

EXHIBIT NO. ___(KJH-3T)
DOCKET NO. UE-060266/UG-060267
2006 PSE GENERAL RATE CASE
WITNESS: KIMBERLY J. HARRIS

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
KIMBERLY J. HARRIS
ON BEHALF OF PUGET SOUND ENERGY, INC.

AUGUST 23, 2006

PUGET SOUND ENERGY, INC.

**PREFILED REBUTTAL TESTIMONY OF
KIMBERLY J. HARRIS**

CONTENTS

I. INTRODUCTION1

II. REVISED REQUEST FOR RELIEF3

III. RESPONSE TO THE OTHER PARTIES' OBJECTIONS TO PSE'S
PROPOSED RELIEF.....5

 A. Financial Structure and Rate of Return.....5

 B. The Power Cost Adjustment (PCA) Mechanism.....7

 C. The Depreciation Tracker10

 D. Decoupling – the Gas Revenue Normalization Adjustment
 ("GRNA")12

 E. Gas Rate Design.....13

 F. Electric Energy Efficiency Proposals14

IV. EXPANDED BENEFITS FOR LOW INCOME CUSTOMERS16

V. CONCLUSION.....17

1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED REBUTTAL TESTIMONY OF**
3 **KIMBERLY J. HARRIS**

4 **I. INTRODUCTION**

5 **Q. Are you the same Kimberly J. Harris who submitted prefiled direct**
6 **testimony in this proceeding on February 15, 2006, on behalf of Puget Sound**
7 **Energy, Inc. ("PSE" or "the Company")?**

8 A. Yes.

9 **Q. Please summarize the purpose of your rebuttal testimony.**

10 A. My testimony responds generally to the testimony submitted by the other parties
11 to this case and presents an overview of the Company's rebuttal filing.

12 **Q. What is the Company's reaction to the response testimonies submitted by the**
13 **other parties?**

14 A. With a few exceptions, we are very disappointed in the positions that have been
15 staked out by the other parties. PSE has been doing great things for its customers.
16 We are investing in our delivery systems and in new electric resources in order to
17 continue to provide high quality, reliable gas and electric service, now and into
18 the future. The Company has also been a leader in searching out and investing in
19 cost-effective energy efficiency measures.

1 The Company has come to the Commission requesting financial relief that
2 supports these efforts. We are asking the Commission to approve the mechanisms
3 we have proposed in order to remove or reduce regulatory disincentives that exist
4 to the important tasks we are undertaking. The Company carefully designed its
5 proposals in order to create more alignment between the interests of its customers
6 and shareholders. In each case, we presented balanced, reasonable mechanisms
7 for the consideration of the Commission and the other parties.

8 The response cases of the other parties are disappointing because, with limited
9 exceptions, they do not address the barriers that exist to the Company's ability to
10 continue its efforts on behalf of its customers. The Company appreciates that
11 none of the other parties has challenged the prudence of the new resources
12 presented for the Commission's approval in this case. But the financial relief
13 proposed by the other parties is not sufficient to support our resource acquisition
14 efforts or delivery system investments.

15 In addition, the other parties nearly universally oppose the mechanisms PSE has
16 proposed. In doing so, they are expressing a preference for the status quo over
17 changes that will provide real and lasting benefits to customers. The Company
18 respectfully requests that the Commission consider the longer term interests of
19 PSE's customers and the region in considering the issues that are before it in this
20 case and approve the Company's requested relief.

1 With respect to the specific relief the Company is requesting, PSE is not blindly
2 defending the positions taken in its original filing in February 2006. The
3 Company recognizes that there is more than one way to address the issues that are
4 challenging PSE and others in the industry. PSE has carefully considered the
5 objections presented by the other parties. Whenever possible, the Company has
6 modified its position to accommodate specific concerns raised by other parties.

7 **II. REVISED REQUEST FOR RELIEF**

8 **Q. Has the financial relief that is being requested by the Company changed**
9 **since its initial filing of this case in February 2006?**

10 A. Yes. In early July 2006, the Company made a supplemental filing in this case to
11 update the amount of the gas and electric increases it is requesting. The
12 supplemental filing incorporated more current information about the Company's
13 anticipated rate year (calendar year 2007) costs than the information that was
14 available to the Company when it prepared its February 2006 filing. In addition,
15 the Company adjusted the electric revenues to take into account the July 1, 2006
16 increase that was approved by the Commission in Docket Nos. UE-050870 and
17 UE-060783 in the amount of power costs recovered in rates.

18 That supplemental filing reduced the Company's original request for an annual
19 increase in electric revenues from approximately \$140.9 million to approximately
20 \$42.9 million. The supplemental filing also reduced the Company's original

1 request for an annual increase in gas revenues from approximately \$40.4 million
2 to approximately \$39.2 million.

3 **Q. Is the Company's request for relief in this rebuttal case the same as its**
4 **request for relief in the July 2006 supplemental filing?**

5 A. No. Although the Company does not agree with most of the positions set forth in
6 the other parties' testimonies, the Company has accepted several of their revenue
7 requirement adjustments. The Company is also proposing some additional
8 updates based on information that has become available since it prepared its July
9 2006 filing.

10 The result is a reduction in the Company's request for an increase in electric
11 revenues to approximately \$33.8 million. If approved, this would represent an
12 average 1.97% electric rate increase. The Company's rebuttal case also requests
13 an annual increase in gas revenues of approximately \$39 million. This would
14 represent an average 4.06% gas rate increase.

15 In addition, the Company is proposing that the Commission consider approving
16 an alternative to the Depreciation Tracker proposed in PSE's original case, as
17 proposed by the Federal Executive Agencies ("FEA") in its response testimony.
18 Under this alternative the Commission would adjust the revenue requirements in
19 this case to include certain additional investments that the Company has made in
20 its transmission and distribution system since the end of the September 30, 2005
21 test period. As described in the prefiled rebuttal testimony of Ms. Susan McLain,

1 Exhibit No. ___(SML-5T), these transmission and distribution additions are
2 infrastructure replacements or upgrades that do not produce new revenues but
3 were needed to help maintain system reliability for existing customers. The
4 facilities are already being used by the Company today to provide electric and gas
5 service to customers. If approved by the Commission, the additional revenue
6 requirement for these infrastructure replacements or upgrades would be
7 approximately \$8.8 million for electric operations and \$3.5 million for gas
8 operations.

9 **III. RESPONSE TO THE OTHER PARTIES' OBJECTIONS TO**
10 **PSE'S PROPOSED RELIEF**

11 **A. Financial Structure and Rate of Return**

12 **Q. What is the Company's response to the other parties' recommendations**
13 **regarding capital structure and return on equity?**

14 A. The Company's direct case explained that the Company's approved equity
15 percentage and its authorized return on this equity need to be raised to higher
16 levels in order to support the Company's ability to meet the long-term interests of
17 its customers. The requested financial relief will support the Company's
18 investment in new power plants and other infrastructure as well as the hedging
19 activities that help protect customers from wholesale energy market volatility and
20 price spikes. The Company proposed an authorized return on equity of 11.25%
21 on a capital structure that includes 45% equity.

1 None of the other parties' witnesses dispute the Company's need to replace aging
2 components of the Company's electric and gas delivery systems, maintain a
3 reliable and adequate energy supply by acquiring new electric generation
4 resources, and enter into risk management transactions to mitigate energy price
5 volatility. Yet the parties do not support a financial structure that will allow the
6 Company to successfully undertake these activities, as described in the prefiled
7 rebuttal testimonies of Mr. Bertrand Valdman, Exhibit No. ___(BAV-7CT), Mr.
8 Donald Gaines, Exhibit No. ___(DEG-7CT), and Dr. Roger Morin, Exhibit
9 No. ___(RAM-15T).

10 The other parties also oppose the mechanisms the Company has proposed to give
11 PSE the opportunity to actually earn its authorized return on equity ("ROE") by
12 reducing the lag on recovery of infrastructure investments, reducing the extent to
13 which PSE must absorb power costs incurred to serve electric customers that are
14 not recovered in rates, and increasing PSE's ability to recover the costs of serving
15 gas customers.

1 **Q. Does the Company have specific concerns about the way in which the**
2 **Commission Staff and the Industrial Customers of Northwest Utilities**
3 **("ICNU") cost of capital witnesses have calculated what they believe should**
4 **be the Company's authorized return on equity?**

5 A. Yes. As stated in Dr. Morin's rebuttal testimony, their witnesses have made a
6 number of errors in their return on equity estimations. If these errors were
7 corrected, Commission Staff's recommended return on equity would be 10.775%
8 (rather than 9.375%) and ICNU's recommended return on equity would be 11.2%
9 (rather than 9.90%).

10 **B. The Power Cost Adjustment ("PCA") Mechanism**

11 **Q. What is the Company's reaction to the other parties' proposal that the**
12 **PCA Mechanism remain "as is" other than approval of the Company's**
13 **proposal with respect to the costs of a credit facility for wholesale market**
14 **transactions?**

15 A. The Company is pleased to see that the other parties do not oppose PSE's proposal
16 to establish a separate credit line dedicated to supporting its wholesale energy
17 market transactions and to pass the costs of such credit facility through to PSE's
18 customers in the same manner as other power and gas commodity costs, via the
19 PCA Mechanism and Purchased Gas Adjustment Mechanism ("PGA").

1 However, the Company strongly disagrees that the PCA Mechanism should
2 remain in its current form. As described in Mr. Salman Aladin's prefiled rebuttal
3 testimony, Exhibit No. ____ (SA-4T), the expiration of the four-year, \$40 million
4 cumulative cap on excess power costs on June 30, 2006, results in a massive shift
5 of exposure to PSE to absorb extreme power costs going forward unless changes
6 are made to the existing PCA Mechanism in this case.

7 Given the volatility of power costs and the limitations on PSE's ability to control
8 or hedge hydro conditions, PSE's proposed revisions to the PCA Mechanism--
9 including the proposed elimination of the existing deadband--would provide a fair
10 and balanced sharing of power cost risks and rewards between the Company's
11 customers and shareholders that better align the interests of both sets of
12 stakeholders. PSE's proposed revisions would also continue to provide
13 substantial incentive for the Company to control power costs.

14 **Q. Do you agree with the other parties that the PCA sharing bands were**
15 **designed by reference to the Company's earnings retention?**

16 A. No. I was a principle negotiator for the Company in the 2001 general rate case in
17 which the PCA Mechanism was developed. I do not agree with the Joint
18 Testimony of Messrs. Lazar, Schoenbeck and Mariam on the PCA Mechanism in
19 which they suggest that the PCA Mechanism was designed with the primary goal

1 of protecting the Company's annual dividend.¹ That was not the Company's intent
2 or understanding. The Company never agreed with, or to, the general
3 propositions or calculations on this issue that are set forth in their joint testimony.

4 **Q. Is the testimony of the other parties regarding projected rate year power**
5 **costs in this case relevant to the PCA Mechanism dispute?**

6 A. Yes. As described in the Company's direct case, it is our hope that elimination of
7 the deadband and a 50/50 sharing of the first \$25 million of power costs or
8 benefits will align all parties to seek to set the power cost baseline rate as close as
9 possible to the level of power costs that are actually likely to prevail in future
10 PCA years. With a deadband, parties other than PSE are incented to take
11 positions on power cost projections that are biased toward trying to set the power
12 cost baseline rate as low as possible.

13 In the present case, the other parties again challenge PSE's power cost projections
14 in a manner that appears calculated merely to reduce the amount of power costs
15 recovered in rates rather than to develop a reasonable projection of the costs of
16 the power that PSE will need to serve its customers during the rate year. Mr.
17 David Mills explains in his prefiled rebuttal testimony, Exhibit No. ____ (DEM-
18 19CT), why the Commission should approve the Company's power cost
19 projections.

¹ See Exhibit No. ____ (JOINT-19T).

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

3 A. In that event, Mr. Aladin's rebuttal testimony explains that the deadband should
4 be reduced from \$20 million to \$7.5 million and that the power cost baseline rate
5 should be updated two to three times each year so that it more accurately reflects
6 power costs that PSE is actually likely to incur on behalf of its customers.

7 **C. The Depreciation Tracker**

8 **Q. Does the Company agree with the other parties that the PCA Mechanism, the**
9 **PCA Mechanism's power cost only rate case ("PCORC") feature, and the**
10 **PGA already protect PSE such that no Depreciation Tracker is needed?**

11 A. No. None of these existing mechanisms apply to PSE's investments in its energy
12 delivery infrastructure. In order to continue forward with the work PSE has
13 planned for its transmission and distribution systems, PSE needs to receive
14 adequate and timely cost recovery of these investments. The Company believes it
15 is in the best long-term interests of its customers and the region for PSE to
16 continue forward with such work on a proactive, rather than reactive, basis. PSE
17 asks that the Commission support the Company's efforts through approval of the
18 proposed Depreciation Tracker.

19 One of the primary concerns raised by these parties is that adoption of the
20 Company's proposed depreciation tracker would constitute single issue

1 ratemaking. However, this Commission has in the past recognized tracking
2 mechanisms as acceptable and several states already have infrastructure trackers
3 that include both "recovery on" and "recovery of" new investments in
4 infrastructure. The Company's proposed Depreciation Tracker is a far more
5 limited mechanism that addresses only the "recovery of" and not "recovery on"
6 transmission and distribution system investments made since the end of the most
7 current test year. This capital investment is being made to help maintain system
8 reliability and help meet the customers' demands for safe and reliable energy
9 service, as discussed in Ms. McLain's prefiled direct and rebuttal testimony.

10 **Q. Is approval of the Depreciation Tracker the only way the Commission could**
11 **support the Company's investments in its transmission and distribution**
12 **system?**

13 A. No, there is more than one way to address this issue. The "known and measurable
14 adjustment" proposed by FEA witness Mr. Smith would also help support the
15 Company's infrastructure investments. Consistent with this suggestion, PSE
16 requests as an alternative to its proposed Depreciation Tracker that the
17 Commission adjust the revenue requirements in this case to include such
18 investments made after the end of the test year, as detailed by Ms. McLain and
19 Mr. Story.

1 **D. Decoupling – the Gas Revenue Normalization Adjustment ("GRNA")**

2 **Q. What is the Company's response to the objections of the other parties to**
3 **PSE's proposed gas decoupling mechanism?**

4 A. The Company believes it is unfortunate that some of the other parties are so
5 resistant to a mechanism that has become relatively widely accepted as a way of
6 reducing the disincentives to utilities to invest in gas energy efficiency measures.
7 Although Commission Staff supports establishment of a limited type of gas
8 decoupling mechanism, the Company is surprised and disappointed by Staff's
9 objections to including a weather component to the mechanism. Weather
10 variability is a factor that is widely recognized by utility regulators in allowing
11 gas utilities to make periodic and automatic adjustments to their rates.

12 The GRNA will protect the Company from recovering less than the Commission
13 has approved for PSE's fixed costs and it will protect customers from paying more
14 than is needed to recover such costs. As described in the prefiled direct testimony
15 of Mr. Ron Amen and further detailed in his prefiled rebuttal testimony, Exhibit
16 No. ___(RJA-11T), the Company's GRNA proposal addresses all of the factors
17 that this Commission has indicated are important in a decoupling mechanism.

18 The GRNA will permit PSE to recover the overall amount of revenues from its
19 gas customers that this Commission approves in rate cases even when the amount
20 of gas used by individual customers subsequently declines or when the weather is
21 warmer than normal. The GRNA will thereby remove the disincentive that

1 currently exists for the Company to invest in more gas energy efficiency
2 measures.

3 **Q. Will undesirable impacts be created by the GRNA as proposed?**

4 A. No, as explained by Mr. Amen and Mr. David Hoff, Exhibit No. ____ (DWH-6T),
5 inclusion of weather variability in the GRNA will not cause increased bill
6 volatility or shift risk to customers.

7 **E. Gas Rate Design**

8 **Q. What is the Company's position with respect to gas rate design?**

9 A. The Company initially proposed a charge of \$8.25 per month with adoption of the
10 GRNA and a charge of \$17 if the GRNA is rejected. As described by Mr. Hoff,
11 after consideration of the other parties' testimonies, the Company now believes it
12 would be appropriate to both approve the GRNA and increase the customer
13 charge (and decrease the delivery charge correspondingly) to \$17. A \$17 charge
14 would provide better recovery of the fixed costs that are incurred just to serve gas
15 customers, reduce customer bill volatility, be fair and understandable, and send an
16 appropriate price signal, all without undue bill impact.

1 **F. Electric Energy Efficiency Proposals**

2 **Q. Would you please summarize the positions of the other parties with respect**
3 **to PSE's proposed electric energy efficiency incentive mechanism?**

4 A. The other parties support the concept that an incentive mechanism would
5 encourage PSE to aggressively strive for cost-effective energy savings. However,
6 each of the parties submitting testimony on this issue proposes an alternative
7 incentive mechanism.

8 Mr. Calvin Shirley's prefiled rebuttal testimony, Exhibit No. ___(CES-9T),
9 reviews these various positions and proposes a modified incentive mechanism.

10 The Company's proposed modified mechanism is consistent with the general
11 structure proposed by the other parties but sets a more reasonable baseline target
12 and is a more balanced and symmetrical structure than the various proposals of
13 other parties. Like its original proposal, the Company's modified proposal sets a
14 base target with a "deadband" where no incentive or penalty applies.

15 **Q. Why does the Company support a deadband in the energy efficiency**
16 **incentive mechanism but oppose a deadband in the PCA Mechanism?**

17 A. The fundamental concern driving PSE's position on each issue is that forecasts
18 and estimations are imperfect. Mechanisms that make use of such forecasts or
19 estimations should provide for some margin of error.

1 The financial consequences of the energy efficiency incentive mechanism (receipt
2 of an incentive or payment of a penalty) are triggered when the energy savings
3 base target is exceeded or not met. A deadband is required in this case to provide
4 for a margin of error around the base target forecast.

5 In the case of the PCA Mechanism, there are immediate financial consequences
6 when power costs are higher or lower than the power cost baseline rate. Inclusion
7 in the PCA bands of a deadband prior to any sharing of excess power costs places
8 all the risk on the Company that the power cost baseline rate will be set too low or
9 on the customer that the power cost baseline rate will be set too high. Elimination
10 of such a deadband – and immediate sharing of any excess power costs (or power
11 cost savings) -- is required in this case to provide for a margin of error around the
12 forecasts that go into development of the power cost baseline.

13 **Q. Is the Company also modifying its proposal for new demand side resource**
14 **programs?**

15 A. Yes. Rather than engaging with the Company in fleshing out the details for such
16 pilot programs, the other parties object to their inclusion in this proceeding. PSE
17 is disappointed with this reaction but recognizes it has the ability to recover the
18 costs for such programs through the electric energy efficiency tariff rider,
19 Schedule 120. Therefore PSE has agreed to withdraw its request in this case for
20 approval and funding of new demand response pilot programs. The Company
21 will pursue establishment of these programs through the Conservation Resources

1 Advisory Group ("CRAG") and hopes that the other parties will assist in that
2 effort.

3 **IV. EXPANDED BENEFITS FOR LOW INCOME CUSTOMERS**

4 **Q. Please describe the status of the Company's proposal to increase bill**
5 **assistance benefits for low income customers.**

6 A. As part of the Partial Settlement Agreement Re: Electric Rate Spread, Rate
7 Design and Low Income Energy Assistance that the parties have filed in this case,
8 the parties, including the Company, propose to increase the funding cap in the
9 low income bill assistance electric program from the current \$5.7 million to
10 \$6.925 million. The parties also propose to increase the funding cap in the low
11 income bill assistance natural gas program from the current \$2.8 million to \$3.325
12 million.

13 **Q. When would the increased caps in cost recovery go into effect?**

14 A. The Company will be filing proposed changes to the caps in Schedules 129 to
15 implement this aspect of the Partial Settlement Agreement no later than
16 September 1, 2006, with a requested effective date of October 1, 2006. Cost
17 recovery to provide funds for the increased caps would start coincident with the
18 effective date of the tariffs, October 1, 2006, so that the increased funds are
19 available for the upcoming heating season.

1
2
3
4
5
6
7
8
9
10
11
12
13

V. CONCLUSION

Q. Please summarize the Company's rebuttal case.

A. The Company's proposals in this case are designed to address critical barriers the Company is facing to providing safe, reliable service to its customers over the long term. They are fair, balanced, and reasonable, notwithstanding the many objections raised by the other parties to this case. PSE has carefully considered the positions set forth by other parties and accepted them whenever possible. But we simply do not agree that their remaining objections are correct or would serve the best interests of PSE's customers. The Company requests that the Commission support PSE's efforts on behalf of its customers and approve the relief PSE has requested in this case, as modified in this rebuttal filing.

Q. Does that conclude your prefiled rebuttal testimony?

A. Yes.