EXHIBIT NO. ___(KO-1HCT)
DOCKET NO. UE-06___/UG-06___
2006 PSE GENERAL RATE CASE
WITNESS: KRIS OLIN

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-06____** **Docket No. UG-06____**

PREFILED DIRECT TESTIMONY (HIGHLY CONFIDENTIAL) OF KRIS OLIN ON BEHALF OF PUGET SOUND ENERGY, INC.

REDACTED VERSION

FEBRUARY 15, 2006

PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY (HIGHLY CONFIDENTIAL) OF KRIS OLIN

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PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

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

A. My name is Kris Olin. My business address is 10885 N.E. Fourth Street Bellevue, WA 98004. I am the Manager – Hydro Assets for Puget Sound Energy, Inc. ("PSE" or "the Company").

Q. Have you prepared an exhibit describing your education, relevant employment experience, and other professional qualifications?

A. Yes, I have. It is Exhibit No. ___(KO-2).

Q. What are your duties as Manager – Hydro Assets for PSE?

A. My responsibilities include oversight of the following for Company-owned hydroelectric projects: (i) operations and maintenance; (ii) implementation of Federal Energy Regulatory Commission ("FERC") license conditions; and (iii) compliance with FERC license conditions.

Q. What is the nature of your testimony in this proceeding?

A. My testimony presents information on the relicensing efforts of the Company related to the Baker River Hydroelectric Project (the "Baker River Project" or "Project") in order to obtain a replacement for the existing Project license that expires on April 30, 2006. I explain why the Company entered into a Settlement Agreement with the other parties interested in the terms of the new license rather than pursuing other potential alternatives for addressing the expiring license. I also detail the additional costs related to the Project that PSE is seeking to recover in this case.

The Settlement Agreement, which has been filed with FERC and is expected to be approved in 2006, will enable PSE to continue generating low-cost hydropower at the Project for 45 more years. The cost of power associated with the terms of the new license proposed in the Settlement Agreement is anticipated to be approximately $[redacted]/MWh (levelized) over thirty years, after which time the Company will still be entitled to generate power for 15 more years under the proposed license. The Settlement Agreement, if approved, would also provide other public benefits, such as improvements to fish and wildlife habitat and recreational facilities for the public, enhanced flood control, and preservation of cultural resources.

In addition to my discussion of the Baker River relicensing efforts, I describe a recent arbitration decision that required the Company to pay the Muckleshoot

Tribe operations and maintenance costs related to the Tribe's White River fish hatchery for the period September 1, 1998 through January 15, 2004. As described in the testimony of Mr. John H. Story, Exhibit No. ___(JHS-1T), the Company is seeking recovery of these costs in this case.

II. BACKGROUND REGARDING THE BAKER RIVER PROJECT

Q. Please describe the Baker River Project generally.

A. The Baker River Project, FERC No. 2150, is owned and operated by the Company and is located on the Baker River in Skagit and Whatcom Counties, north of, and partially within, the Town of Concrete. The Project consists of two developments: the Lower Baker Development and the Upper Baker Development. The present installed capacity of the Baker River Project is 170 MW.

A. <u>The Lower Baker Development</u>

Q. Please describe the Lower Baker Development.

A. The Lower Baker Development currently consists of (i) a concrete arch dam 1.2 river miles upstream of the Baker River's confluence with the Skagit River, (ii) a 7-mile-long reservoir, (iii) a power tunnel, (iv) a single-unit powerhouse at river mile 0.9, (v) a fish barrier dam and trap at river mile 0.6, (vi) a primary

transmission line, and (vii) associated facilities.

In 1917, PSE's predecessor announced plans to build a hydroelectric dam on the Baker River to provide electricity for the growing Puget Sound population.

In 1924, in accordance with Section 23 of the Federal Power Act, Puget Sound Power & Light Company ("Puget") filed a declaration of intent with the Federal Power Commission, a predecessor of FERC, to construct the Lower Baker Development. The Federal Power Commission found that the proposed construction would not affect the interests of interstate or foreign commerce and granted Puget permission to proceed.

Construction of the Lower Baker Development began on April 15, 1924. The original development contained two 19.75-MW generators with the provision for an additional 55-MW unit. On April 13, 1927, the Federal Power Commission issued Puget a minor part license for the occupancy of 75.5 acres of United States lands within the Mt. Baker National Forest. The plant was commissioned for service on November 19, 1925. In 1927, the dam was raised 33 feet to its existing height of 285 feet.

The third generating unit at the Lower Baker Development was installed in October 1960. An earth slide subsequently destroyed the powerhouse in May 1965. The powerhouse was rebuilt but Units 1 and 2 were abandoned.

In 2001, the Company rewound the Unit 3 generator and refurbished the turbine,

thereby increasing the authorized plant capacity to 79.33 MW.

B. The Upper Baker Development

Q. Please describe the Upper Baker Development.

A. The Upper Baker Development currently consists of (i) a concrete gravity dam at river mile 9.35, (ii) an earthen dike, (iii) a 9-mile-long reservoir, (iv) a two-unit powerhouse, and (v) associated facilities.

During World War II, the Puget Sound area again experienced an increase in population and the development of new infrastructure. To meet the need for additional generating capacity, Puget sought authorization for the construction of a second hydroelectric project on the Baker River.

On June 4, 1956, the Federal Power Commission issued the existing license authorizing construction of the Upper Baker Development. The same license also served to integrate the Lower Baker Development into the same license, thereby establishing one project. Construction began immediately and the development went into operation in October 1959.

Puget rewound one generator (Unit 2) in 1989 and the second (Unit 1) in 1990. The Unit 2 turbine was repaired, and the wicket gates and servo-motor were refurbished in 1996. In 1997, the Unit 1 turbine was refurbished, and the runner was replaced. The authorized capacity of the Upper Baker Development is

currently 90.70 MW.

C. The Expiration of the Existing License for the Baker River Project

Q. What is the status of the existing license for the Baker River Project?

A. As discussed above, the Federal Power Commission issued the existing license on June 4, 1956. This license will expire on April 30, 2006. If FERC does not approve the Settlement Agreement on or before April 20, 2006, FERC will issue annual licenses to allow the Baker River Project to operate until the relicensing process is complete.

III. THE BAKER PROJECT RELICENSING PROCESS

A. Overview

Q. Please describe the relicensing process for the Baker River Project?

A. The formal relicensing process required by FERC began in the Spring of 2000 and has continued to the present. The Company used FERC's Alternate Licensing Process for the relicensing of the Baker River Project. This process ultimately led to a Settlement Agreement setting forth proposed terms of a new license for the Project that PSE filed as an offer of settlement with FERC on November 30, 2004. A chronology of significant events during the course of the relicensing effort is provided as Exhibit No. ___(KO-3).

The Company expects FERC to issue a new license in 2006, and if this occurs, such that the Company must operate the Baker River Project in compliance with the terms of the new license as of the beginning of the rate year for this case, calendar year 2007.

Q. What is the Alternate Licensing Process?

A. At the time that the Company began the relicensing process for the Baker River Project, FERC had two methods for seeking a new license[1]--the Traditional Licensing Process and the Alternate Licensing Process. FERC now has a third method for seeking a new license--the Integrated Licensing Process--that became effective July 23, 2005, and was not available for the relicensing process for the Baker River Project.

Q. What are the differences between the Traditional Licensing Process and the Alternate Licensing Process?

A. The primary difference is that the Alternate Licensing Process integrates the consultation and National Environmental Policy Act environmental review processes during the period before the applicant submits a license application. This allows for an Applicant Prepared Environmental Assessment to be drafted during the consultation process. This differs from the Traditional Licensing Process where the National Environmental Policy Act analysis is conducted by

[1] An "original license" is the initial license for a hydropower project, and any subsequent license for a hydropower project is a "new license."

FERC after the license application has been submitted.

Q. What are the benefits of the Alternate Licensing Process?

A. The benefits of the Alternate Licensing Process relate to the following goals identified by FERC in developing the Alternate Licensing Process:

(i) to facilitate greater participation and improved communication among interested parties;

(ii) to promote cooperative efforts between the license applicant and interested parties for sharing information about potential resource impacts and environmental proposals; and

(iii) to create more opportunities to narrow the areas of potential disagreement between interested parties, and to enable parties to reach consensus on a settlement agreement to be submitted with the license application.

Q. Please describe the Alternate Licensing Process?

A. Applicants must request approval from FERC before using the Alternate Licensing Process. In its request, the licensee must demonstrate to FERC that the interested parties have agreed to pursue the alternative procedures for relicensing. In addition to obtaining consensus, the licensee must develop a communications protocol that describes how the interested parties, licensee and FERC will communicate until the final license application and National Environmental National Environmental Policy Act document are filed with FERC.

Once FERC approves the use of Alternate Licensing Process, the licensee, at a minimum, must conduct the following steps:

(i) prepare and distribute information on the project works, operation, and environmental resources;

(ii) conduct an initial public information meeting;

(iii) involve all participants in a cooperative examination of environmental issues, including the selection and design of required scientific studies;

(iv) file a status report with FERC every six months; and

(v) Submit a draft National Environmental Policy Act analysis with the final license application.

B. Development of Working Groups

Q. How did the Company begin the relicensing process for the Baker River Project?

A. In March and April of 2000, PSE initiated the relicensing process with four public information meetings in Mount Vernon and Concrete, Washington. The Company notified about 160 organizations of the opportunity for involvement. Participants received information about the Project as it then-existed – including generation capabilities, recreational opportunities, fish and other habitat enhancement measures and flood control provisions. In addition, the Company discussed the benefits of using FERC's Alternative Licensing Process to facilitate a collaborative relicensing process, and began soliciting stakeholders' interests and concerns.

In July 2000, the Company held a fifth public meeting. In addition, nearly

100 members of the public visited the Baker River Project on a special tour day in July 2000. Shortly thereafter, more than 60 individuals attended one of several two-day training workshop emphasizing a process called RESOLVE to use for conflict-resolution and consensus-building.

Q. What happened next?

A. Participants' involvement began formally with the formation of five resource-specific working groups addressing the following interests: (i) wildlife and terrestrial, (ii) aquatics, (iii) recreation and aesthetics, (iv) cultural and historical, and (v) economics and operations. Participants in the Baker River Project collaborative relicensing process held more than 400 separate meetings over more than four years, ultimately leading to the settlement described below.

PSE staff, governmental agencies, tribes, non-governmental organizations and the public began meeting monthly to establish operating procedures and meeting norms, share information, gather and discuss the relicensing interests of all entities, and begin preparing for what was to become the most time-consuming of their efforts – the identification, planning and completion of resource studies.

In addition to the five on-going groups, a technical working group formed to address issues related to fish passage.

Q. Did any experts oversee the recommendations provided by the individual working groups?

A. Yes. A team of high-level experts--called the Baker Solution Team--was formed to oversee the relicensing effort, consider recommendations provided by the individual working groups, determine which proposals to include in the Application for a New License, and ultimately craft the settlement agreement. The Baker Solution Team included a representative from every interest involved in the relicensing effort--some 30 different organizations.

The Baker Solution Team's initial objective was to prepare a communications protocol and process document--two plans addressing how involved parties would endorse collaboration, consensus-building, creativity and flexibility as afforded by the FERC Alternative Licensing Process. Once complete in 2002, the communications protocol outlined tools for coordination and communication between all participants, and the process document governed their interaction.

C. Preparation of the Notice of Intent and the Initial Consultation Document

Q. What initial filings were made in support of the relicensing?

A. On May 11, 2001, the Company filed a Notice of Intent to File Application for a New License with FERC.

In March 2002, PSE filed with FERC the Initial Consultation Document, after

review by the Baker Solution Team. The Initial Consultation Document provides an overview of the physical and operational aspects of the Baker River Project and summarizes the environmental resources and programs associated with the Project as it then-existed. These include geology and soils, water quality and quantity, fish and aquatic resources, terrestrial resources, cultural resources, recreation, and aesthetics.

D. Preparation of Resource Studies and Project Materials

Q. What steps followed the filing of the Notice of Intent to File Application for a New License and the Initial Consultation Document?

A. Beginning in 2001 and continuing into 2003, the working groups conducted studies related to each project resource area. In all, more than 75 studies were completed, some taking a few months, and others more than a year.

Q. Did PSE conduct the meetings involved in the preparation of such studies?

A. No. A professional facilitator organized and ran nearly all meetings, which allowed the PSE team leaders to actively participate rather than focus on conducting meetings. The independent facilitator provided credibility and organization to the relicensing process, and she played an integral role in keeping the process on track and parties at the negotiating table. Also, PSE hired a separate consultant to provide feedback on the collaborative process.

Q. Were these project materials available to the public for review?

A. Yes. The Company, consistent with FERC regulations, opened a public document room providing a place for interested parties to view project materials. The Baker River Project web site was expanded and updated to include all documentation and provide information on the working groups and solution team. The Company established an e-mail address and phone message line available as alternative ways to access information.

Additionally, a public involvement subgroup within PSE planned several public initiatives including Project tours for public and elected officials, and corporate participation in community events and efforts.

E. Scoping Meetings, Request for Alternative Licensing Process, Bi-Annual Progress Reports

Q. What happened next?

A. In May 2002, PSE and FERC held two public scoping meetings to solicit comments and viewpoints about potential impacts of the Baker River Project relicensing. In conjunction with the meetings, PSE and FERC jointly prepared a draft Scoping Document 1, which identified environmental issues associated with the Baker River Project relicensing, including water quality and impacts to fish and wildlife.

At the meetings, about 25 individuals and organizations offered spoken or written

comment on the Scoping Document and the Initial Consultation Document, to which FERC later responded with a Scoping Document 2. The second scoping document, issued in May 2003, served as the basis for the Preliminary Draft Environmental Assessment.

Q. When did the Company formally request approval from FERC to use the Alternative Licensing Process?

A. PSE officially requested approval from FERC to use the Alternative Licensing Process in May 2002. As part of that request, PSE also filed the completed Communications protocol, the completed Process document, and letters of support from the participants.

Q. Did FERC approve the request to use the Alternative Licensing Process?

A. Yes, FERC granted PSE's request for approval to use the Alternative Licensing Process in July 2002. FERC simultaneously requested that PSE begin issuing bi-annual Baker River Project relicensing progress reports.

Q. Did PSE subsequently issue bi-annual Baker River Project relicensing progress reports?

A. Yes, PSE subsequently issued relicensing progress reports in January and July of 2003, and January of 2004. As discussed below, PSE filed the Application for a New License in April 2004. Further progress reports were unnecessary after that

time.

Q. What subjects did the bi-annual Baker River Project relicensing progress reports address?

A. The bi-annual Baker River Project relicensing progress reports addressed the progress made regarding the various regulatory processes affecting relicensing, both state and federal, including but not limited to the Washington State Department of Ecology's Clean Water Act Section 401 Certification, the Endangered Species Act Consultation required by the U.S. Fish and Wildlife Service and National Oceanic and Atmospheric Administration ("NOAA") Fisheries, and compliance with the National Historic Preservation Act.

Q. How did the Company coordinate the resolution of these regulatory requirements?

A. PSE worked together with FERC and the affected agencies to develop a schedule and milestones for each regulatory requirement, with the goal of working these regulatory processes in parallel with FERC's relicensing process.

F. Preparation of Protection, Mitigation and Enhancement Measures and the Preliminary Draft Environmental Assessment

Q. What are protection, mitigation and enhancement measures?

A. Protection, mitigation and enhancement measures are potential actions that could

be taken to address the requirements of the Federal Power Act for a new license. In this instance, protection, mitigation and enhancement measures were collaboratively developed by the Baker Solution Team and working groups to address resource issues and interests related to the Baker River Project relicensing, justification for the measure, and how the measure could be implemented.

Q. How many protection, mitigation and enhancement measures were identified for the Baker River Project relicensing?

A. The working groups prepared approximately 150 draft protection, mitigation and enhancement measures in the fall of 2002 to address resource issues identified during the first two years of the relicensing process.

Q. How were these draft protection, mitigation and enhancement measures used in the Baker River Project relicensing?

A. The Baker Solution Team requested that PSE use the initial draft protection, mitigation and enhancement measures as a basis for preparing a "draft proposed action" for the Baker River Project. PSE negotiated with the involved parties and ultimately developed 54 proposed actions to address the 150 protection, mitigation and enhancement measures.

In early March 2003, 61 representatives from the working groups, the Baker Solution Team, consultants and FERC participated in a 2 ½ day cross-resource

workshop. At this workshop, the participants reviewed and discussed the initial protection, mitigation and enhancement measures and PSE's proposed actions.

Q. Were additional draft protection, mitigation and enhancement measures developed?

A. Yes, subsequent to the March 2003 meeting, participants prepared a second set of draft protection, mitigation and enhancement measures. The parties returned in May 2003 for another day-long cross-resource workshop to further discuss and refine the protection, mitigation and enhancement measures. From this collaborative work, PSE was able to prepare another draft proposed action document, containing 50 specific actions.

Q. How was the second draft of the proposed action document used in the Baker River Project relicensing?

A. The second draft of the proposed action document was used for evaluation in preparing the Preliminary Draft Environmental Assessment and as initial drafts of articles for the proposed license.

Q. Did PSE or any working group conduct any modeling regarding the draft protection, mitigation and enhancement measures and proposed actions?

A. Yes. In 2003 a new group, the technical scenario teamlet, was charged with processing modeling requests from the working groups using the Baker River

HYDROPS model. The HYDROPS model determines how water usage affects other Baker River resources. The technical scenario teamlet served as a clearinghouse for scenario modeling requests and provided standardized formats for input and output model runs, and ran the modeling requests. A second teamlet also convened to discuss flood control issues on the Baker River.

Q. Did the Company prepare the Preliminary Draft Environmental Assessment for the Baker River Project relicensing?

A. No, with the approval of the Baker Solution Team, PSE contracted with The Louis Berger Group in September of 2002 to prepare a Preliminary Draft Environmental Assessment for the Baker River Project relicensing.

Q. What was the purpose of the Preliminary Draft Environmental Assessment?

A. The Preliminary Draft Environmental Assessment is part of the overall application for a FERC license and specifically responds to requirements of the National Environmental Policy Act. There are two parts to a license application. The application itself consists of historical background, a project description, operating parameters, and proposed changes. The Preliminary Draft Environmental Assessment described is part two of the application. It addresses anticipated environmental effects associated with implementing the actions proposed in license application.

G. The Application for a New License

Q. Did the Company circulate drafts of the Application for a New License prior to filing it with FERC?

A. Yes. First, FERC issued the final Scoping Document 2 in May 2003, which incorporated comments to Scoping Document 1. In October 2003, the Company issued a four-volume draft Application for a New License for the Baker River Project. PSE requested that all parties submit comments on the draft Application for a New License by January 2004, which left four months to incorporate changes and complete the final Application for a New License.

Q. When did the Company file the final Application for a New License?

A. PSE filed the final Application for a New License and Preliminary Draft Environmental Assessment for the Baker River Project on April 30, 2004, while the Policy Team continued its work in hopes of reaching a final settlement within the subsequent months.

H. The Comprehensive Settlement

Q. At what point did PSE and the other stakeholders engage in a settlement process?

A. In some sense, the entire Alternate Licensing Process is a comprehensive settlement process. The parties focused in earnest on reaching settlement terms

contemporaneously with the Application for a New License.

Q. When did PSE and the stakeholders begin discussing the preparation of a settlement agreement?

A. In April of 2003, the parties began circulating outlines of draft settlement agreements. Over the course of the following year, a legal working group comprised of the attorneys representing various participants helped with drafting the settlement agreement.

In early 2004, at the final stages of the development of the settlement agreement, a group of high-level participants from PSE and the stakeholders, called the Policy Team, began work on reaching consensus on remaining issues. The Policy Team was tasked with reviewing the settlement agreement and making compromises between proposed measures as needed.

Q. Did the parties ultimately reach a comprehensive settlement?

A. Yes. The Baker River Hydroelectric Project Relicensing Comprehensive Settlement Agreement (the "Settlement Agreement") is 162 pages long and was crafted by 24 different parties. PSE filed the Settlement Agreement as an offer of settlement with FERC on November 30, 2004. A copy of the Settlement Agreement is provided as Exhibit No. ___(KO-4).

Q. Please describe the improvements to fish and wildlife habitat provided by the Settlement Agreement?

A. The Settlement Agreement, if approved, provides that the Company will, with respect to fish habitat, construct improved upstream and downstream fish-passage facilities for moving migrating salmon around the Baker River Project's two dams, and provide fish passage between Lake Shannon, Baker Lake, and other parts of the Baker basin for bull trout and other native, non-salmon species. PSE will also construct new fish-hatchery facilities and upgrade spawning beaches to increase the Project's sockeye propagation at least threefold (with eventual capacity for 14.5 million fry per year). Additionally, PSE will increase the minimum outflow and reduce the maximum outflow of water from Lower Baker Development to protect fish and fish habitat. The planned construction of two new Lower Baker Development turbines will enable higher minimum outflows than is currently possible.

With respect to wildlife habitat, the Company will provide funding to acquire, maintain, and enhance varied habitats for elk, mountain goats, osprey, loons, bald eagles, spotted owls, marbled murrelets, and other endangered or threatened species. PSE will also provide funding for additional acquisition or enhancement of wetlands or riparian habitat in the Skagit and Baker basins.

Q. Please describe the improvements to recreational facilities for the public provided by the Settlement Agreement?

A. The Settlement Agreement, if approved, will require the Company to redevelop the Baker Lake Resort with 30 to 50 new campsites, reconstruct Bayview Campground, and provide funding to maintain numerous U.S. Forest Service campgrounds, trails, and roads. PSE will also construct or fund additional recreational improvements of a nature and at locations to be determined around Baker Lake and Lake Shannon.

Q. Please describe the flood control enhancements provided by the Settlement Agreement?

A. The Company has agreed to work with the U.S. Army Corps of Engineers to provide 74,000 acre-feet of flood storage at the Upper Baker Development. This agreement continues an existing arrangement between PSE and the Corps of Engineers, for which the Company is partially compensated.

The Settlement Agreement also addresses an opportunity for PSE to work with the Corps of Engineers to provide an additional 29,000 acre-feet of flood storage at the Lower Baker Development. The Settlement Agreement also establishes a protocol to be followed for reservoir "draw downs" in advance of an imminent flood event.

Q. Please describe the cultural resource enhancements provided by the Settlement Agreement?

A. In the Settlement Agreement, the Company has committed to provide training, education, and program coordination to preserve artifacts and to protect and enhance historic properties and traditional cultural properties that are affected by Baker River Project construction and use of the Baker River Project area. There will also be a Cultural Resources Enhancement Fund that will be used for the enhancement, conservation, and /or restoration of cultural resources. A joint committee of tribal members and PSE staff will administer actions funded through this portion of the agreement.

Q. Will the above habitat and other improvements increase the cost of the license for the Baker River Project?

A. Yes, the improvements will increase the cost of the license for the Baker River Project. It is important to note that, throughout the relicensing process, the Company stated its interest in maintaining a cost-effective Project. Other parties, however, found it difficult to evaluate and discuss their interests in economic terms, either because of legal constraints that bear upon factors that agencies can appropriately take into consideration in decision-making or, in other cases, because cultural or other values cannot be readily expressed in economic terms.

For example, some agencies charged with the responsibility to address fish and wildlife interests cannot, in many cases, balance "what is best for fish" against

economic considerations. In the case of instream flows, other agencies and third-party interests, such as flood storage and recreation, were addressed. So, PSE had to find ways to meet all interests through collaboration.

Another case in point is the agreement struck with respect to fish passage facilities. Various fishery agencies and tribes advocated the use of fish screens as a protective measure in lieu of a less expensive fish passage facility based on a design concept currently used at the Baker River Project. Fish screens would have added approximately $210 million to the capital cost requirement for the Project, whereas the cost of fish passage facilities agreed upon in the Settlement Agreement is estimated at $50 million. Therefore, the "reasonableness" of proposals considered overall plant economics, but the test of "reasonableness" that ultimately lead to consensus among all parties to the Settlement Agreement necessarily considered a broad range of interests.

Q. What are the estimated costs to be borne by PSE in association with the Settlement Agreement?

A. PSE estimates that the Settlement Agreement's proposed licensing provisions will cost the Company about $360 million over the next 30 years (or about $178 million measured in current dollars).

IV. PSE'S CONSIDERATION OF ALTERNATIVES FOR ADDRESSING THE EXPIRING BAKER RIVER PROJECT LICENSE

Q. Did the Company consider relicensing alternatives?

A. Yes, the Company considered three relicensing alternatives and a decommissioning alternative. These alternatives were:

(i) Relicense the Baker River Project with the provisions contained in the Company's initial Application for the New License (the "Company Alternative");

(ii) Relicense the Baker River Project with the preferred terms and conditions formulated by resource agencies, Native American tribes and other interested parties (the "Agency/NGO Alternative");

(iii) Relicense the Baker River Project with a settlement proposal that seeks to resolve differences between the Company's Alternative and the Agency/NGO Alternative (the "Settlement Alternative"); and

(iv) Decommission the Baker River Project and acquire replacement power (the "Decommissioning Alternative").

The Company's consideration of these alternatives is documented and further detailed in Exhibit No. ___(KO-5HC) and Exhibit No. ___(KO-6HC).

Q. What was the "Company Alternative"?

A. The Company Alternative is reflected in the Company's initial Application for New License, which was responsive to all elements PSE believed to be necessary for a meritorious and defensible application for a new license (e.g., Part I of the Federal Power Act and various related regulatory requirements addressing

matters, such as fish and wildlife, water quality, cultural resources and listed species). The cost of power associated with the Company Alternative would be $[redacted]/MWh (levelized) over the thirty-year term of a new FERC license.

Q. What was the "Agency/NGO Alternative"?

A. The Agency/NGO Alternative consists of the preferred terms and conditions for a new FERC license, as formulated by the resource agencies,[2] several Native American tribes,[3] and other interested parties.[4] The Agency/NGO Alternative represented what those parties presented as meritorious and defensible conditions responsive to applicable legal and regulatory requirements. The cost of power associated with the Agency/NGO Alternative would range between $[redacted]/MWh (levelized) and $[redacted]/MWh (levelized) over the thirty-year term of a new FERC license.

Q. What was the "Settlement Alternative"?

A. The Settlement Alternative consists of compromises between the Company

[2] The resource agencies included the U.S. Forest Service, the U.S. Fish and Wildlife Service, the National Park Service, NOAA Fisheries, the Washington Department of Ecology, the Washington Department of Fish and Wildlife and the Washington Department of Natural Resources.

[3] The Native American tribes included the Upper Skagit Indian Tribe, the Sauk-Suiattle Indian Tribe and the Swinomish Indian Tribal Community.

[4] The other interested parties included Skagit County, the City of Anacortes, the Town of Concrete, Public Utility District No. 1 of Skagit County, the Interagency Committee for Outdoor Recreation, The Nature Conservancy of Washington, the North Cascades Conservation Council, the North Cascades Institute, the Rocky Mountain Elk Foundation, the Skagit Fisheries Enhancement Group, the Washington Council of Trout Unlimited, the Wildcat Steelhead Club, and Skagit County resident Bob Helton.

Alternative and the Agency/NGO Alternative discussed above. The Settlement Alternative provides value to PSE and all parties by substantially reducing the regulatory risk associated with a contested FERC decision. The cost of power associated with the Settlement Alternative would be approximately $[redacted]/MWh (levelized) over the thirty-year term of a new FERC license. The Settlement Agreement, however, recommends that FERC grant a 45-year license, which provides fifteen additional years of dependable generation at a stable and favorable cost.

Q. What was the "Decommissioning Alternative"?

A. The Decommissioning Alternative would have required decommissioning of the Baker River Project and acquiring replacement power if the Company could not secure a new FERC license on favorable terms. Costs associated with the Decommissioning Alternative are difficult to quantify. There could be revenues, such as revenues from the sale of surplus properties, that might offset some expenditures associated with the Decommissioning Alternative.

The Company estimated a potential range of costs associated with the Decommissioning Alternative between $15 million and $400 million. The lower end of this range represents a scenario in which both the Lower and Upper Baker Developments remain, all assets are sold to a third party, and the only remaining costs are small net costs associated with decommissioning, plus the cost of replacement power. The high end of this range addresses a scenario in which the

Company is required to remove both the Lower and Upper Baker Developments and restore the Baker River basin to its pre-project condition.

Q. Why are the estimated costs enumerated above levelized over thirty-years when the term of the new FERC license is expected to be longer than thirty years?

A. PSE's analysis followed the FERC methodology. The FERC economic analysis methodology requires the use of a thirty-year term for calculating Project costs, regardless of the actual term of the FERC license.

Q. Why did PSE ultimately adopt the Settlement Agreement alternative?

A. The Company concluded that the Settlement Agreement alternative should be pursued as it substantially reduced the Company's risk that much less favorable license terms and conditions would be imposed by FERC.

If PSE were to pursue the Company Alternative, then a contested FERC proceeding could commence. In this context, some of the regulatory agencies advocating the Agency/NGO Alternative (e.g., U.S. Forest Service, U.S. Fish and Wildlife Service, NOAA Fisheries and Washington Department of Ecology) have mandatory conditioning authority under sections 4(e) and 18 of the Federal Power Act, as well as the Endangered Species Act and the Clean Water Act. If PSE had not adopted a collaborative approach to settlement of the relicensing process, these agencies could simply have imposed their desired terms and conditions.

Additionally, in a contested proceeding, all parties would likely take positions that would significantly depart from the Settlement Agreement. These factors very likely would have resulted in less favorable license conditions, a cost of power well in excess of the Settlement Alternative and further uncertainty and costs associated with protracted regulatory proceedings and litigation (it is not unusual for a contested FERC relicensing proceeding to extend for several years). PSE believed that it would be best to minimize these substantial costs, risks and potential delays, and the Settlement Alternative was the best way to achieve this objective.

All parties invested substantial time and resources in crafting the Settlement Agreement. The Company believes that the Settlement Agreement reflects the best and final offer of all parties and represents a reasonable compromise between the Company Alternative and the Agency/NGO Alternative. This collaborative effort has built upon and improved positive relationships with the 23 parties that signed the Settlement Agreement. These positive relationships will be carried forward in implementing a new license, and PSE believes that these positive relationships will help the Company to better manage costs and risks in the years to come.

The Company rejected the Decommissioning Alternative because of the uncertainty and high costs that would likely be required as part of any decommissioning and the cost of obtaining replacement power.

V. CURRENT STATUS OF THE BAKER RIVER RELICENSING PROCESS

A. Status of the FERC Process

Q. Has FERC accepted the Settlement Agreement and issued a new license?

A. Not as of the time this testimony was filed. However, the Company anticipates that FERC will ultimately issue a new license for the Baker River Project in calendar year 2006 on terms that are the same as, or substantially similar to, the Settlement Agreement.

Q. What steps remain to be taken before FERC issues the new license?

A. FERC must complete and issue a Draft Environmental Impact Statement for public comment. The Company anticipates that the Draft Environmental Impact Statement will be issued in March of 2006. FERC must also wait until a number of state regulatory reviews are concluded. These state requirements are described below. PSE is hopeful, however, that FERC can issue a final Environmental Impact Statement and new license in calendar year 2006.

Q. If FERC does not issue a new license by the date the current license expires, in April 2006, will the Company need to cease generation at the Baker River Project?

A. No. As noted above, the Company expects that FERC will issue annual licenses

(on the terms of the existing license) until such time that FERC issues a new license.

B. Status of State Regulatory Approvals

Q. What state regulatory approvals must still be obtained for the Baker River Project?

A. The Washington State Department of Ecology must issue a Water Quality certification pursuant to the Clean Water Act and make a Coastal Zone Management Act consistency determination before FERC can issue a new license. Ecology has issued a draft Water Quality certification, and the comment period on the draft closed on January 27, 2006. The Washington State Department of Ecology has not set a date for its final Water Quality certification.

The Washington State Department of Ecology has also taken comment on its Coastal Zone Management Act consistency determination and is due to act on this matter in early February 2006. It is possible that the Washington State Department of Ecology will request an extension to afford the agency time to review FERC's Draft Environmental Impact Statement before it completes its Coastal Zone Management Act process. As with the Water Quality certification, the Washington State Department of Ecology has not set a date for its final Coastal Zone Management Act consistency determination.

VI. COSTS FOR WHICH THE COMPANY REQUESTS RECOVERY

Q. What costs associated with the Baker River Project does the Company seek approval and recovery of through this proceeding?

A. In addition to its ongoing recovery of capital and operations and maintenance costs related to the Baker River Project, the Company is seeking in this proceeding Commission approval for the recovery of: (i) costs associated with the relicensing process for the Baker River Project, and (ii) increases to operations and maintenance costs related to the conditions of the new license that is anticipated to be in effect during the rate year for this case, calendar year 2007.

A. Relicensing Costs

Q. Please describe the relicensing costs associated with the Baker River Project?

A. The Company has incurred capital costs of $25.1 million associated with its relicensing efforts for the Baker River Project. A detailed breakdown of these relicensing costs (including AFUDC) is provided in Exhibit No. ____(KO-7C). An update of these costs will be provided upon the issuance of the license by FERC.

About $11 million of the costs were for outside consultant services. The general assistance they provided was in preparing studies that addressed proposals suggested by Federal and State Agencies and others in the collaborative process.

A portion of this amount was for facilitation services. This was work that helped organize meetings, provided a focus during the meetings, kept track of process, and documented outcomes. Another component of the relicensing costs was for internal labor that participated in the process. This was about $2.8 million.

B. Increased Operating and Maintenance Costs

Q. What increased operating and maintenance costs are related to the new license?

A. There are $3.8 million of increased operations and maintenance costs associated with satisfying individual license article requirements listed in the Settlement Agreement during the rate year. A detailed breakdown of these relicensing costs is provided in Exhibit No. ____(KO-8C). These increases will vary over time depending on payment schedules and type of commitment. Costs of some individual articles are based on a fixed amount to be paid toward an item, whereas others are based on satisfying the intent of the article. Therefore, costs associated with license-related operations and maintenance may need to be revised in future rate proceedings.

C. Request for Recovery Do Not Include Costs Related to Capital Improvements to the Baker River Project

Q. Do any of the costs for which the Company seeks approval for recovery in this proceeding include costs related to capital improvements to the Baker River Project required by the Settlement Agreement?

A. No, the Company is not seeking, at this time, recovery of any capital improvements to the Baker River Project required by the Settlement Agreement. PSE will include costs associated with capital improvements to the Baker River Project required by the new FERC license in future filings as those costs are incurred.

VII. THE MUCKLESHOOT TRIBE ARBITRATION DECISION

Q. What is the purpose of this section of your testimony?

A. This section of my testimony describes an arbitration decision that was issued against PSE on June 29, 2005, regarding operating and maintenance costs of a fish hatchery located on the White River for the period September 1, 1998 through January 15, 2004. The Company's proposed treatment of such costs in this case is described in the testimony of Mr. John Story.

Q. Please describe the dispute that led to the arbitration decision.

A. In 1986, the Company entered into a settlement agreement with the Muckleshoot

Indian Tribe (the "Tribe"). The settlement agreement resolved litigation between the Company and the Tribe with respect to the White River Hydroelectric Project's impact on the Tribe's alleged rights regarding the White River's resources. The litigation raised matters such as whether the Tribe held treaty-related water rights with priority over the Company's White River Project water rights and whether the Company, by exercise of its White River Project water rights and development and operation of the White River Project, had interfered with the Tribe's treaty-protected fishing rights. The settlement agreement resolved all claims which were made or asserted or which could have been made or asserted by the Tribe against the Company in the action.

As one aspect of the settlement agreement, the Company agreed to fund the construction of a fish hatchery, to be owned and operated by the Tribe. The hatchery was built in 1989. The Tribe has operated and controlled the hatchery since it was completed.

From 1989 until September 1, 1998, PSE paid the Tribe for the operation and maintenance ("O&M") costs for the White River fish hatchery. As of September 1, 1998, PSE stopped paying such costs based on PSE's reading of the terms of the 1986 settlement agreement. The Tribe claimed that PSE was required to continue paying the Tribe for the O&M costs for the hatchery for the period from September 1, 1998 through January 15, 2004 (the day PSE discontinued operation of the White River Project). This dispute was submitted to binding arbitration before a panel of three arbitrators pursuant to the terms of the 1986 settlement

agreement.

Q. What did the Arbitration Panel conclude?

A. On June 29, 2005, the Arbitration Panel issued a decision in favor of the Tribe that was signed by two members of the panel, with one dissenting panel member. A copy of the arbitration award is provided as Exhibit No. ___(KO-9C). The decision concluded that PSE was required to pay the O&M costs for the hatchery from September 1, 1998 through January 15, 2004. The panel further determined that PSE owed the Tribe $2,211,100 ($1,422,800 in unpaid O&M costs and $788,300 in interest) within 30 days.

Q. Has PSE complied with the arbitration award?

A. Yes, PSE paid the Tribe in full by the deadline set forth in the award.

VIII. CONCLUSION

Q. Does this conclude your testimony?

A. Yes, it does.

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