman's projections if they were
10 forward looking.

11 Q. You qualified your answer by referring to
12 within the last year. Were there projections of merger
13 savings that were made not at the time of the merger, I
14 understand, I'm not really asking you about those, I
15 think those are generally available in the merger
16 record, but before the last year, were there projections
17 for merger savings?

18 A. Really it sounds like you're asking between
19 the time of the merger and last year. I don't know the
20 answer to that. If there were, I would expect them to
21 have been closer to the time of the merger.

22 Q. The last thing I wanted to inquire about was
23 the Chairwoman's sort of three part scenario for the
24 life and times of Puget Sound Energy in the last few
25 years. The first part I think was described as a

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1 pre-crisis merger mode, and the second part was power
2 crisis/good, and the third part was power crisis/bad I
3 guess.

4 A. Power price drops/bad, I had word for word on
5 that last one.

6 Q. So keeping good notes here.

7 A. Yeah.

8 Q. I just wanted to ask you if you could give me
9 your understanding of the dates when those three periods
10 or those sort of three different states existed?

11 A. Well, I can attempt. I don't have those
12 here. Pre-crisis merger mode I interpreted to mean sort
13 of before it -- sometime after '96 or '97 and going up
14 until the time when power prices/good would have come
15 in, which probably would have been before the end of the
16 rate -- it would have been before the end of the rate
17 stability period. I don't know the specific date on
18 that.

19 Q. Can you give me a year?

20 A. I don't know if it's '99 or 2000, Mr. ffitich.
21 It would be a better question for Mr. William Gaines.
22 I'm just not -- that's not something that I have kept in
23 my mind, nor can I think of an exhibit that I have with
24 me that I can turn to. With respect to power price
25 drops/bad, I believe and it's my understanding from

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1 reading Mr. William Gaines's testimony that that's
2 sometime, as I mentioned earlier, around the June, July,
3 August time frame of 2001, sort of end of, I believe I
4 said earlier, end of the spring, beginning of the summer
5 is how I would refer to those dates. So the one that I
6 think I'm missing is the beginning of power crisis/good,
7 and I'm sorry, I just don't know.

8 MR. FFITCH: All right, thank you, those are
9 all my questions.

10 Thank you, Your Honor.

11 JUDGE MOSS: Go ahead.

12 COMMISSIONER HEMSTAD: Just to clarify the
13 record and pursuing the question and answer with regard
14 to merger savings, I think it would be helpful, I want
15 to read from the 14th Supplemental Order in Docket
16 UE-951270, which was the order accepting the stipulation
17 of the parties and approving the merger. And it reads
18 within the paragraph at the top of page 22:

19 All parties appear to agree or at least
20 not contest that the merger will result
21 in significant savings. In their merger
22 filing, the joint applicants have
23 estimated net merger synergy savings of
24 nearly \$370 Million (\$400 Million
25 savings less \$30 Million in costs to

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1 achieve) over the next ten years through
2 the elimination of duplicate corporate
3 and administrative programs and the
4 integration of field operations and
5 facilities. Commission Staff and Public
6 Counsel have identified additional areas
7 in which savings have been estimated by
8 the joint applicants, including
9 implementation of best operation
10 practices in achieving certain power
11 stretch goals. These potential
12 additional savings are significant.

13 And the citation is to Exhibit TS-34, page 5.

14 MR. FFITCH: I guess, Your Honor, I'm sorry.

15 COMMISSIONER HEMSTAD: I guess I don't have a
16 question I was just putting that in the record for
17 clarity.

18 THE WITNESS: When Mr. ffitch was asking me
19 about merger savings projections and I said I knew there
20 were some that were done around the time of the merger,
21 it was those that I was thinking of.

22 JUDGE MOSS: Anything else, Mr. ffitch?

23 MR. FFITCH: Well, yes, in view of the
24 clarification from the Bench, just to sort of tie things
25 up.

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1 BY MR. FFITCH:

2 Q. Does Puget Sound Energy take the position at
3 this point that those projections are still accurate,
4 still valid projections for the merger savings to be
5 achieved?

6 A. We have no way of knowing.

7 Q. If you have no way of knowing, how is it that
8 several Puget Sound witnesses in this case are
9 testifying that those merger savings are, as you said,
10 being admirably achieved?

11 A. I believe those measures are by comparing our
12 costs. Certainly in my knowledge it's comparing our
13 costs with those of other utilities and over time
14 historically. So, for example, I mentioned that we have
15 the second lowest non-production costs in the nation of
16 all combination gas and electric companies, something
17 like \$155 per customer compared to an average that
18 exceeds \$260 per customer. It's that type of
19 information, I suspect, that people are thinking of.
20 And as I mentioned, Mr. Sherman has done some
21 calculations.

22 Q. Thank you, I will look at his testimony.

23 So are you saying that Puget Sound Energy is
24 or is not achieving the merger savings projected in --

25 A. I have no way of knowing if we're achieving

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1 the levels projected as Commissioner Hemstad read.

2 MR. FFITCH: I don't have any further
3 questions, thank you.

4 JUDGE MOSS: Thank you, Mr. ffitch.

5 CHAIRWOMAN SHOWALTER: I just have a follow
6 up to this discussion.

7

8 E X A M I N A T I O N

9 BY CHAIRWOMAN SHOWALTER:

10 Q. If we're in the -- if you were in the merger
11 mode pre-crisis, and I think your earlier testimony was
12 that had the crisis and other events not occurred coming
13 toward the end of the merger stability period, things
14 would not have looked too good.

15 A. Right, it's likely we would have been filing.

16 Q. Right. And can you give me in a qualitative
17 sense why, that is, there were merger savings, there's
18 an interest rate reduction, there's some rate increases,
19 I understand those three things are positives. The
20 power costs we're setting aside. So there's something
21 else, maybe it's inflation, maybe it's growth, I don't
22 know what it is. But just in a qualitative sense, what
23 are the elements that would have brought us to a rate
24 case even absent power drop/bad?

25 A. You ended up asking a question going a

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1 different way than where I had thought you were going,
2 so I'm not sure that I can answer it the way that you
3 said, because a rate case has a specific way of being
4 calculated, and I --

5 Q. Oh, maybe that was just -- I don't really
6 mean that term. I mean just tell me in a qualitative
7 sense what the negative elements were or are or have
8 been that are pulling down on the company outside of the
9 drop in power prices?

10 A. That's where I thought you were going.

11 Q. Okay.

12 A. I know of two. I don't know of all of them.
13 Clearly there are, I would suspect, I don't know for a
14 fact but I would suspect more than these two. One is we
15 put in an integrated like an intranet, internal
16 internet, to facilitate communications inside the
17 company. It's one that neither company had had
18 pre-merger. We included an enterprise wide accounting
19 system, the SAP system. We initiated several programs
20 such as the PEM program. All of those things were
21 things that have costs and benefits associated with them
22 certainly, and those were things that weren't, I
23 believe, anticipated when the merger savings were
24 projected.

25 Q. All right, so these are things that cost

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1 money and we will be examining in the rate case, which
2 is one reason I don't know what they are.

3 A. They have costs and benefits associated with
4 them certainly, yeah, and all of that gets netted out
5 into the final reported costs of the company. I don't
6 know how, you know, Mr. Swofford may have testimony,
7 Mr. Sherman may have testimony on savings. As I sit
8 here, I don't know.

9 Q. All right. I think what I'm really just
10 trying to get is a conceptual sense of why things were
11 probably going to be neutral to negative even prior to
12 the power crisis/good phase?

13 A. I don't know the answer. I would love to
14 know it so that I could tell you, because the obvious
15 answer is there were costs that went up offsetting those
16 things to result in the negative result that we were
17 envisioning or positing. My studying coming here today
18 was really the subsequent period, and so I didn't go
19 back and look in that period, and so I apologize for my
20 ignorance in being able to answer your question, which
21 seems very obvious and a good one.

22 Q. Well, I recognize that it's not the immediate
23 issue of this case, it's really just trying to
24 understand the dynamics of how we got here to the
25 current state, which is one for analysis of a temporary

1384

1 period of time.

2 A. You know, and I don't know when power
3 prices/good started, but the test period for the
4 company's general rate proceeding is the 12 months ended
5 June of '01, so clearly that reaches back into a time --
6 and power costs are normalized, I believe, in that. So
7 to the extent that there's a need for relief, it would
8 be included in that, those numbers. And I don't want to
9 talk about the general rate case filing, but clearly,
10 and I don't know the drivers of that, which is what
11 you're getting at, but clearly we view that there were
12 drivers when you normalize out power costs and net
13 benefits against costs and so forth, or we wouldn't have
14 made our general rate case filing. I just don't know
15 the drivers as I sit here, I apologize.

16 CHAIRWOMAN SHOWALTER: Thank you.

17 JUDGE MOSS: We're actually going to get to
18 the redirect in a few moments, I promise, I just wanted
19 to follow up on one other point, Mr. Gaines.

20

21 E X A M I N A T I O N

22 BY JUDGE MOSS:

23 Q. With respect to the consolidated balance
24 sheet we were looking at a moment ago, and now I
25 foolishly turned my pages and lost track of it.

1385

1 A. I have done the same thing, Judge Moss.

2 Q. 414C, page 6 I think it was.

3 A. Page 6 of 7, I believe that's correct.

4 Q. And that's a consolidated balance sheet. Are
5 there similarly unconsolidated balance sheets that show
6 these data for the various companies such as the Puget
7 Western in the same period?

8 A. I know there are, you know, this is a report
9 out of an internal company document, and I know there
10 are none in there. I know there are none in our
11 publicly reported financial results. I can check if you
12 would like to see if there's one for Puget Western.

13 Q. All right.

14 A. I suspect there may be. I would be happy to
15 do that and provide that as either a Bench request or a
16 records requisition.

17 JUDGE MOSS: I will make it a Bench Request
18 and I will number it 461.

19 THE WITNESS: Is that described as the
20 balance sheet of Puget Western as of December 31st,
21 2001?

22 JUDGE MOSS: Yeah, let's get it for the same
23 period as the consolidated balance sheet.

24 MR. CEDARBAUM: Your Honor, can I ask a
25 clarification about the Bench Request you just gave. Is

1386

1 that limited just to Puget Western or to all of the sub
2 parts of the consolidated?

3 JUDGE MOSS: I was interested in Puget
4 Western, but if you think the other information would be
5 useful, I suspect to the extent it exists for one, it
6 probably exists for all.

7 THE WITNESS: I would not suspect that only
8 because a lot of them -- we had a list earlier that
9 shows a bunch of them and a lot of them are inactive,
10 and so I don't think that they have them. Why don't we
11 do this, we will look and see if we have them for other
12 subsidiaries, and what we have we will provide in
13 addition to Puget Western.

14 JUDGE MOSS: Okay, that would seem to satisfy
15 everyone's interests then.

16 BY JUDGE MOSS:

17 Q. Okay, well, I have one final question,
18 Mr. Gaines, and it's really just a point of curiosity,
19 but I was noticing in, and that's the exhibit I had
20 flipped to and now I have misplaced it again, but in the
21 list of assets, the million dollars and above list of
22 assets we have talked about a good bit, I'm sure you can
23 find the exhibit momentarily.

24 A. I recall it visually, not the number.

25 Q. Yes, I think we all do. It just caught my

1387

1 eye that there are quite a number of entries listed in
2 there that involve loans to Schlumberger, and I was just
3 wondering if that had to do with your PEM program or
4 something else?

5 A. That's a better question for Mr. Swofford.

6 JUDGE MOSS: All right, thank you.

7 Anything else?

8 Then, Mr. Quehrn, is it, for this witness?

9 MR. QUEHRN: Yes.

10 JUDGE MOSS: We have had Mr. Gaines for such
11 a long time I forgot who put him on.

12 MR. QUEHRN: Thank you, Judge Moss.

13 MR. FFITCH: It wasn't Public Counsel.

14 JUDGE MOSS: I wasn't pointing any fingers,
15 Mr. Ffitch.

16 MR. QUEHRN: I just have a few questions for
17 Mr. Gaines.

18

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

20 BY MR. QUEHRN:

21 Q. First I guess, Mr. Gaines, I would like to
22 start with the several questions that were directed to
23 you concerning merger savings. Are you the witness in
24 this proceeding best suited to address those questions?

25 A. No, not at all.

1388

1 Q. Might that be Mr. Swofford?

2 A. Mr. Swofford in this proceeding, I suspect
3 Mr. Swofford or Sherman in the other proceeding.

4 Q. I would now, Mr. Gaines, like to direct your
5 attention back once again to Exhibit 414C, page 6. I
6 believe it was the page that Judge Moss was referring
7 to, and it also really follows on the Chairwoman
8 Showalter's question about the \$82 Million.

9 A. Yes, I have that here.

10 Q. And I would also like to refer to Exhibit
11 425, and I'm going to hand you up a copy.

12 A. I do now that you have handed me one, thank
13 you.

14 Q. And I understood the Chairwoman's questions
15 to essentially try to run at if the \$82 Million figure
16 needs to be different, how different should it be. And
17 in referring to Exhibit 425, question A and response A,
18 is there an itemization of subsidiary -- 425 now we're
19 looking at.

20 A. Go ahead.

21 Q. Response A, bottom of the first page, about
22 four or five lines up from the bottom, are there figures
23 there that relate to the cash that would have been Puget
24 Western cash and Connext I think is the other reference?

25 A. That's correct. In fact, the asset sale that

1389

1 I couldn't think of that was in the \$15 Million plus or
2 minus \$3 Million is the \$17 Million sale of Connex, and
3 if we were to add those two, the total number included
4 in that \$82,708,000 is \$77,586,000 for a difference of
5 roughly \$5 Million.

6 Q. And if you turn the page continuing the
7 response to question A there, I think you then go on to
8 say how far off, if you will, or how far off of the
9 projection that that, once you adjust for the
10 non-regulated cash, that that number was, and could you
11 tell us what that number is?

12 A. That number is \$1.7 Million.

13 Q. Could I now ask you then to return to Exhibit
14 414C, back to page 1, line 5.

15 A. I have that.

16 Q. Is that calculation we just went through the
17 reason why you would adjust or should I ask -- let me
18 reask the question.

19 In light of that calculation you just made,
20 would you adjust the figure on line 5 from \$62 Million
21 or \$62.6 Million to \$1.7 Million?

22 A. Were I doing my own calculation, I would.

23 Q. Mr. Gaines, I'm sorry, we're going to skip
24 around just a little bit so we can do this as quickly as
25 possible. I would like you now to if you can find

1390

1 Exhibit 84, which was one of the ones Mr. Cedarbaum
2 distributed for cross-examination.

3 CHAIRWOMAN SHOWALTER: What number?

4 MR. QUEHRN: 84, actually 84C, excuse me.

5 BY MR. QUEHRN:

6 Q. And if you could turn to I think it's the
7 fifth page in, it does say line 3 at the bottom.

8 CHAIRWOMAN SHOWALTER: Page 3?

9 MR. QUEHRN: I'm sorry, page 3 at the bottom,
10 yes, thank you.

11 A. I have that, it was one Mr. Cedarbaum and I
12 were discussing earlier.

13 BY MR. QUEHRN:

14 Q. Now on page 3, there's a projection of --
15 there's an earnings forecast for both regulated and
16 non-regulated entities. Looking at these numbers, would
17 you surmise that the earnings forecast and the increased
18 earnings for non-regulated, excuse me, for regulated
19 entities would have included a rate increase as part of
20 the forecast?

21 A. I think this shows a couple of things,
22 Mr. Quehrn. First of all, I see that there are no
23 assumptions here, so there's nothing specific I can
24 refer to. But we can see from the non-regulated line
25 the increase in earnings from non-regulated activities.

1391

1 We were talking about Infrastrux, for example, being in
2 its infancy and moving towards adolescence. I believe
3 that's depicted there. And then moving forward, and
4 this being a confidential document I don't want to
5 describe the numbers, but looking at the line
6 immediately above under regulated earnings, we see a
7 decline until there is a bump in the year 2004. And
8 because of the growth that we were talking about when I
9 was having a conversation with -- during on the record
10 with Commissioner Oshie that that business doesn't grow
11 too much, I suspect in that year the reason for the bump
12 is a general rate assumption.

13 Q. So the answer to the question was yes?

14 A. The answer is yes.

15

16 E X A M I N A T I O N

17 BY JUDGE MOSS:

18 Q. I think before we move on, I want to jump
19 into this inquiry, because I'm looking at page 1 at the
20 key assumptions, and I'm just wondering if those key
21 assumptions relate to these numbers?

22 A. You found assumptions. In fact, they do, and
23 it says here that there is not an increase in general
24 electric rates, oh, yeah, post rate stability period.

25

1392

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

2 BY MR. QUEHRN:

3 Q. Thank you for that clarification.

4 I would like now then to refer back to
5 another line of inquiry that I believe was undertaken by
6 Commissioner Oshie. And to paraphrase, I think the
7 discussion had to do with investor expectations that as
8 the financial health of the company declines as
9 represented by say a decrease in stock price, that there
10 would be an expectation that perhaps, you know, I think
11 at this point we were talking about the yield, the yield
12 being affected by a decline in the stock price, and I
13 think it was posited to you that if the stock price
14 declines that maybe investors would expect -- would also
15 expect a decrease in the amount of dividend. I believe
16 the question was asked with an expectation that
17 investors would continue to invest in that scenario in
18 that particular stock. Might investors do something
19 else?

20 A. Well, as I described, investors in
21 particularly this stock are looking for a stable
22 dividend and expecting that to be generated from the
23 utility and are expecting the earnings to come from the
24 non-regulated businesses. To the extent that didn't
25 happen, investors' cash is very portable, and so I would

1393

1 suspect that were those two conditions, either one of
2 them to change, they would not necessarily remain
3 investors in this company. They would switch to more
4 attractive investments.

5 Q. And those attractive investments might
6 include things like insured dividend; is that correct?

7 A. Well, I would think it would or a fixed
8 income investment, because the bulk of the, as I
9 mentioned, 75% or so of our investors are retail holders
10 who primarily own the stock for the income.

11 Q. Mr. Gaines, I'm going to try to capture with
12 a single question, various members of the Bench and
13 other witnesses have asked you in a variety of ways, why
14 have we presented essentially a characterization of the
15 financial health of this company and focused so much on
16 power costs, and I would like to I guess ask the
17 question the other way around.

18 In light of your knowledge of the overall
19 financial condition of Puget Sound Energy as it stands
20 today on the basis of its existing financial condition
21 and future projections of the company's financial
22 condition, can you imagine a way that you could present
23 the company's current financial health or its projected
24 financial health without focusing on the underrecovery
25 of power costs?

1394

1 A. No, that's the key driver of the problem.

2 Q. Just a couple final questions. This one
3 relates back to a question that I believe Chairwoman
4 Showalter asked yesterday, and it was a bit of a
5 hypothetical. I think that just as a reminder, it was,
6 I think, a situation where perhaps you and Ms. Steel
7 were visiting a credit rating agency on Wall Street, and
8 I think the question was asked something like this, that
9 ignoring the differences as far as the underlying
10 numbers between how the company portrays its financial
11 situation and how Ms. Steel has, how would the
12 investors, or excuse me, how would the credit rating
13 agencies react to the characterization of the financial
14 health of the company as far as Ms. Steel has portrayed
15 it.

16 I would like to take that just a little bit
17 further, because there is an assumption built into that
18 question. And the question assumes that Ms. Steel has
19 viewed the company's financial condition in a
20 methodology that credit rating agencies might look at,
21 so here is my question. If you take Ms. Steel's
22 methodology, which is essentially what's reflected on
23 414C, and present that to the credit rating agencies as
24 a means of assessing the company's financial health, how
25 would you anticipate that they would view that

1395

1 methodology and comment on its sufficiency?

2 MR. CEDARBAUM: Your Honor, I realize this is
3 a question that follows on the Bench's questions
4 yesterday, but I would object on the basis of calling
5 for speculation. I mean I know Mr. Gaines has given his
6 opinion yesterday on a number of these scenarios, but he
7 did that yesterday, and I don't think we need to hear
8 that again today. But I think coming from counsel, that
9 calls for speculation, and I would object on that basis.

10 JUDGE MOSS: Well, I think it does call for a
11 significant degree of speculation. Only in the sense
12 that it follows on to questions that were posited
13 yesterday do I think it should be allowed, but we
14 recognize your objection, Mr. Cedarbaum, and certainly
15 would take into account the speculative quality of the
16 answer, both then and now, in terms of assessing any
17 weight that might be given the testimony. So I will
18 allow the question to be answered in that light.

19 MR. QUEHRN: Thank you.

20 A. Why don't I preface then with this is my
21 opinion. Ms. Steel's methodology is depicted on the
22 first page of 414C, and ignoring the numbers, which I
23 suspect was the basis of your question or if I recall
24 was the basis of your question, so we're getting to
25 methodology alone, there are a couple of things that I

1396

1 would say with respect to that. This calculation
2 doesn't at all address earnings, which are key to
3 several of the quantitative aspects that rating agencies
4 look at when they are setting the rating. It also
5 doesn't address the continued underrecovery of power
6 costs and the related erosion in equity caused by that
7 in this case. And as a third, it doesn't touch on the
8 qualitative aspects of the rating that we have had lots
9 of discussion on with other parties. In fact, it's in
10 essence a fairly simplistic cash flow analysis, and it's
11 similar in construct to the one that I have on Exhibit
12 26-DEG-6.

13 BY MR. QUEHRN:

14 Q. Just two final questions for the witness.

15 Chairwoman Showalter also asked you yesterday
16 what the credit agencies might be looking to in
17 connection with the Commission's disposition of this
18 matter as far as one of those qualitative factors,
19 qualitative factors in this instance, regulatory
20 climate, what do you think the credit agencies will be
21 looking for in the Commission's decision as it relates
22 to a qualitative factor?

23 MR. CEDARBAUM: Your Honor, same objection
24 for the record, speculation.

25 JUDGE MOSS: Okay, thank you, Mr. Cedarbaum.

1397

1 Go ahead, you can answer it.

2 A. Same preface, in my opinion, there's a couple
3 of different things probably related. I think in
4 addition to cash flow, which we have been talking about,
5 they look for a level of earnings, but not in terms of
6 earnings per share, in terms of book earnings as they
7 relate to pre-tax interest coverage to those earnings
8 that flow through funds from operations, interest
9 coverage, funds from operations to average debt, and
10 those. And although those are quantitative measures,
11 Mr. Quehrn, I believe that they look at that as a
12 concern for credit quality of the utility.

13 So much as they look at the company's
14 management, which isn't one of the qualitative aspects
15 of a rating, and look for the credit concerns, concerns
16 for credit quality that management have, I think they
17 would be looking for an order that had something with
18 respect to concern for credit quality there and would
19 view that favorably even were it something
20 unquantifiable. Really it comes down to considering the
21 need for earnings and cash flow.

22 Q. And one final question, Mr. Gaines, and then
23 we're going to flip to a completely different subject
24 now. Mr. Kurtz, who is not here today, had asked you
25 to, and I believe this was also the subject of a records

1398

1 request, to make some assumptions with respect to
2 authorized rate of return, and I believe this was
3 talking about going forward or looking forward. But
4 just to look at it with respect to the electric side of
5 the business as opposed to a consolidated perspective,
6 which is in fact what our projections have been, and my
7 question is, would such a view have any relevance
8 whatsoever in terms of your ability to go out and do
9 things like obtain financing?

10 A. No, it doesn't. As you probably recall from
11 the exhibits as we have talked about first mortgage bond
12 indenture coverage ratios, there's no distinction
13 between fuel type, gas or electric. As we talked about,
14 the credit agreement is the borrower is Puget Sound
15 Energy, interpreted to be the utility. There's no
16 distinction there between gas and electric. The lenders
17 as they look at the company and make their projections
18 looking forward are looking at the consolidated entity,
19 not split by fuel type.

20 MR. QUEHRN: Thank you, Mr. Gaines, I have no
21 further questions.

22 THE WITNESS: Thank you.

23 JUDGE MOSS: Anything further from the Bench?

24 CHAIRWOMAN SHOWALTER: Well, I should
25 probably refrain.

1399

1 THE WITNESS: I can keep going.

2

3 E X A M I N A T I O N

4 BY CHAIRWOMAN SHOWALTER:

5 Q. I followed the first question about taking
6 into account power costs, Mr. Quehrn's question, I
7 follow. But in these three phases that I posited,
8 another possibility is that the first phase, the merger
9 mode, was going along pretty well or okay. And then the
10 power crisis/good came along and made things really
11 good. And then the power drop/bad came along and made
12 things not so great but not really bad. And isn't one
13 explanation of the Staff's case that scenario? That is,
14 you started from a better position, then it got great,
15 and now, yes, there are expenses and cash going out the
16 door, but that you started from a better position. It
17 really gets back to the analogy of how fat was the
18 person who was losing 30 pounds, you know.

19 A. Yeah, I think, and I would let Staff speak
20 for themselves on their view of it, I don't think it's so
21 much the starting point where you're starting from, I
22 think it's just a difference of interpretation of how
23 bad is bad. I would say that. There is disagreement at
24 that level certainly between the company and Staff.

25 You, I believe, posited it as it's bad. You

1400

1 didn't say very bad like you had said very good in the
2 good scenario. I think the disagreement comes to two
3 things. It's a relative term, you know, bad, how bad is
4 it, and then also what's the appropriate indicia or
5 measurement to use with respect to measuring bad when
6 comparing that to the PNB standard. I think that's
7 probably the bulk of the differences.

8 CHAIRWOMAN SHOWALTER: All right, thank you.

9 (Discussion on the Bench.)

10 JUDGE MOSS: All right, Mr. Gaines, I believe
11 that completes the examination, your examination, and
12 you are gleefully on your part, it appears, excused.

13 THE WITNESS: Very gleefully.

14 JUDGE MOSS: And since we're changing guard
15 here at the witness stand, why don't we go ahead and
16 take our afternoon recess, and we'll come back at 10
17 after the hour.

18 (Recess taken.)

19 JUDGE MOSS: Just to make the most efficient
20 use of our time here, one piece of housekeeping that I
21 always have to take care of at the end of the case I
22 will go ahead and take care of now. We have marked for
23 identification at various points during the course of
24 the hearing Bench requests and records requisition, and
25 so we have Bench Requests Numbers 1 through 10, 17B

1401

1 through 20B and 461B. We also have Record Requisitions
2 Numbers C11 through 16 and number 460. Most of these
3 have been submitted and those that haven't I think have
4 been sufficiently well described and discussed so that
5 I'm simply going to admit those now subject to any
6 objection.

7 And there apparently is none, so I will go
8 ahead and do that. And then also we will have to have
9 placeholder exhibits, I'm going to reserve two numbers,
10 462 and 463, for any public comment or related materials
11 that either Public Counsel or another party may wish to
12 submit from the Commission's public records. And that
13 typically would take the form of letters.

14 And, Mr. ffitch, would you want to include
15 the ones you received last night in that same set or
16 have a separate number for those?

17 MR. FFITCH: Would the Bench have a
18 preference on that? I guess I would prefer to just have
19 them be a separate exhibit just so that it's clear where
20 they came from. They're easier to find. If somebody is
21 looking for the written materials from the public
22 hearing, it's easier not to bury them in with the other
23 hundreds of letters.

24 JUDGE MOSS: We will reserve 462 for the ones
25 that you received last evening or that you would prefer

1402

1 to have in that set, and we will reserve a second number
2 for you, 463, and then I will reserve a third number,
3 464, in case the company wanted to submit some materials
4 we had previously discussed either on or off the record,
5 probably both. And if anybody else wants to do
6 something of that nature, I will assign an exhibit
7 number if and when that happens. And, of course, we may
8 yet have additional Bench requests or whatnot, so I will
9 take care of that as it comes up.

10 MS. DODGE: Your Honor, just as a matter of
11 clarification, I wanted to ensure that Public Counsel
12 will make Exhibit 462 a complete set of the public
13 comment received yesterday evening.

14 MR. FFITCH: Yes, that's my intention, yes.

15 Your Honor, as far as those exhibits go,
16 another point, you stated to the public last night at
17 the hearing that the record would close on February
18 27th.

19 JUDGE MOSS: So why don't you plan to submit
20 your full body of public comment at that time. Would
21 that be agreeable to you?

22 MR. FFITCH: Yes, Your Honor.

23 JUDGE MOSS: That way you won't have to do it
24 twice. I'm just trying to save you some trouble. If
25 that works for you, it works for me.

1403

1 MR. FFITCH: Well, at least theoretically,
2 because of the preparation and transmittal time, we will
3 basically be starting to prepare, there are several
4 hundred letters, and we will be starting to prepare that
5 so that we can get it to you and to the other parties
6 probable that will be happening on Monday and Tuesday
7 so --

8 JUDGE MOSS: Well, the briefs come in on
9 Friday if I'm not mistaken.

10 MR. FFITCH: So there may be a few things
11 that come in to the Commission after the, you know, we
12 have sort of finalized production, and, you know, I
13 think we -- I'm not sure what to do about those.

14 JUDGE MOSS: All right, well, we will take
15 this up again at the end of the day and work out the
16 logistics. I just wanted to take care of that little
17 bit of housekeeping.

18 MR. FFITCH: All right.

19 JUDGE MOSS: Mr. Swofford, if you will please
20 rise and raise your right hand.

21

22 (The following exhibits were identified in
23 conjunction with the testimony of GARY B. SWOFFORD.)

24 Exhibit 251T is GBS-1T: Pre-filed Direct
25 Testimony. Exhibit 252 is GBS-2: Gary B. Swofford

1404

1 Professional Qualifications. Exhibit 253 is GBS-3:
2 Arborist, The Economic Impacts of Deferring Electric
3 Utility Tree Maintenance, April 1997. Exhibit 254T is
4 GBS-4T: Pre-filed Rebuttal Testimony (2/11/02). Exhibit
5 255 is PSE Response to Staff DR No. 345-I. Exhibit 256
6 is PSE Response to Staff DR No. 346-I. Exhibit 257 is
7 PSE Response to Staff DR No. 347-I. Exhibit 258 is PSE
8 Response to Staff DR No. 98-I. Exhibit 259 is PSE
9 Response to Staff DR No. 354-I. Exhibit 260 is PSE
10 Response to Staff DR No. 350-I.

11

12 Whereupon,

13

GARY B. SWOFFORD,

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

16

17 JUDGE MOSS: Thank you, please be seated.

18

Your witness, Ms. Dodge.

19

MS. DODGE: Thank you, Your Honor.

20

21

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

22

BY MS. DODGE:

23

Q. Good afternoon, Mr. Swofford.

24

A. Good afternoon.

25

Q. Could you please state your full name, and

1405

1 spell your last name for the record.

2 A. My name is Gary B. Swofford, S-W-O-F-F-O-R-D.

3 Q. What's your position with Puget Sound Energy?

4 A. I'm the Vice President and Chief Operating
5 Officer.

6 Q. Mr. Swofford, do you have before you your
7 direct testimony and rebuttal testimony that have been
8 pre-filed in this matter?

9 A. Yes, I do.

10 Q. And those have been identified as Exhibits
11 251T and 254T?

12 A. They have now.

13 Q. Do you also have before you the exhibits to
14 your testimony which have been identified as Exhibits
15 252 and 253?

16 A. Yes, I do.

17 Q. Were you responsible for preparation of this
18 testimony and these exhibits, or were they prepared
19 under your supervision?

20 A. Yes, it was prepared under my supervision.

21 Q. Have you also prepared a notice of errata to
22 Exhibit 254T?

23 A. Yes, I have.

24 JUDGE MOSS: And that has been distributed to
25 the parties and to the Bench. I think we have all made

1406

1 those changes.

2 Q. Are any of those changes substantive,
3 Mr. Swofford?

4 A. The second one on page 6, line 4, where it
5 currently reflects that we have expenditures to the 2002
6 budget reflect a 2% decrease, that should be a 3%
7 decrease.

8 Q. Mr. Swofford, with the changes set forth in
9 the notice of errata, are the answers to the questions
10 in Exhibits 251T through 254T true and accurate to the
11 best of your knowledge?

12 A. Yes, they are.

13 Q. And would you give the same answers were you
14 asked those questions today?

15 A. I would.

16 MS. DODGE: Your Honor, we offer Exhibits
17 251T through 254T into evidence.

18 JUDGE MOSS: Hearing no objection, they will
19 be admitted as marked.

20 MS. DODGE: Thank you, the witness is
21 available for cross-examination.

22 JUDGE MOSS: Mr. Cedarbaum.

23 MR. CEDARBAUM: Thank you.

24

25

1407

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

2 BY MR. CEDARBAUM:

3 Q. Good afternoon, Mr. Swofford.

4 A. Good afternoon.

5 MR. CEDARBAUM: Your Honor, hopefully by
6 stipulation of counsel, I would like to move the
7 admission of Exhibits 255 through 260 for
8 identification.

9 JUDGE MOSS: And that's per stipulation,
10 Ms. Dodge?

11 MS. DODGE: Yes, Your Honor.

12 JUDGE MOSS: All right, then those will be
13 admitted as marked.

14 BY MR. CEDARBAUM:

15 Q. Mr. Swofford, if you could please look at
16 Exhibit 257, which is the company's response to Staff
17 Data Request 347-I.

18 A. I have it.

19 Q. And why don't you just take a minute to
20 review it just to make sure that you recall it.

21 A. I'm ready.

22 Q. It appears from the response that for the
23 2002 budget year that the periods of time over which
24 capital budget items would be depreciated is not
25 specifically identified.

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1 A. We put things into plant, if you will, to
2 begin depreciation when they are completed, and that is
3 not necessarily on a budget cycle. The budget
4 anticipates projects that will be worked on that year.
5 They won't all necessarily be completed in the year
6 2002. So in the year that they are completed, they are
7 then put into plant, and depreciation starts at that
8 time.

9 Q. The question we asked you in Data Request 347
10 was to provide the depreciation schedules for each
11 capital expenditure the company plans to undertake in
12 2002, and the response indicates that that information
13 is not an output of the budget model.

14 A. We at least interpreted the question to be
15 seeking for the plans to undertake in 2002 would be the
16 plans that were in our budget to undertake in 2002, and
17 so our response to this request was we don't necessarily
18 know when those plans will actually go with those
19 projects, will go into service, and therefore we
20 wouldn't -- we don't have a plan for depreciation. We
21 may have interpreted that wrong, Mr. Cedarbaum, but
22 that's how we --

23 Q. No, I think that was fine. My question is,
24 do you know what the depreciation schedule or schedules
25 would be for any of the PEM capital and anything that

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1 was budgeted for the PEM program in 2002, do you know
2 what their depreciation schedules would be?

3 A. I don't exactly know when things are
4 scheduled to go into plant in 2002. Much of PEM has
5 already been put into plant and is currently being
6 depreciated. There are some items that will be added in
7 2002. There is a capital piece of PEM for 2002. Upon
8 its completion, it would go into plant. But I can't
9 tell you specifically when that completion would be,
10 because we are not undertaking that project until the
11 completion of the general rate case.

12 Q. Would the same -- do you know if the -- what
13 the depreciation life is for any of the PEM capital
14 expenditures for the 2002 budget year?

15 A. I don't know the answer to that question.

16 Q. Are your answers to that question and the
17 prior question with respect to PEM the same with respect
18 to any information technology investment?

19 A. As to the life that depreciation say puts on
20 that, I'm not aware of what the life is for any of the
21 technology investments the company has made.

22 Q. Or budgeted?

23 A. Or budgeted?

24 Q. Yes.

25 A. I'm aware of what we budgeted for those

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1 projects.

2 Q. Are you aware of the depreciation life for
3 what you budgeted?

4 A. No, I'm not.

5 MR. CEDARBAUM: Thank you, those are all my
6 questions.

7 JUDGE MOSS: Thank you, Mr. Cedarbaum.

8 Mr. ffitch.

9

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

11 BY MR. FFITCH:

12 Q. The first line of your correction is going to
13 shorten up my cross a little bit, Mr. Swofford, so it
14 shouldn't take too long. We won't have to get into that
15 area.

16 At page 3 of your rebuttal, could you turn to
17 that, please, page 3, line 4.

18 A. I'm there.

19 Q. And there you state that PSE has far exceeded
20 expectations at the time of the merger in terms of
21 potential benefits, correct?

22 A. That's correct.

23 Q. So the company is on track to meet or exceed
24 the expectations projected at the time of the merger?

25 A. With respect to the benefits that were

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1 identified at the time of the merger that we would be
2 able to achieve as a result of the merger, we are, we
3 are on track and ahead of schedule as far as achieving
4 those synergy benefits that were identified.

5 Mr. Sherman in his testimony in the general rate case
6 describes where we are with respect to where we
7 anticipated being through the year 2000, as I recall.

8 Q. Well, you have partially answered my next
9 question, which is, and perhaps I will rephrase it,
10 other than the testimony that you have just referred to,
11 that of Mr. David is it Sherman?

12 A. Sherman.

13 Q. Sherman in the general rate case, does the
14 company have financial analyses, documents, workpapers,
15 or projections on which that conclusion is based? And
16 I'm referring to your previous answer that you're on
17 track to meet or exceed the original projections.

18 A. We have not tracked the specific items
19 identified other than to put in place a number of plans
20 to achieve savings. Mr. Sherman is the one who has done
21 the analysis that has looked at what we have
22 accomplished with respect to what was projected at the
23 time of the merger to be accomplished.

24 Q. All right. And his analysis goes up through
25 2000, I think you said?

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1 A. As I recall, his testimony takes it up
2 through the year 2000 is what he has identified.

3 Q. And you haven't done any of your own analysis
4 along those lines since that time?

5 A. Our analysis has been tied to the projects,
6 the plans that we put in place to achieve the benefits
7 of the merger. We know that individually we achieved
8 and in many cases exceeded what was anticipated at the
9 time of the merger. But to go back and take a look and
10 bring them all together and say this is what was
11 anticipated, I'm not aware of that work. I haven't
12 undertaken it, but I know that Mr. Sherman has.

13 Q. All right. And do you know what the basis of
14 the number that we have heard today discussed of the
15 achievement of \$156 Million in savings is?

16 A. That comes out of the work that Mr. Sherman
17 did as a result of the analysis that he undertook.

18 Q. All right. Now can I ask you to turn to page
19 8 of your rebuttal testimony, really pages 8 and 9, and
20 there you list six different steps that Puget would have
21 to consider taking if the interim relief is not granted,
22 correct?

23 A. That's correct.

24 Q. And as I look at those six steps, they all
25 appear to be cuts in operations that directly impact

1413

1 customer service, correct, except perhaps vegetation
2 management, but you can make that distinction.

3 A. When I put this together, I think that when
4 you read this that these are the kinds of things a
5 company would look at to make modifications to in the
6 eventuality that we aren't granted interim relief. I
7 don't say these are the things that we will cut. I do
8 say these are the things that we will have to take a
9 look at. We have to review those things that can make a
10 difference, if you will, that we can take advantage of.
11 I also go on to say in my testimony that much of the
12 work that is undertaken by the company is work that is
13 required for customers that request new service, which
14 we are obligated to provide for safety or reliability
15 reasons.

16 Q. Now there's nothing on this list in the
17 category of administrative expenses, executive salaries,
18 other things of that nature that I can see; is that
19 right?

20 A. There are other places in my testimony where
21 I talk about action that we have taken with respect to
22 salaries, travel, et cetera, and some other things that
23 we have put in place. We have over the course of the
24 last four years to achieve the level that we have of the
25 second lowest cost non-production O&M company in the

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1 country taken a lot of the optionality, if you will,
2 today that we have. So when you look at this list, you
3 do see things that impact service, because we have
4 eliminated the other kinds of things within the company
5 that would be available for us to be able to take action
6 under, could be available.

7 Q. So if I understand your testimony, basically
8 you're saying that in the past you have already cut or
9 frozen as much as you can cut in those categories like
10 salaries and so on and administrative expenses, and so
11 now if you didn't get the interim relief you would be
12 looking at these six factors and others like them?

13 A. That's correct, we have achieved I believe it
14 says in my testimony \$21.6 Million reductions A&G costs
15 in comparison to pre-merger to where we are today, so we
16 have taken a healthy percentage of A&G cost out of the
17 company to date. Likewise, we have modified our
18 services, we have implemented new programs like tree
19 watch to increase our reliability as well as our O&M
20 costs, and so we are -- we are looking at the kinds of
21 things that I talk about in my testimony now.

22 Q. Well, if we go to page 5 of your testimony,
23 there's a paragraph at line 11, I think you're talking
24 about these are the kinds of things you're talking about
25 that you have already done, is that right, with regard

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1 to management, salaries and hiring, and travel, things
2 of that nature?

3 A. That's correct.

4 Q. And again, as I understand your testimony,
5 this is the most the company will do in this area, and
6 from here on out, you would be cutting services to
7 customers and making those other kinds of operating
8 cuts, the six areas that you have testified to and that
9 we just looked at, page 8?

10 A. Well, it's not my testimony that these are
11 the only things that we have done. These are the
12 actions that we have taken. We believe --

13 Q. I'm sorry to interrupt, but I didn't say
14 these were the only things that you had done. I'm
15 talking about your sort of projection of what you would
16 do if you didn't get the interim rate relief. And my
17 understanding from what your previous testimony was just
18 a moment ago was that you have kind of done everything
19 you could do in these administrative areas, and you
20 would have to look at the operating cuts. Isn't that
21 what you said?

22 A. I don't know that I said we had done
23 everything we could do, Mr. Ffitch. I said that these
24 are the actions that we have taken. Clearly we would
25 continue to take a look at other actions that we can

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1 come up with. If we can come up with others that would
2 not impact service, we will take a look at them. But to
3 achieve the kinds of savings that would be required if
4 we didn't get interim relief, these actions will
5 certainly produce savings, but they're rather small in
6 comparison to the size of the problem that we have of
7 \$695,000 per day in underrecovery of costs. This isn't
8 going to get the job done.

9 MR. FFITCH: Thank you, Mr. Swofford, those
10 are all the questions I have.

11 JUDGE MOSS: Are there any questions from the
12 Bench?

13 CHAIRWOMAN SHOWALTER: I just have one.

14

15 E X A M I N A T I O N

16 BY CHAIRWOMAN SHOWALTER:

17 Q. If you could turn to your rebuttal testimony,
18 page 3.

19 A. Yes, I'm there, Chairwoman Showalter.

20 Q. Line 23 and 24, you say that even with the
21 proposed rates, your rates will be the second lowest
22 compared to those utilities adjacent to your service
23 area. What utilities are you including there?

24 A. Seattle, Tacoma, Snohomish, as well as
25 ourselves.

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1 Q. I suppose you could say so of four, you are
2 second lowest?

3 A. That's correct. It says the largest
4 utilities. There are clearly others around us, but we
5 picked the larger ones.

6 Q. And the lowest would be?

7 A. Tacoma, as I recall.

8 CHAIRWOMAN SHOWALTER: Thank you.

9

10 E X A M I N A T I O N

11 BY COMMISSIONER HEMSTAD:

12 Q. I have just one question, and Judge Moss
13 raised this before. I'm just curious as to the loans to
14 Schlumberger that are referenced in Exhibit 425. I'm
15 sure you're familiar with them. The total is perhaps
16 around \$50 Million or thereabouts if I roughly add it up
17 correctly. Would you describe what that was for and why
18 you would be making those loans and just what is the
19 general arrangement?

20 A. At the time that we decided that the
21 technology at that time Cellnet was deploying was the
22 one that we wanted to select for our automatic meter
23 reading system, they offered us the opportunity to
24 basically finance for them, loan them the money so that
25 they could build out their network. We're basically

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1 leasing the network from them. For that, we got a
2 concession on the price we were going to pay for the use
3 of the network. So when we did our analysis of what by
4 loaning them the money and getting the price concessions
5 that we got on the use of the network, that it was a --
6 it was to our benefit to do that. So we loaned them the
7 money. Schlumberger has since purchased Cellnet and has
8 since repaid all of those loans. So as of today, those
9 loans have been repaid, and there is no outstanding
10 owing to the company.

11 COMMISSIONER HEMSTAD: Okay, thank you,
12 that's all I have.

13 JUDGE MOSS: Anything else from you,
14 Mr. Cedarbaum, or you, Mr. ffitch?

15 MR. FFITCH: No.

16 JUDGE MOSS: Do we have any redirect?

17 MS. DODGE: No, Your Honor.

18 JUDGE MOSS: Mr. Swofford, that completes
19 your examination, thank you for being with us. We
20 appreciate your patience waiting through the hearing to
21 be last. Or actually not last, because we're going to
22 recall Ms. Steel.

23 MR. FFITCH: Your Honor, while Ms. Steel is
24 coming up, I wanted to do a bit of housekeeping on one
25 exhibit. I believe I offered 172C, however, my own

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1 notes don't show that it was admitted, so I wondered if
2 I could check with your records.

3 JUDGE MOSS: 172C?

4 MR. FFITCH: Yes.

5 JUDGE MOSS: I have it marked as admitted,
6 and if it wasn't previously admitted, unless I hear an
7 objection now, we won't be concerned that it was not
8 admitted.

9 All right, no objection, so.

10 MR. FFITCH: Thank you.

11 JUDGE MOSS: Ms. Steel, welcome back, and, of
12 course, you remain under oath.

13 THE WITNESS: Thank you.

14 JUDGE MOSS: And I believe the, excuse me,
15 I'm trying to do two things at once, and I shouldn't do
16 that, especially this late in the hearing. Ms. Steel,
17 the Bench has actually recalled you, so I think we
18 perhaps have some questions from Chairwoman Showalter at
19 least and perhaps the others, and then we'll see if
20 there's anything further we need to have you up for this
21 afternoon.

22

23 Whereupon,

24 LISA A. STEEL,

25 having been previously duly sworn, was called as a

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1 witness herein and was examined and testified as
2 follows:

3 E X A M I N A T I O N

4 BY CHAIRWOMAN SHOWALTER:

5 Q. I think for purposes of my question, if you
6 had in front of you Exhibit 414C, page 2 of 4, and also
7 Exhibit 80 handy.

8 JUDGE MOSS: Okay, and I think that was page
9 2 of 7.

10 Q. Oh, I see, no, page 1 of 7, I was reading the
11 date instead of the page there, 1 of 7.

12 A. Would you please refresh my memory about
13 which one was Exhibit 80. I didn't mark it correctly.

14 Q. It's ICNU Request Number 8.1, and it was
15 provided by Puget. It's the statement of a bank account
16 for non-regulated cash.

17 JUDGE MOSS: It would be 81.

18 CHAIRWOMAN SHOWALTER: Oh, 81, oh, I see, I'm
19 sorry, it's 81.

20 JUDGE MOSS: That would be among the exhibits
21 that were tendered in connection with Mr. Donald Gaines.

22 MR. CEDARBAUM: Do you have that, Ms. Steel?
23 You can borrow mine if you need to.

24 THE WITNESS: I do have it, thank you.

25 CHAIRWOMAN SHOWALTER: All right.

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1 BY CHAIRWOMAN SHOWALTER:

2 Q. My version of 414C, this first page, there is
3 many markings on it. It seems to be one of the central
4 exhibits of our hearing. And I just want to ask you,
5 well, first of all, have you listened to Mr. Don
6 Gaines's testimony on his differences with you on this
7 Exhibit 414?

8 A. I believe I have heard the essence of it. I
9 have been called out of the room a couple of times, but
10 with those exceptions, I think I have heard his
11 exceptions.

12 Q. All right. Well, turning to line 2, does
13 anything in his testimony or the exhibit, and I think
14 the exhibit was 81 that he provided, modify or alter
15 your opinion on whether the \$25 Million is appropriately
16 listed on line 2?

17 A. No, Mr. Gaines's testimony does not cause me
18 to change my judgment about the amount in line 2. I
19 think that \$25 Million is an appropriate amount to
20 consider for the return of capital that Puget did in the
21 first quarter of 2001. Because I have several
22 unanswered questions about that transaction that would
23 be required for me to know whether or not the rates that
24 would result from at Puget Sound Energy could be fair,
25 just, and reasonable.

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1 And the first question that I would have
2 still is, what is the net position of PSE's
3 non-regulated investments for each quarter from let's
4 say 1996 to the present. And the chart in Exhibit 81
5 does not give me that net position. And I also believe
6 that the response to the Bench Request about Puget
7 Western will not give me that information either,
8 because it will exclude what Mr. Gaines calls small
9 inactive subsidiaries, and those are precisely the sort
10 of subsidiaries that I'm interested in, because they are
11 the ones which were most likely to have incurred
12 permanent net losses. So without having the complete
13 consolidating statements for Puget Sound Energy, I
14 wouldn't be able to calculate the net position and know
15 whether or not there was any net equity available to be
16 returned as capital to Puget Energy.

17 The second question that I have that's
18 unanswered is did Puget Sound Energy, the utility, have
19 the equity to invest 100% equity in Infrastrux, or
20 rather was Puget Sound Energy's investment in Infrastrux
21 in part financed with debt at the Puget Sound Energy
22 level. The discussion that I hear about the utility and
23 these regulated investments causes me to believe that if
24 I did not know otherwise that there is a Puget Sound
25 Energy itself is a holding company that holds a utility,

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1 whereas the organization chart that I passed out earlier
2 shows that there -- the utility, in fact, is Puget Sound
3 Energy itself. So it is the utility that owns these
4 investments in non-regulated subsidiaries, and the
5 utility itself is only 30% equity financed.

6 Q. Do you mean by that that in your view today
7 it's the utility that owns Infrastrux because the
8 utility is Puget Energy? I was a little unclear about
9 what you are equating with the utility.

10 A. I'm equating Puget Sound Energy with the
11 utility, and Puget Sound Energy is itself a company that
12 holds other companies, and it holds non-regulated
13 subsidiaries. But Puget Sound Energy, which holds other
14 companies, is itself the utility. It's not like the
15 utility is a sister level to these non-regulated
16 investments. Rather it is the utility that owns these
17 investments. And it may be that Puget Sound Energy, the
18 utility, should still own Infrastrux.

19 Q. Okay. You were using the present tense, so
20 that's why I wondered. As I understood it, and I'm not
21 saying I really did understand everything, but as I
22 understood it, Puget Sound Energy, the utility, owned
23 Infrastrux, but that the explanation was there always
24 were these unregulated parts of Puget Sound Energy, and
25 separate accounts were kept, in fact, separate bank

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1 accounts were kept. And so just as today Puget Energy
2 has regulated and unregulated parts to it, so does Puget
3 Sound Energy or so did Puget Sound Energy have regulated
4 and unregulated parts of it, and one of those
5 unregulated parts separately tracked was Infrastrux. Is
6 that your understanding of at least what the company is
7 saying?

8 A. Well, I wouldn't -- I couldn't relate back to
9 whether or not that's what the company is saying. But I
10 do think it is true that there are still regulated and
11 non-regulated parts of Puget Sound Energy. Some of them
12 are winners, some of them are losers. We're going to
13 get some more information on the winners, but I still
14 don't have the information on the losers. So on a net
15 basis, I don't know whether or not there was any equity
16 to be transferred out from these non-regulated ventures
17 taken as a whole.

18 The reason I don't have that information is
19 that the company has not provided it to me. I have
20 asked some of the right questions, which if answered
21 fully would have given me that information, but I do not
22 have the full information that I need to make that
23 determination.

24 Q. All right. So you're saying the fact that
25 the accounts may have been kept separately doesn't

1425

1 answer the question of what other non-regulated entities
2 there were and what were the winners and losers, and was
3 Puget Sound Energy stuck with some of the losers; is
4 that in essence your question?

5 A. Yes, I think that's it, the essence of the
6 question.

7 Q. Okay.

8 A. And I also don't know the date that this U.S.
9 Bank Account Number 153590857726 was set up, and I don't
10 know what the source of funds was for that. But if it
11 was during a recent period, I would presume that Puget
12 Sound Energy, the consolidated utility, which is the
13 borrower on the line of credit, did not have 100% equity
14 to invest in anything, because it didn't have 100%
15 equity in itself.

16 Q. All right, then moving to line 5. In
17 response to some questions from either Mr. Cedarbaum or
18 Mr. ffitch, I forget, Mr. Gaines answered some questions
19 that got to why he thought the \$62 Million is incorrect
20 and the appropriate figure should be I think \$2 Million.
21 Did you hear any of that discussion, or do you
22 understand what the company's position is on that point?

23 A. I believe I understand the company's position
24 on that point.

25 Q. Has anything in the hearing since you

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1 testified last changed your opinion as to whether the
2 \$62 Million is correct?

3 A. No, nothing that I have heard in the hearing
4 has changed my opinion on the \$62 Million. And I would
5 note that the documents that I have available which
6 confirm the agreement for Puget Sound Energy's line of
7 credit which the company provided in response to Staff
8 Data Request Number 35 as well confirm that Puget Sound
9 Energy is the borrower. There is not some subsidiary
10 that is the borrower.

11 And I find nothing in that agreement to cause
12 me to believe that the banks who provided that agreement
13 believed that they would not have access to cash flows
14 from non-regulated sources to support repayments under
15 that agreement.

16 In addition, I met with one of the bankers
17 who is a member of the bank group for that line of
18 credit, and my understanding of their belief of the cash
19 flow supporting that line of credit is that it comes
20 from all of the sources of cash that Puget Sound Energy
21 itself owns.

22 Q. And my last question is on whether certain
23 budget expenditures should or shouldn't be made in this
24 time period. I think it's your testimony that certain
25 expenditures could be delayed; am I right on that?

1 A. Yes, that's correct, they could be deferred,
2 or they might be alternatively not entered into.

3 Q. And my question is, to the extent that these
4 kinds of expenditures are appropriate in general,
5 doesn't delaying otherwise appropriate expenditures
6 simply push into another time period additional costs
7 unless everything is deferred, you know, quarter to
8 quarter to quarter, why is that in the public interest?

9 A. Well, we might ask that same question about
10 the entire deferral that the company has requested. How
11 is that in the public interest to not recognize the
12 expense in the period incurred and rather instead to
13 provide selective moving by pushing those expenses
14 forward and extending the time that those expenses will
15 be recognized over. That is always a question of
16 whether or not it is in the public interest to do that.

17 With these kinds of expenses, it's not just
18 pushing the recognition of them, but it's actually
19 pushing the actual cash flow into a future period. And
20 these are precisely the kinds of decisions that
21 businesses with whom I work routinely, when faced with
22 an extraordinary expense, they make choices among all of
23 the good programs they might select among. And they
24 also take a closer look at their programs to see which
25 they probably should not select at all.

1 If this rate increase is approved as
2 requested, 100,000 Puget Sound Energy business customers
3 will be making precisely those kinds of choices, and
4 some of them I would expect would be deferring,
5 delaying, or forgoing entirely expenditures of the type
6 I have identified for Puget Sound Energy. The company,
7 however, if Staff's case were accepted, would have the
8 freedom to select among its expenses, its budgeted
9 expenditures, and choose among them.

10 Q. And I understand why non-regulated businesses
11 are put to choices when they can't control necessarily
12 the prices that they charge or at least the prices that
13 customers will buy. But it seems to me that a regulated
14 utility is in a little different position. At least
15 this Commission is in a different position, because we
16 get to decide whether it is in the public interest to
17 increase the price in order to continue expenditures or
18 make the company healthier, those sorts of questions.
19 It's a regulated monopoly, it's an essential service.

20 And so I guess again, rather than compare it
21 to other businesses, just looking at this business, a
22 regulated electrical utility, why is it in the public
23 interest to defer those expenses? And I understand
24 that's a single element question that's to be weighed
25 against a number of other factors, but it doesn't seem

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1 as simple a question as, well, other businesses have to
2 do this sometimes.

3 A. I think it's in the public interest for the
4 Commission to choose that the company defer some of
5 these expenses even if they are or may be good in the
6 end, because the cash flow pressures outweigh the good
7 that those programs would cause over the near term.

8 CHAIRWOMAN SHOWALTER: Thank you.

9 COMMISSIONER HEMSTAD: I don't have any,
10 there's no questions.

11 COMMISSIONER OSHIE: No questions.

12 JUDGE MOSS: Mr. Cedarbaum, did you wish to
13 have any inquiry while we have your witness back on the
14 stand in light of the Commission's inquiry before we
15 allow the other parties to see if they might?

16 MR. CEDARBAUM: I do have just one question.

17

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

19 BY MR. CEDARBAUM:

20 Q. Getting back to the Infrastrux issue, I think
21 you indicated in your answers to Chairwoman Showalter
22 that you didn't have sufficient information to determine
23 whether or not Puget Sound Energy had sufficient equity
24 to invest 100% equity in Infrastrux or if that was
25 partially financed with debt; do you recall that?

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1 A. Yes, I recall that.

2 Q. If the financing by PSE was 100% equity in
3 Infrastrux, do you think that would have been a prudent
4 decision?

5 A. Based on my information that I have available
6 at this time, I question whether that would be a prudent
7 decision, and it is a topic that we are looking into at
8 this time.

9 Q. What types of issues go into your
10 determination as to the prudence of that? What are you
11 looking at to answer that question?

12 A. Well, we are still trying to determine the
13 facts about whether or not there was equity available
14 and the source of that equity, of that claimed equity.
15 And second, we are looking at the alternative uses to
16 which Puget Sound Energy, the utility and also the
17 consolidated entity, could have put that money rather
18 than another non-regulated investment.

19 MR. CEDARBAUM: Thank you, that was all, Your
20 Honor.

21 JUDGE MOSS: Okay, does the company have any
22 questions?

23 MR. QUEHRN: I have two questions, Your
24 Honor.

25

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

2 BY MR. QUEHRN:

3 Q. Ms. Steel, I would like to refer you once
4 again to Exhibit 81.

5 A. Okay, I have it.

6 Q. Do you understand the total amount that's
7 shown in this bank account referring to the lines that
8 show Infrastrux, basically the \$87 Million, do you
9 understand that to be approximately equivalent to the
10 amount of equity contribution that was made to
11 Infrastrux, just the numbers or the approximately
12 equivalent, that's my only question on this exhibit?

13 A. The numbers are not comparable. We're
14 comparing apples and oranges.

15 Q. Excuse me, numerically are they approximately
16 equivalent?

17 A. I could not take that question out of the
18 context just saying an 87 from some unknown source
19 that's not --

20 MR. QUEHRN: Then I withdraw the question,
21 Your Honor.

22 BY MR. QUEHRN:

23 Q. My other question for the witness is, you
24 just testified a few moments ago that you met with one
25 of the bankers whose firm is a party to the \$375 Million

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1 credit agreement. Could you please state the name of
2 the banker you met with and which firm that he or she
3 was representing?

4 A. I met with two representatives of the
5 Industrial Bank of Japan. I do not have their names
6 available, but I would have them in my records of
7 contacts with whom I met, and I would also be able to
8 specify the date. We talked about the company's
9 publicly filed documents, including its line of credit
10 agreement which is filed with the SEC.

11 Q. Do you know approximately when that meeting
12 took place?

13 A. January of 2002, I believe, or it could have
14 been December in 2002 in person.

15 JUDGE MOSS: I believe you misspoke, it would
16 be December 2001.

17 A. December 2001.

18 MR. QUEHRN: Thank you, Ms. Steel, no further
19 questions.

20 JUDGE MOSS: Before we release Ms. Steel --
21 oh, and, Mr. Ffitch, did you have any questions?

22 MR. FFITCH: No.

23 JUDGE MOSS: I'm feeling a certain
24 ambivalence, Mr. Cedarbaum, but at the same time a mild
25 concern in that I hear your witness testifying that she

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1 was unable to undertake certain analyses she wished to
2 undertake in sufficient detail to satisfy her in light
3 of apparently not receiving information that she thought
4 had been asked for. And I just want to enter into a
5 brief colloquy regarding the discovery process. I did
6 not receive any motions to compel during the course of
7 discovery. I recognize that time was short, and that's
8 part of the reason I'm feeling ambivalent. I realize
9 there may have been some practical considerations that
10 got in the way of the potentials of that process to
11 elicit information that is not forthcoming in a timely
12 way. And, of course, there is also the records
13 requisition mechanism which tends to yield data on a
14 fairly prompt basis when it's requested. And so I'm
15 just wondering if there's anything we need to be
16 concerned about in connection with our record at this
17 juncture.

18 MR. CEDARBAUM: I don't think so, Your Honor.
19 I think we -- there were no motions to compel to
20 disclose information. We took the track of making our
21 requests and following up as we thought was necessary.
22 I know Ms. Steel met many times, I shouldn't say many
23 times, met for a certain amount of time, probably for a
24 fairly long period of time with Mr. Gaines. A number of
25 issues were discussed, probably this one as well. I

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1 think we just tried to pursue it that way, and given the
2 time schedule, we did our best.

3 MS. DODGE: Your Honor, may we be heard on
4 this point?

5 JUDGE MOSS: Sure.

6 MS. DODGE: We have been assured at numerous
7 junctures that the Commission has no concerns with the
8 completeness of the data requests. This is the first
9 that I'm hearing that there's any concern about it, and
10 it's my understanding that on numerous occasions
11 Ms. Steel has declined to meet and confer about certain
12 matters of concern upon invitation of the company. We
13 would be happy to recall Mr. Gaines if that's an issue.

14 JUDGE MOSS: Well, I did express my
15 ambivalence, and perhaps I should have added the word
16 reluctance to get into this, and I don't want to get
17 into it too deeply. It strikes me that the
18 circumstances are such that the Staff is satisfied with
19 the case that was put on, and I think we can just leave
20 it at that for now. Now there's, of course, the general
21 case, and this issue may be pursued in that context, and
22 if such issues arise, then certainly we will take care
23 of them.

24 And I don't mean to imply, and if you took it
25 that way I'm sorry that you did, I did not mean to imply

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1 any lack of cooperation on the part of the company. I
2 just wanted to be certain that I understood, if you
3 will, the lay of the land with respect to this. And if
4 there was a need to do something, then I wanted to
5 provide the opportunity, but Mr. Cedarbaum has given me
6 the assurance that I required in that regard, and so I
7 don't see any need to take it any further at this point.

8 MS. DODGE: Your Honor, we would perhaps like
9 to state for the record that I think an implication has
10 been inserted into the record that Staff does not have
11 somehow, that they can not agree with the company's
12 position or change their position because they somehow
13 don't have information that they would need to have, and
14 the implication has been somehow that the company did
15 not provide that information. That's I think the
16 primary concern.

17 JUDGE MOSS: And I think we have taken care
18 of that concern, and so let's not pursue it any further
19 at this juncture.

20 CHAIRWOMAN SHOWALTER: I just want to say, I
21 think Ms. Steel has been implicated here by counsel, and
22 she's not having an opportunity to respond, and so given
23 that nothing is going to be asked for or inquired into,
24 I think it's better to leave it that the parties have
25 negotiated with each other, and nothing is being asked

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1 of us, and we are not asking anything of anyone else,
2 and we're not drawing any implications one way or the
3 other.

4 JUDGE MOSS: And I appreciate that, and I
5 should have broadened my comments in the same fashion
6 that Chairwoman Showalter did, we don't want to leave
7 any implications of criticism or concern anywhere in
8 connection with this. I simply wanted to confirm the
9 satisfaction of everybody with the case at this stage,
10 and that's what I have heard, and so that's where we
11 will leave it. All right.

12 CHAIRWOMAN SHOWALTER: That was a happy note.

13 JUDGE MOSS: Well, I probably should add some
14 cheer into my voice as we draw near the close.

15 Ms. Steel, I will release you from the stand,
16 no point in having you sit there any longer than
17 necessary. I know you spent quite a bit of time with us
18 at the beginning of the hearing as well, so we thank you
19 again for your testimony and for coming back and making
20 yourself available on short notice this afternoon.

21 THE WITNESS: Thank you.

22 JUDGE MOSS: Are there other housekeeping
23 matters that we need to take care of? Well, let me ask
24 first if there's anything substantive that the
25 commissioners would want to be present to hear, and if

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1 we just have housekeeping things regarding exhibits and
2 that sort of thing, I don't see any reason to make them
3 sit through that either, so is there anything
4 substantive?

5 It does not appear that there is, so I would
6 just say that the commissioners certainly could be free
7 to return to their offices and carry on the business of
8 the State while I sit here for a few more minutes with
9 the parties and ascertain whether there is any
10 housekeeping with respect to exhibits or other matters.

11 I think we did have something, Mr. ffitch,
12 with respect to how we were going to go forward with the
13 public comment exhibits. Did you have any further
14 thought on that?

15 MR. FFITCH: I guess my thought at this point
16 was that we would simply submit as complete a set as we
17 possibly could, and then the Commission -- we could
18 either do -- we could do one of two things, we could
19 just leave the last minute letters would not be a part
20 of the exhibit.

21 JUDGE MOSS: Let me ask, why don't we do
22 this, why don't you submit as complete a set as you can
23 by the 27th, and then I will give you leave to
24 supplement it with anything that comes in later.

25 MR. FFITCH: I was going to say, we could

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1 submit a supplemental exhibit.

2 JUDGE MOSS: That will work out fine. These
3 things don't tend to be controversial, so obviously I
4 won't close the opportunity if somebody wants to
5 controvert something.

6 MR. FFITCH: And Ms. Dodge and I have been
7 sort of discussing how to deal with the letters that
8 have come in and so on in terms of how many exhibits
9 there would be, how we would divvy them up, and I'm
10 hoping that we can work something out on that that's
11 acceptable to both of us. We would both like the public
12 comments to be -- I'm comfortable with the public
13 comments being offered in some form, it's just a
14 question of who is the appropriate party to do it.

15 JUDGE MOSS: Sure, well, you all work that
16 out, I have reserved enough numbers for everybody, so I
17 think that will give you the latitude that you need to
18 work out whatever you want to work out, one exhibit or
19 two or whatever.

20 Anything else in the way of housekeeping?

21 I will endeavor to distribute on let's say
22 Monday, maybe we better say Tuesday, I have another
23 matter on Monday that has unexpectedly come up, so
24 certainly on Tuesday I will distribute electronically
25 the final exhibit list. I hope by then to have all the

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1 if there are any outstanding Bench Requests or Records
2 Requisition Requests outstanding, I hope to have those
3 at the earliest possible time. And again, I will ask
4 the parties to let me know of any errors I have made in
5 the exhibit list that they believe should be changed,
6 corrected, redescribed, what have you, and I will
7 certainly take those into consideration.

8 I would like to thank all the parties,
9 unfortunately there are only a few of you left to hear
10 my kind words, but I would like to thank all of you for
11 the wonderfully professional presentations that you have
12 all made, and I truly do enjoy seeing you all at work,
13 consummate professionals, and it's a pleasure to have
14 you before the Commission.

15 So with that, we will close the evidentiary
16 phase subject to the matters I have left open through
17 the 27th, and we will be off the record.

18 (Hearing adjourned at 4:15 p.m.)

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