EXHIBIT NO. ___(SA-4T)
DOCKET NO. UE-060266/UG-060267
2006 PSE GENERAL RATE CASE
WITNESS: SALMAN ALADIN

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-060266** **Docket No. UG-060267**

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF SALMAN ALADIN ON BEHALF OF PUGET SOUND ENERGY, INC.

AUGUST 23, 2006

PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

Q. Are you the same Salman Aladin who submitted prefiled direct testimony in this proceeding on February 15, 2006, on behalf of Puget Sound Energy, Inc. ("PSE" or "the Company")?

A. Yes.

Q. Please summarize your rebuttal testimony.

A. My prefiled rebuttal testimony responds to the recommendations of Staff of the Washington Utilities and Transportation Commission ("Commission Staff"), Public Counsel, and Industrial Customers of Northwest Utilities ("ICNU") (collectively, Commission Staff, Public Counsel and ICNU are referred to herein as the "Joint Parties") and the Federal Executive Agencies ("FEA") that the Company's Power Cost Adjustment ("PCA") Mechanism remain unchanged. These parties incorrectly suggest that PSE's proposed changes to the PCA Mechanism would require electric customers to bear a much larger share of power cost risks than customers have shared since the mechanism was implemented in 2002. Their arguments gloss over the fact that the expiration of the $40 million cumulative cap on excess power costs during the first four years of the

PCA Mechanism on June 30, 2006, results in a massive shift of exposure to PSE to absorb extreme power costs going forward unless changes are made to the existing PCA Mechanism in this case.

In addition, by focusing their discussion on the power cost increases that customers would have been exposed to under the revised mechanism over the past four years--three of which had much lower hydro conditions than normal--these parties ignore the potential upside to customers of PSE's proposed revisions during years in which hydro conditions are better than normal.

Given the volatility of power costs, the full range of potential outcomes in any given year, and the limitations on PSE's ability to control or hedge hydro conditions, PSE's proposed revisions to the PCA mechanism--including the proposed elimination of the existing deadband--would provide a fair and balanced sharing of power cost risks and rewards between the Company's customers and shareholders that better align the interests of both sets of stakeholders. PSE's proposed revisions would also continue to provide substantial incentive for the Company to control power costs.

Q. What if the Commission determines that the Company's PCA Mechanism should retain a deadband?

A. In that event, my prefiled rebuttal testimony also explains why the deadband should be much smaller than the $20 million deadband under the existing PCA. Retention of a deadband should also be accompanied by regular, mechanical

updates of the power cost baseline rate so that it more accurately reflects power costs that PSE is actually likely to incur on behalf of its customers.[1]

II. PSE'S PROPOSAL FAIRLY ALLOCATES POWER COST RISK BETWEEN CUSTOMERS AND SHAREHOLDERS

A. Customers Will Not Experience Greatly Increased Power Cost Risk Under PSE's Proposal

Q. Do you agree with the suggestion in the Joint Parties' and Mr. Selecky's prefiled response testimony for FEA that the Company's proposed changes to the PCA Mechanism would result in a large shifting of risk to PSE's customers?

A. No, I do not. In considering this argument, it is important to remember that from the inception of the PCA Mechanism until very recently, PSE has been protected by the cumulative $40 million cap from power costs that exceed the amount of power costs that is built into electric rates. At the same time, customers have been bearing the risk for 99% of costs that exceeded the cap.

With the expiration of the cap, a huge amount of extreme power cost risk is being shifted onto PSE going forward, unless the Commission approves modification of

[1] Please note that my prefiled rebuttal testimony focuses on the other parties' assertions regarding power cost risks related to the PCA Mechanism. Their assertions regarding the alleged reasons for the methodology that was agreed to in 2002 are addressed in the prefiled rebuttal testimonies of Ms. Kimberly Harris and Mr. John Story and their assertions regarding PSE's financial strength and relative ability to absorb excess power costs are addressed in the prefiled rebuttal testimonies of Mr. Bertrand Valdman and Mr. Don Gaines.

the PCA Mechanism in this case. PSE's proposed changes to the PCA Mechanism actually reduce customers' exposure to extreme power cost events from what they have been bearing for the past four years, as shown in the below example.

Q. Please explain.

A. Take, for example, a simple mathematical application of the bands of the three different versions of the PCA Mechanism that are at issue in this discussion: (1) with the $40 million cap that existed for the first 4 years of the mechanism; (2) without the $40 million cap; and (3) as proposed by PSE. Table 1, below, shows the total amount of costs that customers and shareholders each would have to absorb in the event that power cost excesses of $120 million were experienced each year for four years.

TABLE 1
Comparison of Existing and Proposed
Power Cost Adjustment Sharing Mechanisms
over a four year period
($ in millions)

	Customer Share of +/- $120 MM	PSE Share of +/- $120 MM
Existing Mechanism with $40 million cap	438.9	41.1
Proposed Mechanism	392.0	88.0
Current Mechanism without $40 million cap	328.0	152.0

Table 1 shows how customer risk is reduced from $438.9 million under the mechanism as it has been in place over the past four years to $392 million under PSE's proposed modifications to the PCA Mechanism. By contrast, if PSE's proposed modifications to the sharing bands are not approved, PSE's shareholders

will be exposed to $152 million in excess power costs over four years, more than a three-fold increase in the level of risk to which they have been exposed under the PCA Mechanism from its inception to the date the cap expired.

Q. Is it realistic to assume that power cost excesses of $120 million would be experienced each year for four years?

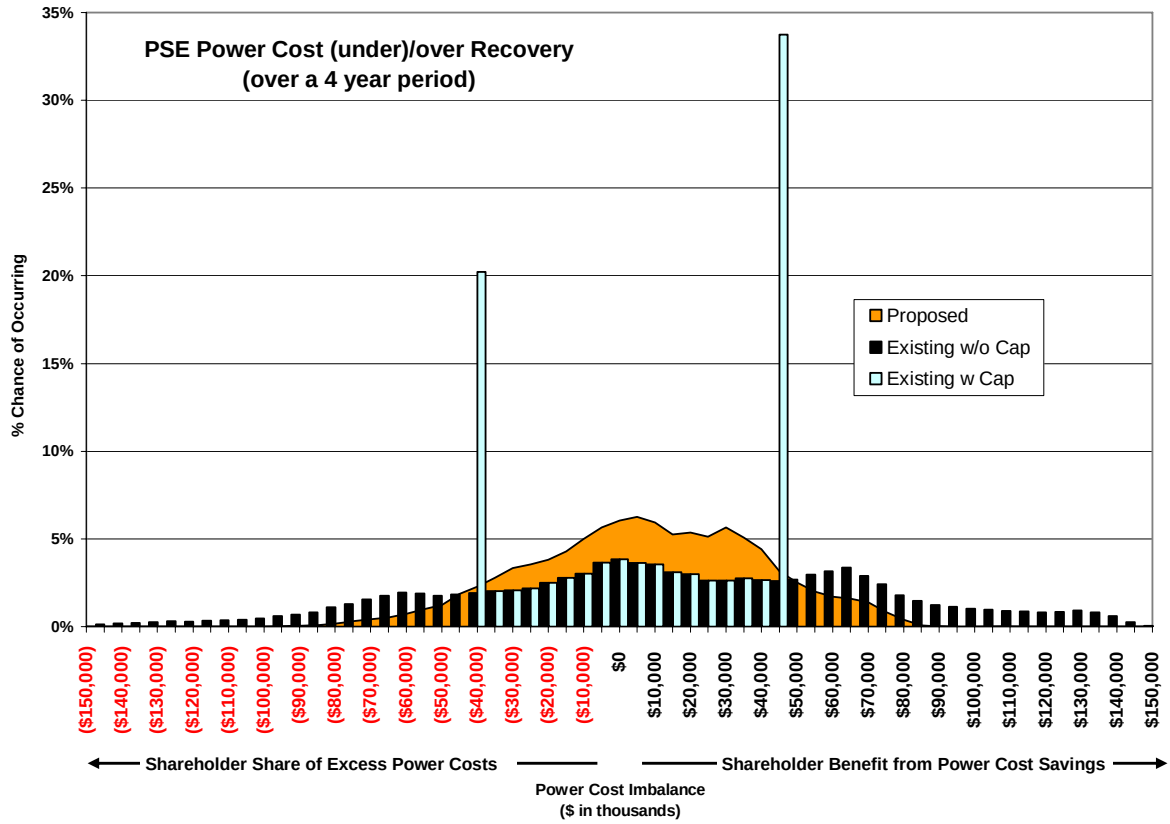
A. The point to the above example is not that these costs are likely to be incurred in any given four year period but rather that this is the risk that customers and shareholders are each exposed to by application of the various versions of the bands. Assuming excess power costs of $120 million each year for four years permits application of the full range of the bands and the cumulative cap.

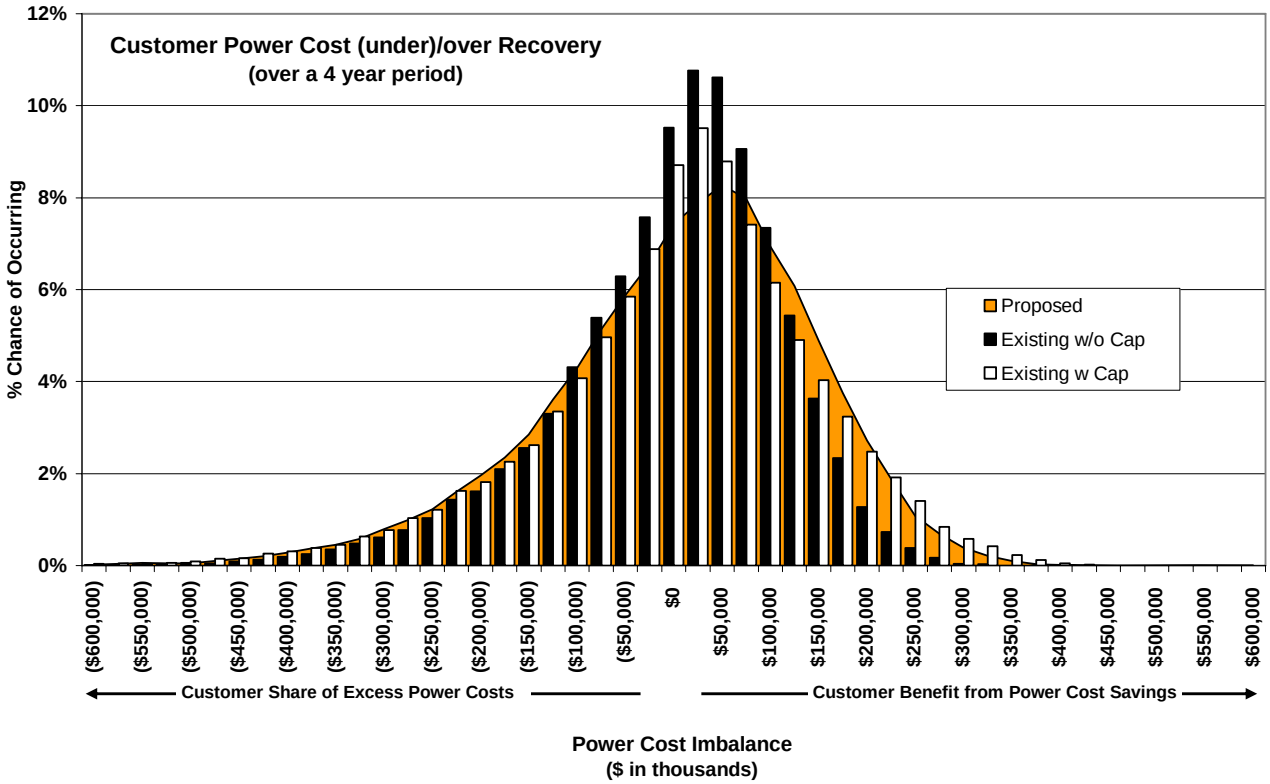
In any case, the general propositions I make above about the relative risks borne by customers and shareholders holds true under a modeling approach that incorporates a full range of potential power cost excesses or savings.

Q. Would you please explain?

A. Recall the description in my prefiled direct testimony of the Monte Carlo simulation that PSE performed using the AURORA model in which power costs were simulated using a full range of different hydro conditions, load and gas prices based on actual historic data. *See* Exhibit No. ___(SA-1CT) at 10-14. That modeling was for a single year because PSE was focused in its direct case on showing the power cost risks inherent in a single (PCA) year.

If the output from this methodology is used to model potential over or under recovery of power costs over a four-year period (in order to compare the impact on risk of the four year cumulative cap), the results with respect to shareholder exposure are shown in the first chart below and the results with respect to customer exposure are shown in the second chart below:





Q. Please explain what these charts show.

A. These show that for shareholders, a PCA Mechanism without the cap results in much larger exposure than they experienced with the cap. PSE's proposed changes to the PCA moderate this exposure, but still result in greater risk to shareholders from extreme power cost events than they have experienced over the past four years with the cap. Similarly, PSE's proposal would result in less risk from extreme power cost events being placed on customers than they have borne over the past four years with the cap in place.

Q. Isn't more risk being placed on customers to pay for excess power costs under less extreme conditions because PSE is proposing elimination of the deadband?

A. It is true that PSE's proposal will result in customers being at risk of having to pay 50% of the first $25 million of power costs in excess of those recovered in rates, a risk that customers do not have under the current PCA Mechanism. However, this is a fair risk for customers to bear given the magnitude of power cost volatility that cannot be controlled by the Company due to hydro variability alone, as described in my prefiled direct testimony. In addition, customers' 50% share of $25 million--$12.5 million--comes out to only 66 cents ($0.66) per month for the average residential customer, as stated in Mr. Hoff's prefiled rebuttal testimony, Exhibit No. ___(DWH-6T).

Moreover, the 50/50 sharing PSE proposes will give customers the opportunity to immediately share in the power cost savings that result in years with good hydro conditions, as further described in my prefiled direct testimony and below.

B. PSE's Proposal Incorporates Potential "Upside" For Customers

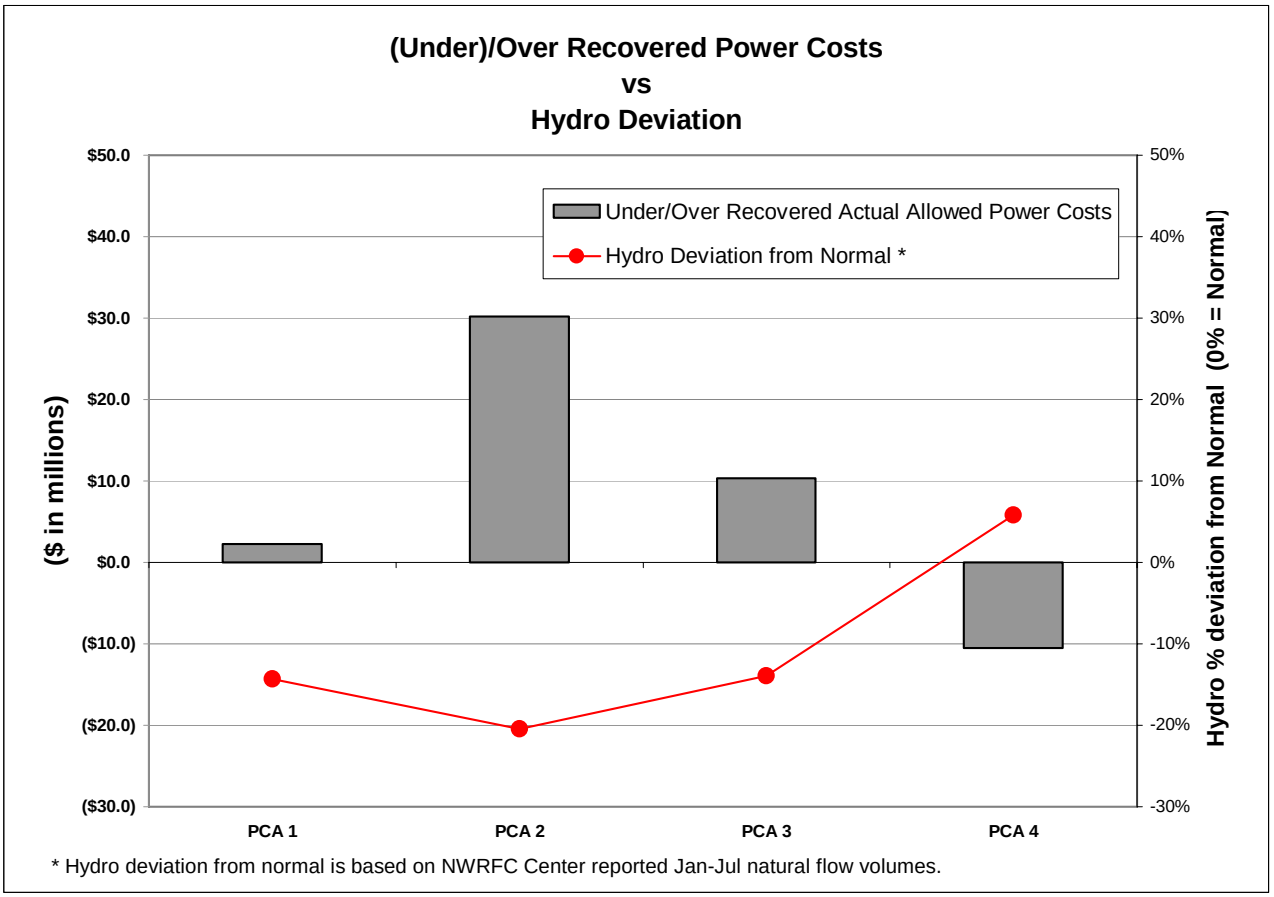
Q. Are there other aspects of the prefiled response testimony of the Joint Parties and the FEA that you believe incorrectly portray the potential costs or risks associated with PSE's proposed changes to the PCA Mechanism?

A. Yes. By focusing on what has actually happened with power costs in the past four years, these parties are limiting their analysis to four scenarios that do not represent the full range of potential conditions that impact power costs. Because three of the past four years have had dry hydro conditions, this limited analysis leads them to conclude and argue that PSE's proposed changes to the PCA Mechanism would increase customer costs.

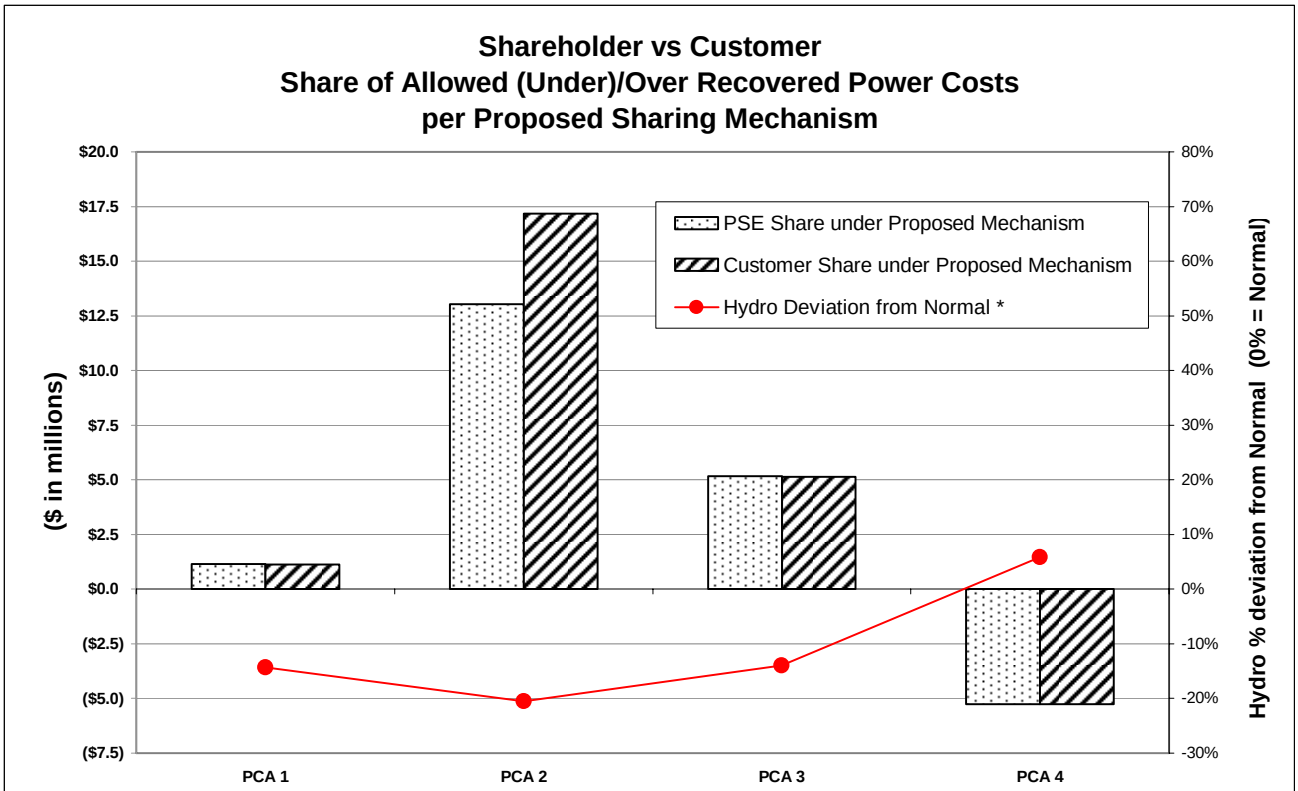
Q. Would you please further illustrate why you believe that use of the past four PCA periods to evaluate the merits of the proposed sharing mechanism is inappropriate?

A. Because PSE's rates are set assuming that water conditions will be "normal" (based on the average of a 50-year data set), when hydro conditions inevitably turn out to be higher or lower, it impacts PSE's actual power costs. In general, "dry" years increase power costs such that they are typically under-recovered, while "wet" years decrease power costs such that they are typically over-recovered.

As shown in the chart below, during PCA periods 1-3, lower than "normal" hydro conditions produced excess power costs. During PCA period 4, higher than "normal" hydro conditions produced power cost savings.



Naturally, if PSE's proposed revised PCA sharing bands are applied to these four particular power cost scenarios, the result would have been increased power costs for customers during the past four years because they would have shared more of the excess costs of the dry years, as shown in the chart below.



Q. What is your concern about the other parties' focus on power costs experienced during the past four years?

A. The region's three "dry" years over the past four PCA periods should not be used to make far-reaching conclusions that PSE's proposed sharing mechanism unfairly shifts costs or risks to customers.

Q. Are there better ways of examining and understanding the potential consequences of the changes PSE has proposed?

A. Yes, the modeling presented in my prefiled direct testimony and the additional modeling presented above is a better basis from which to consider the merits of

PSE's proposed changes to the sharing mechanism. This modeling is not limited to four specific years that are over-weighted to dry years and excess power costs. Instead, it examines the likelihood of power cost outcomes under a range of potential conditions.

Q. Do these observations also impact your reaction to the Joint Parties' request that PSE be ordered to conduct a "study of the financial risk posed by power costs under the current PCA mechanism, from the date of inception to the present"?[2]

A. Yes. PSE has already undertaken and presented several studies of the financial risks and costs under the current and the proposed PCA Mechanism in this case, through the modeling that the other parties have largely ignored. There is no need to impose a requirement that a new study be conducted. Furthermore, by limiting such a study to historical circumstances that actually occurred over the past four years, the results of such a study would inherently fail to capture or present an adequate or accurate picture of the potential costs and risks associated with the PCA Mechanism.

[2] Exhibit No. ___(JOINT-19T) at page 28.

C. PSE's Proposal Will Continue to Incent PSE to Aggressively Manage Power Costs that PSE Can Control

Q. Are there other aspects of the Joint Parties' and FEA's prefiled response testimony on the PCA Mechanism with which you disagree?

A. Yes. The Joint Parties' and FEA's assertions regarding the Company's ability to control power costs fail to acknowledge the extent of the power cost volatility caused by changes in hydroelectric conditions and temperature. Their testimonies suggest that PSE has far more control over power costs than it does.[3]

In doing so, they ignore the analysis presented in my prefiled direct testimony regarding the variability of hydro and the magnitude of the resulting impact on power costs. They also largely ignore the evidence I presented to show that hydro costs are uncontrollable and not capable of being hedged in a cost-effective manner.[4] The fact acknowledged in my prefiled direct testimony -- that PSE uses wholesale market purchases and sales to *respond* to the variability in hydro – does not mean that PSE is able to *manage* the variability in hydro conditions or come anywhere close to eliminating the impact of such variability on power costs. The suggestion of the Joint Parties and FEA that PSE is in a better position than customers to manage power cost risks ignores the significant extent to which power costs are outside of the control of PSE as well as its customers.

[3] *See, e.g.,* Exhibit No. ___(JOINT-19T) at page 24; Exhibit No. ___(JTS-1T) at page 9.
[4] Exhibit No. ___(SA-1CT) at pages 17-19.

Q. How does this inability to control hydro risk relate to PSE's proposal for this case?

A. Given the inability to control the volatile hydro conditions and the resulting consequences to power costs that I described in my prefiled direct testimony, PSE's proposed elimination of a deadband in the PCA and 50/50 sharing of the first $25 million excess or savings is a reasonable approach that will equitably share between customer and shareholders the power cost savings associated with wet years and the excess power costs associated with dry years. As shown in my prefiled direct testimony, PSE will still have a strong incentive to manage its power costs--to the extent it can--even with its proposed revisions to the PCA Mechanism.

III. IF A DEADBAND IS RETAINED, IT SHOULD BE MUCH SMALLER THAN $20 MILLION

Q. Why is PSE seeking the elimination of a deadband when Avista just settled for a mechanism with a deadband and when this Commission has spoken positively of the benefits of deadbands?

A. As the Joint Parties acknowledge in their prefiled response testimony, and as this Commission recently stated in its PacifiCorp rate case order, not all companies are alike and not all PCA Mechanisms in the state need to be alike. Furthermore, PSE has conducted and presented to the Commission in this case rigorous analysis depicting the risks associated with PSE's power portfolio. To PSE's

knowledge, such analysis has never before been presented to this Commission to aid in its consideration of a proposed PCA Mechanism. For the reasons described in my prefiled direct testimony and above, as well as by Ms. Harris and Mr. Valdman, PSE believes that the deadband should be eliminated from PSE's PCA Mechanism at this time.

Q. If the Commission nevertheless believes that a deadband should continue to be a feature of the Company's PCA Mechanism, should the current $20 million deadband be retained or increased?

A. No. As described in my prefiled direct testimony, the Company's proposed revisions to the PCA Mechanism were designed to be fair and balanced and align the interests of shareholders and customers while providing a level of financial risk to the Company that the Company is in a position to bear. If a deadband is deemed attractive by the Commission as a feature of the PCA Mechanism, the level of the deadband should place no more risk on the Company than it can reasonably bear, given the expiration of the $40 million cap and the considerations set forth in Mr. Valdman's prefiled direct and rebuttal testimonies.

The table shown below presents a sharing band structure that keeps the Company risk profile approximately the same as PSE's proposed mechanism but that includes a deadband:

Power Costs ($ in millions) (over or under the PCA baseline)	Customers' Share	Shareholders' Share
$0 - $7.5 +/-	0%	100%
$7.5 - $15 +/-	50%	50%
$15 - $120 +/-	90%	10%
> $120	95%	5%

Q. Should a mechanism that includes a deadband incorporate any other changes?

A. Yes. As set forth in Ms. Harris' prefiled rebuttal testimony, the Company remains quite concerned about the tendency of a deadband to incent other parties in rate cases to seek a power cost baseline that is artificially and unreasonably low. In addition, as described in my prefiled direct testimony, projections that are made in rate cases to set a power cost baseline rate are inherently inexact and inevitably incorrect. Changes in power costs from projected levels are often driven entirely by the weather or other factors beyond the Company's control and/or by the need to set power costs based on a "normal" or historic average level.

One way to address these issues while retaining a deadband would be to update the power cost baseline on a regular basis through a process that is relatively mechanical and not subject to dispute. The Company proposes that if a deadband is ordered to be maintained in this case, the Commission order such updates of PSE's power cost baseline rate two or three times annually to ensure that the baseline rate is set as accurately as possible. This would permit better matching of the power cost baseline rate with hydro conditions that are actually likely to

occur in a given year. It would also permit regular and timely updating of gas prices per the Commission-approved 3-month average of forward gas price methodology. If the Commission orders such power cost baseline rate updates, the Company will propose a specific standard methodology in its first update filing that can be examined by the Commission and other stakeholders at that time.

IV. CONCLUSION

Q. Please summarize your prefiled rebuttal testimony.

A. PSE's proposed revisions to the PCA Mechanism represent a fair and balanced compromise that would provide a sharing of power cost risks between the Company's customers and shareholders that better align their interests. Customers will not inevitably pay higher power costs under PSE's proposed changes, and instead will have the opportunity to share in the benefits of better hydro years while taking on an appropriate share of the risks associated with bad hydro years, given PSE's inability to control or hedge such risks.

Elimination of the deadband is an important aspect of PSE's proposal. However, if the Commission believes that a deadband should continue to be a feature of the PCA, the current $20 million deadband should be reduced to $7.5 million, with accompanying changes to the sharing bands. In addition, if a deadband is retained, the power cost baseline rate should be updated through a regular,

mechanical process in order to more accurately embed in rates the power costs that are likely to be incurred to serve PSE's electric customers.

Q. Does this conclude your prefiled rebuttal testimony?

A. Yes.