Puget Sound Energy, Inc.
Docket Nos. UE-011570, UG-011571
Direct Testimony: Jim Lazar
PCA
Exhibit ____(JL-T)

**BEFORE THE**

**WASHINGTON STATE UTILTIES AND TRANSPORTATION COMMISSION**

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| WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,<br><br>Complainant,<br><br>v.<br><br>PUGET SOUND ENERGY, INC.,<br><br>Respondent. | **DOCKET NOS. UE-011570**<br>**UG-011571** |

**DIRECT TESTIMONY**

**OF**

**JIM LAZAR**

**ON BEHALF OF**

**THE PUBLIC COUNSEL SECTION OF**

**THE WASHINGTON STATE ATTORNEY GENERAL'S OFFICE**

**POWER COST ADJUSTMENT**

**Q. PLEASE STATE YOUR NAME, ADDRESS, AND A BRIEF SUMMARY OF YOUR EXPERIENCE.**

A. My name is Jim Lazar, I am a consulting economist based at 1063 Capitol Way S. in Olympia, Washington, and have been engaged in electric and natural gas utility rate consulting since 1979. I have appeared before the Commission on more than fifty occasions, testifying in proceedings involving each of the regulated gas and electric utilities.

**Q. WHAT WAS THE NATURE OF YOUR INVOLVEMENT IN THE POWER COST ADJUSTMENT (PCA) PORTION OF THIS PROCEEDING?**

A. I was retained by Public Counsel to review many issues in this proceeding, including the Company's proposed PCA. I participated in the collaborative discussions which resulted in the Stipulation on the proposed PCA.

**Q. WHAT IS YOUR PRINCIPAL CONCLUSION WITH RESPECT TO THE FAIRNESS OF THE PCA STIPULATION?**

A. The proposed PCA is consistent with the public interest, and the stipulation should be approved.

**Q. WHAT WERE THE PRINCIPAL INTERESTS THAT PUBLIC COUNSEL ADDRESSED IN THE DEVELOPMENT OF THIS PCA?**

A. We had many interests. Conceptually, the parties had agreed that there would be a PCA in the Interim Stipulation. That left a myriad of details to be resolved.

First, we were interested in a mechanism that was consistent with past Commission directives on what should and should not be addressed in a PCA. We wanted a mechanism that was fair for customers, did not result in frequent rate changes, and provided a significant incentive for the Company to minimize power supply costs. Second, the mechanism had to share risk between the Company and ratepayers in a



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manner consistent with the understanding that went into the Interim rate case stipulation which set the equity capitalization ratio and the return on common equity. Third, we wanted a mechanism that would be relatively easy to administer.

**Q. PLEASE DISCUSS HOW THE PROPOSED PCA ADDRESSES YOUR INTEREST THAT THE PCA BE CONSISTENT WITH PAST COMMISSION DIRECTIVES.**

A. First, the proposed mechanism clearly defines which power supply costs are to be tracked by the PCA and which are not. It does not permit tracking of costs which are under the Company's control, such as the availability of the Colstrip plant, or changes in the prices of certain long-term contract resources.

Second, past Commission directives have specified that a PCA should only track costs which are weather-related. This mechanism deviates slightly from that previously enunciated policy, but with the $20 million dead band, I believe that there will be no PCA deferrals under circumstances that do not involve significant variations from "normal" weather. It is impossible to isolate all weather factors. For example, while the output of the Company's hydroelectric facilities is directly traceable to weather, the cost of natural gas is affected not only by weather in the Northwest, but also by weather in California and in the East, by gas drilling activity, and by other factors. By including gas costs for the Company's combustion turbines in the mechanism, any variation in gas costs, whether related to weather or not, we have gone beyond the previous directive. However, this is the principal risk that is outside of the Company's control, and therefore appropriate to include in a PCA.

**Q. HOW DOES THE PCA MECHANISM CONTAINED IN THE STIPULATION ENSURE THAT RATE CHANGES WILL BE RELATIVELY INFREQUENT?**



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A. The mechanism requires two significant deviations from "normal" power costs before rates would change.

First, no costs are deferred for future collection until allowable power costs exceed normalized power costs by at least $20 million. This is the so-called "dead band."

Second, the amount of deferred power cost must reach $30 million before a surcharge is triggered. Given the sharing mechanism, power costs would have to exceed normal levels by a total of about $62 million before a surcharge would be triggered. This is likely to be relatively infrequent. While a single "bad" year might result in $40 million or more of excess power costs, under the mechanism, only $10 million would be deferred under such a situation. In most cases a "bad" year or group of years would be followed by one or more "good" years that would erase some or all of the deferred power costs before a surcharge would be triggered.

The mechanism does, however, provide Puget with a measure of security in the event of multiple "bad" years in a row. In the first four years, the "cumulative" cap provides extra protection, and after the Company's capital structure has been rebuilt and the cumulative cap expires, the mechanism continues to provide protection against consecutive bad years through the deferral and sharing mechanism.

**Q. HOW DOES THE PCA MECHANISM PROVIDE A STRONG INCENTIVE FOR PUGET TO CONTROL POWER SUPPLY COSTS?**

A. The Company is always exposed to some percentage of the cost of any power supply cost in excess of the normal level set in this general rate case. It must absorb the first $20 million, half of the next $20 million, 10% of the next $80 million, and 5% of any amounts in excess of $120 million. Even in the first four years, when the "cumulative



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cap" is in effect, the Company is exposed to a small portion of the excess power cost. Similarly, if the Company can lower power cost below the normal level, it will retain all or a portion of the savings. The mechanism provides strong incentives for the Company to control power supply costs.

**Q. HOW IS THE PROPOSED MECHANISM CONSISTENT WITH THE STIPULATION REACHED IN THE INTERIM PROCEEDING THAT THE PCA SHARE RISK EQUITABLY BETWEEN THE COMPANY AND RATEPAYERS?**

A. The sharing mechanism ensures that the PCA only triggers a rate surcharge when circumstances are severely outside the "normal" range. This is consistent with the 11% return on equity that the parties stipulated to. In other Western jurisdictions, such as Nevada, where utilities are entitled to 100% recovery of prudently-incurred power supply costs, the allowed returns on equity are much lower than this.

**Q. FINALLY, WHAT ASPECTS OF THE PROPOSED PCA MAKE IT EASY TO ADMINISTER?**

A. First, the calculations to be performed are not particularly difficult, as evidenced by the relatively succinct exhibits appended to the Stipulation. Second, the requirement for the Company to file quarterly reports ensures that the parties remain aware of the current state of circumstances, so we can mobilize resources in a timely fashion if costs move toward the surcharge range. Finally, the relatively wide dead band and the $30 million minimum deferral to trigger a surcharge make it relatively unlikely that it will be necessary to perform the detailed review of costs in a surcharge proceeding except in fairly extreme circumstances. Obviously the experience of the last few years makes us all keenly aware that extreme circumstances CAN occur, but we expect they will remain rare.

**Q. ARE ALL OF THE DETAILS RESOLVED WITH RESPECT TO THE CALCULATION OF THE APPROPRIATE LEVEL OF COSTS AGAINST WHICH DEFERRALS ARE TO BE MEASURED?**



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A. The parties have not had an opportunity to review the underlying dollar amounts in each and every entry into the Exhibits which accompany the Stipulation to confirm that they are accurate. However, I believe that the language of the Stipulation is clear enough that this is really an auditing function for the future, not a matter where disagreement is likely. Because it is possible that not every potential situation has been considered, all of the parties have the right to request changes in the mechanism at any time in the future. I am optimistic that such changes will not be needed, but there is no "lock" on any of the methods for any period of time.

**Q. WHAT IS YOUR SUMMARY POSITION WITH RESPECT TO THE PCA MECHANISM AND STIPULATION?**

A. The Commission should find that the Stipulation is consistent with the public interest, and the Stipulation should be approved. The PCA mechanism should become effective as of July 1, 2002.

**Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

A. Yes.



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