Exhibit No. RCM-1T
Dockets UE-090704 and UG-090705
Witness: Roland C. Martin

**BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondent.	DOCKET UE-090704 DOCKET UG-090705

TESTIMONY OF

ROLAND C. MARTIN

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Revenue Requirement Adjustments, Mint Farm Deferral

November 17, 2009

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EXHIBIT LIST

I. INTRODUCTION

Q. Please state your name and business address.

A. I am Roland C. Martin. My business address is The Richard Hemstad Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, Washington 98504. My e-mail address is rmartin@utc.wa.gov.

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission ("Commission") as a Regulatory Analyst.

Q. How long have you been employed by the Commission?

A. I have been employed by the Commission since 1982.

Q. Would you please state your educational and professional background?

A. I graduated from the University of the Philippines in 1975, receiving a Bachelor of Arts in Business Administration with a major in marketing management. I also received a degree of Bachelor of Science in Commerce, with a major in accounting, from University of Pangasinan in 1980. On an ongoing basis, I attend classes on regulation and ratemaking.

During my employment at the Commission, I have performed accounting and financial analyses of regulated utility and transportation companies either as lead or as member of a Staff team. I have testified in numerous general rate cases, including the most recent proceeding of Puget Sound Energy, Inc. ("PSE" or "the Company") in Dockets UE-072300 and UG-072301. Among other matters, my testimony in that case addressed the form of PSE's Power Cost Only Rate Case ("PCORC") mechanism.

I have presented Staff recommendations on accounting and revenue requirement issues during open meetings. I have reviewed numerous other regulatory filings, including mergers and acquisitions, petitions for declaratory orders and waivers of rules, accounting petitions, transfers of property, periodic cost adjustments, tariff rider and tracker mechanisms, PCORCs, and periodic compliance reports. I have also served as the Commission's accounting advisor.

II. SCOPE AND SUMMARY OF TESTIMONY

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

A. My testimony presents Staff's review of ten restating and pro forma adjustments proposed by the Company for its electric and gas results of operations for ratemaking purposes. I also address the Company's proposed deferred accounting treatment for the fixed and net variable costs associated with the acquisition of the Mint Farm Energy Center ("Mint Farm").

In my testimony, I refer to provisions of various statutes and rules. In doing so, I provide my understanding of these laws and rules in my capacity as a Regulatory Analyst.

Q. Which adjustments that you reviewed are uncontested by Staff?

A. The following four adjustments proposed by PSE are uncontested and should be accepted by the Commission:

- Adjustments 10.29 and 9.22, Merger Savings;
- Adjustment 10.30, Storm Damage; and
- Adjustment 10.31, Regulatory Assets and Liabilities re: White River;

While Staff agrees with these adjustments, Staff reserves the right to contest any of them if warranted by changed facts or other circumstances. This applies particularly to Adjustment 10.31, as I discuss below.

Q. Which adjustments that you reviewed are contested by Staff?

A. The following seven adjustments proposed by PSE are contested and should be replaced with the Staff recommended adjustment, as described later in my testimony:

- Adjustments 10.19 and 9.13, Interest on Customer Deposits;
- Adjustment 10.31, Regulatory Assets and Liabilities re Westcoast Pipeline Capacity –UE-082013;
- Adjustment 10.34, Amortization of Mint Farm Deferred Costs;
- Adjustments 10.36 and 9.03, Interest Due IRS; and
- Adjustment 10.37, Production Adjustment;

Q. Do you present any adjustment for which there is no Company counterpart?

A. Yes. Staff's proposed Adjustment 10.38, Amortization of Wild Horse Deferred Costs, has no Company counterpart and should be accepted for reasons I discuss later in this testimony.

Q. Please summarize Staff's recommendation regarding the deferral of Mint Farm costs.

A. Staff recommends that the Company's proposed deferral methodology should be approved by the Commission, except for the following elements of the proposal:

1. The Company's request to modify the Power Cost Adjustment ("PCA") mechanism by suspending Exhibit G of the PCA as to Mint Farm costs should be rejected.
2. The Company's proposal to apply a 7 percent net of tax interest rate to the deferred amounts should be rejected. Instead, no interest rate should be applied.
3. The Company's proposal to amortize Mint Farm deferred costs over three years should be rejected. Instead, a 15-year amortization period should be used.

Q. Have you prepared any exhibits in support of your testimony?

A. Yes, I have prepared the following exhibits in support of my testimony:

- Exhibit No. RCM-2, Interest on Customer Deposits- Rate Base Impacts

- Exhibit No. RCM-3, Analysis of Net Benefit Related to SSCM Deductions and Repayments

III. DISCUSSION

A. Uncontested Ratemaking Adjustments

Q. Please briefly describe the adjustments that you determined to be uncontested.

A. Adjustments 10.29 and 9.22, Merger Savings, remove from the test year electric and gas results of operations certain expenses that will no longer be incurred during the rate year due to the merger with Puget Holdings LLC. These savings are allocated between the electric and gas operations, as detailed by PSE witness Stranik in Exhibit No. MJS-1T at page 27.

Adjustment 10.30, Storm Damage, reflects in the electric results of operations the appropriate storm damage expenses in accordance with prior rate case determinations. Company witness Story details this adjustment in Exhibit No. JHS-1T at pages 48 and 49.

Q. You listed as uncontested Adjustment 10.31, Regulatory Assets & Liabilities involving the White River Project regulatory assets. Is this a new deferred item that PSE added since the last general rate case?

A. Yes.

Q. What is the nature of this adjustment?

A. The adjustment includes in the electric results of operations the estimated proceeds from the sale of certain rights and properties related to the discontinued White River Hydroelectric project. As discussed by Company witness Wetherbee in Exhibit No. PKW-1T at page 8, pursuant to an asset purchase agreement between PSE and Cascade Water Alliance, PSE sold certain White River assets for $25 million to be paid at closing, plus an additional $5 million if certain conditions are satisfied. PSE included only the $25 million as a credit against the White River regulatory assets in Adjustment 10.31. Therefore, the adjustment should be revised for the additional $5 million amount, if the stated conditions are met when the sale is consummated.

Q. Did PSE receive Commission authorization to sell the White River assets to Cascade Water Alliance?

A. Yes. On March 13, 2009, PSE requested authority to transfer certain assets to Cascade Water Alliance (Docket UE-090399). The Commission authorized the sale on May 14, 2009, about a week following PSE's general rate case ("GRC") filing in the instant docket.

Q. Are there other White River Project assets not included in the transaction with Cascade Water Alliance?

A. Yes. There are remaining assets, or Surplus Property, that PSE expects to sell to various interested parties in the near future. If these transactions are consummated, the Company should petition the Commission for the necessary prior authorization, considering that PSE's request in Docket UE-090399 for waiver of that requirement was denied by the Commission by order issued May 14, 2009.

Again, Adjustment 10.31 should be further revised if PSE receives additional proceeds from the sale of any or all of the remaining Surplus Property.

B. Contested Ratemaking Adjustments

1. Adjustments 10.19 and 9.13, Customer Deposits

Q. Please discuss contested Adjustments 10.19 & 9.13, Customer Deposits.

A. This adjustment treats customer deposit interest expense incurred by the Company as an above-the-line operating expense for ratemaking purposes, consistent with prior treatments by this Commission. This treatment provides the Company recovery of the cost directly associated with customer deposits and gives the benefit to the general body of affected customers because the customer deposit balances reduce rate base for each of the electric and gas operations. The purpose of the rate base reduction is to recognize that a portion of rate base is funded by customer deposits, which cost less than the Company's overall cost of capital.

The current annual interest rate for customer deposits is .42 percent, which was used in calculating the adjustment. This compares with the test year 2008 annual interest rate of 2.87 percent.

Q. Does Staff contest the entirety of Adjustments 10.19 and 9.13, as proposed by PSE?

A. No. Staff does not contest the interest expense adjustment, but disagrees with PSE's disparate application of the average balances of customer deposits to reduce rate base for the gas versus electric operations.

Q. Please explain Staff's position in more detail.

A. For its electric operations, PSE treats the customer deposit balance as a direct offset to rate base.

In contrast, the gas treatment proposed by PSE uses the customer deposit balance to offset the total investor supplied working capital allowance that is allocated to gas, electric, and non-operating categories. This treatment unfairly denies gas ratepayers, who pay all the gas interest expense, the full benefit of a direct rate base reduction, and unreasonably provides electric and unregulated operations a portion of the benefits from the gas customer deposits.

Staff's proposed adjustments correct this unfairness by treating the gas customer deposit balance as direct gas rate base reduction in identical fashion with the electric treatment. The impacts of Staff's adjustments are a net reduction in gas rate base of $5,344,758 and a net increase in electric rate base of $4,846,474.

Q. Have you prepared an exhibit showing Staff's calculation of the customer deposit adjustments to rate base for the electric and gas operations?

A. Yes. Exhibit No. RCM-2 calculates the rate base impacts of Staff's proposed customer deposit Adjustments 10.19 and 9.13. Staff's adjustments are also reflected on Exhibit No. KHB-2, page 2.26 for PSE's electric operations and Exhibit No. KHB-3, page 3.18 for PSE's gas operations.

2. Adjustment 10.31, Regulatory Assets & Liabilities Adjustment (Westcoast Pipeline)

Q. Please explain contested Adjustment 10.31, Regulatory Assets & Liabilities Adjustment (Westcoast Pipeline).

A. This adjustment relates to a regulatory credit of $3.5 million received by the Company from FB Energy Canada Corporation (FB Energy) for PSE's assumption of contracted transportation capacity on West Coast Pipeline. The purpose of the Company's adjustment is to recognize the rate year average balance of the credit as a rate base reduction and the associated amortization. PSE began amortizing the credit on November 1, 2009, the effective date of the assumption of the pipeline capacity. PSE will continue the amortization over the remaining 9-year term of the contract.

PSE received the payment on October 24, 2008, the day after all transactions necessary to complete the capacity release were completed. Staff does not contest the amortization of the credit beginning November 1, 2009. However, Staff does contest using November 1, 2009 as the date for including the credit as an offset to regulatory assets. It is more appropriate to recognize the credit to regulatory assets on the day of receipt of the payment (October 24, 2008).

Q. Please explain Staff's position in more detail.

A. The intended use of the payment is to offset the cost of the capacity charge, which is a fuel expense classified as a variable cost under the PCA subject to tracking and true up. It is appropriate to treat the balance as a credit offset against power cost-related regulatory assets on the October 24, 2008 date of payment receipt notwithstanding start of the amortization about a year later. Since the payment is a discount from a cost ultimately born by ratepayers, it is fair and reasonable for ratepayers to benefit from the cost-free fund.

Staff's proposal is consistent with the treatment approved by the Commission for deferred payments to PSE by CanWest Gas Supply, Inc. for a gas supply cessation settlement.[1]

Staff's proposal also has no impact on the average balance and amortization level of the credit during the rate year. The earlier regulatory credit recognition allows for a net of tax rate of return to be applied to the balance of the regulatory credit for approximately two months in PCA period 2008 and a full twelve months in PCA period 2009. This compares to PSE's rate base treatment of only two months in 2009.

Staff's Adjustment 10.31, Regulatory Assets & Liabilities Adjustment (Westcoast Pipeline), appears on Exhibit No, KHB-2, page 2.38.

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[1] *In the Matter of the Petition of Puget Sound Energy, Inc., For an Accounting Order Authorizing Deferral of Payments by CanWest Gas Supply Inc. for Gas Supply Cessation Settlement*, Docket No.UE-041846, Order No. 01 (November 24, 2004).

3. Adjustment 10.34, Amortization of Mint Farm Deferred Cost

Q. Please explain contested Adjustment 10.34, Amortization of Mint Farm Deferred Cost.

A. This pro forma adjustment, as proposed by PSE, amortizes over three years the deferred costs associated with the Mint Farm Energy Center and includes the unamortized balance in rate base.

The Company's adjustment should be rejected. For reasons that will be discussed in the Mint Farm Accounting Proposal section of my testimony, Staff recommends that the Commission disallow carrying cost on the net deferred amounts, reject the requested three-year amortization, and deny the requested suspension of PCA mechanism Exhibit G for the Mint Farm deferral. Staff's Adjustment 10.34 incorporates these recommendations. The effect of Staff's adjustment reduces electric net operating income by $2,962,522 and increases electric rate base by $35,562,261, as shown on Exhibit No. KHB-2, page 2.41.

4. Adjustments 10.36 and 9.03, Interest Due IRS

Q. Please explain contested Adjustments 10.36 and 9.03, Interest Due IRS.

A. In this adjustment, PSE proposes to recover in rates over two years the net interest paid to the IRS, including carrying costs, in connection with the tax benefits from an accounting method (simplified service cost) subsequently disallowed by the IRS. Under a settlement with the IRS, PSE was required to pay interest on back taxes net of tax refunds. PSE witness Marcelia provides a comprehensive discussion of the adjustment in Exhibit No. MRM-1T, at pages 10 to 14. Staff believes that the interest amount proposed for recovery over a two-year period is not warranted and should be denied by the Commission.

Q. Please explain Staff's position in more detail.

A. Staff takes issue with PSE's proposal to recover from customers any amount of net interest paid to the IRS because ratepayers did not derive net benefit from the disallowed deductions. In a prior general rate case, Docket UG-040640, *et al.*, the Commission allowed $72 million in reductions to the electric and gas rate bases effective March 4, 2005, which caused rates to be lower than what they would otherwise have been without the reductions. However, the IRS subsequently disallowed the deductions that gave rise to the rate base reduction and required PSE to pay back taxes, causing PSE to incur a cost of financing the repayments. The Commission granted PSE's petitions in Dockets UE-051527 and UG-051528 to defer and accumulate these financing costs. Subsequently, in the 2006 general rate case, Docket UE-060266, *et al.*, the Commission authorized recovery of the deferred financing costs. In fact, the deferred financing costs were fully recovered during the test year of the current GRC, as manifested by Miscellaneous Operating Expense Adjustment 10.14- Amortization of Deferred Taxes on Indirect Overheads Regulatory Asset (Docket No. UE-051527),[2] and Miscellaneous Operating Expense Adjustment 9.09-Amortization of Deferred Taxes on Indirect Overheads Regulatory

[2] *See* Exhibit No. JHS-1T at 33 and 34.

Asset (Docket No. UG-051528).[3] These adjustments remove the amortization expenses recorded during the test year, and reflect zero amounts for the rate year.

This payment, including carrying costs, by ratepayers, when combined with the impact of the lag in reflecting the benefit in rates in the 2004 GRC, effectively eliminates the benefit of the $72 million rate base reduction. PSE was made whole regarding the cost of the benefits that were initially provided to ratepayers, but were subsequently taken back. While it is notable that PSE formally protested the IRS regarding the disallowance of the claimed deductions, the appeal failed. The settlement that took place thereafter resulted in less than 100 percent retention of the original tax deductions, necessitating interest payments to the IRS. It is unfair, inequitable, and inappropriate that ratepayers bear the interest burden.

Q. Please explain.

A. It is necessary to clarify the nature and relationships between the benefits that ratepayers received in the 2004 rate case, the repayment of such benefits back to the IRS, the financing costs associated with the repayment, and the interest that is now proposed by PSE for recovery in rates. This clarification reveals that ratepayers do not deserve to pay any of the interest due the IRS. The key facts are as follows:

- The deductions from the simplified service cost method claimed by PSE resulted in a $72 million tax benefit.
- The $72 million tax benefit was deferred or, in other words, not flowed-through.

[3] *See* Exhibit No. MJS-1T at 14 and 15.

- In the 2004 GRC, the $72 million tax benefit recorded during the test year ended September 2003 was used to reduce rate base, but not to reduce tax expense.
- Ratepayer benefit from the $72 million is the reduced return on rate base, which was not reflected in rates until March 4, 2005. This means that prior to that date, only the Company benefited.
- When the IRS disallowed all of the tax deductions associated with the use of simplified service cost method, the IRS required PSE to pay back the $72 million tax benefits. Ratepayers paid PSE the financing costs associated with the repayment of the tax benefit. This effectively took back from ratepayers the benefit of the reduction to rate base of $72 million.
- Therefore, ratepayers should not pay the interest associated with the disallowed benefits because the benefits were not flowed-through to reduce tax expenses and lower rates. Ratepayers, whose benefit was derived from the lower return due to the rate base reduction, already satisfied their responsibility when they gave that benefit back in the form of reimbursement to the Company of its cost of borrowing to repay the deferred tax benefits.

Q. In the Company's 2004 general rate case, did the Commission recognize the potential repayment of tax benefits with interest if the deductions associated with the accounting method used by PSE ultimately were disallowed by the IRS?

A. Yes. The Commission recognized that when such an event happens, the Company should petition for appropriate treatment of the repayment of the tax benefits taken and presumed interest:

> We cannot lawfully prejudge future rates. However, we do find it appropriate to recognize in principle that if the IRS successfully challenges in court the adjustment PSE and other utilities have taken, and requires future repayment of the current benefits taken, presumably with interest, PSE should file an accounting petition asking for appropriate treatment of any back taxes and interest assessed.[4]

As noted earlier, ratepayers have already satisfied their responsibility to reimburse PSE the financing costs for the funds necessary to repay the disallowed benefits and it was the Company that benefited prior to the 2004 GRC effective date. No further payments by ratepayers are necessary or warranted.

Q. Did you perform an analysis that supports your conclusion and recommendation?

A. Yes. Exhibit No. RCM-3 supports Staff's conclusion and recommendation and demonstrates that Staff's adjustment is justified. The exhibit portrays the estimated revenue requirements of the benefits from deferred tax balances the Company

[4] *WUTC v. Puget Sound Energy, Inc.*, Dockets UG-040640, et al., Order No. 06 at ¶159 (Feb. 18, 2005).

received, compared to what the ratepayers received, and shows the net balance accruing to the Company.

Q. How does PSE attempt to justify recovery from customers of the net interest paid to the IRS?

A. The Company merely claims consistency with past Commission instructions. Exhibit No. MRM-1T at page 14. The Company offers no additional justification in this proceeding to support the requested rate recovery. In other words, PSE failed to satisfy its burden to prove that its ratemaking proposal is fair, just, and reasonable.

Q. What are the impacts of Staff's recommendation regarding the interest paid to the IRS?

A. Staff's proposal in Adjustment 10.36 reduces electric rate base by $3,530,928 and electric net operating income by $0. Staff's proposal in Adjustment 9.03 reduces gas rate base by $2,443,571 and gas net operating income by $0. Staff's adjustments are shown on Exhibit No. KHB-2, page 2.43 for PSE's electric operations and Exhibit No. KHB-3, page 3.8 for the Company's gas operations.

5. Adjustment 10.37, Production Adjustment

Q. Please explain contested Adjustment 10.37, Production Adjustment.

A. Normally, this adjustment adjusts power costs, power production-related operation and maintenance expenses, taxes, depreciation and amortization and production rate base by applying to these cost items a factor derived from the relationship between test year normalized delivered load and rate year delivered load. However, for reasons discussed by Staff witness Parvinen, Staff opposes application of a production factor in this proceeding.

Staff's production adjustment, therefore, reflects zero amounts, as depicted in Staff's electric results of operations Exhibit No. KHB-2, page 2.44. Staff witness Parvinen is responsible for the recommendation on this issue.

6. Adjustment 10.38, Amortization of Wild Horse Deferred Cost

Q. Please explain Adjustment 10.38, Amortization of Wild Horse Deferred Cost.

A. This adjustment has no comparable adjustment by PSE. The purpose of the Staff adjustment is to include the estimated rate year amortization expense and net rate base amount related to the deferred costs associated with PSE's Wild Horse Expansion Project ("WH Project"). On October 27, 2009, PSE filed with the Commission pursuant to RCW 80.80.060(6) a notice of intent to defer costs associated with the WH Project. PSE's WH Project is a renewable resource under the statute and eligible for cost deferral. The WH Project began commercial operation on November 9, 2009, the same date PSE began deferral of the costs.

Q. Why does Staff recommend this adjustment in this proceeding?

A. Staff proposes consideration of the WH Project deferred costs in this proceeding to avoid further build-up of a regulatory asset than if the deferral occurs over a twenty-four month period, as permitted by RCW 80.80.060(6). The current GRC provides the earliest opportunity for consideration.

Staff's recommendation includes the same conditions proposed for Adjustment 10.34, Amortization of Mint Farm Deferred Cost. Specifically, WH Project deferred costs should exclude carrying costs; the operation of Schedule G of the PCA should not be suspended; and deferred costs should be amortized over an appropriate period. Furthermore, PSE should apply a credit to any deferred variable costs for over-collection of power costs under the PCA.

Staff calculated its adjustment based on estimates provided in PSE's Response to Staff Data Request 206. To the extent available during this proceeding, actual costs should be used by PSE in its compliance filing should the Commission accept Staff's proposed adjustment.

Q. What is the appropriate amortization period for WH Project deferred costs?

A. Staff calculated its adjustment using a two-year amortization period. This a reasonable amortization period given the lesser estimated deferred amount for the WH Project relative to Mint Farm deferred costs, for which Staff recommends a 15-year amortization.

Q. What are the impacts of Staff's Wild Horse Expansion adjustment?

A. Staff's adjustment decreases electric net operating income by $1,895,270 and increases electric rate base by $2,842,905. The calculation of the adjustment is shown on Exhibit No. KHB-2, page 2.45.

C. Mint Farm Deferred Accounting Proposal

Q. Please briefly describe the Company's proposed deferred accounting methodology for Mint Farm costs.

A. PSE's methodology defers Mint Farm fixed and variable costs (as defined by the PCA), beginning on the December 5, 2008 acquisition date and ending on the effective date of a Commission final order in this GRC. To enable the Company to defer those fixed and variable costs, PSE proposes to not apply to Mint Farm the existing restrictions of Exhibit G of the PCA.

PSE also proposes to offset the deferred variable costs by the benefits of reduced purchases due to Mint Farm production. In addition, PSE proposes to apply against the deferred variable costs up to the deferred balance, any over-collection of power costs from the PCA true-up process during the deferral period.

PSE proposes to accrue interest on the deferred amounts at the authorized net of tax rate of return of 7 percent. Finally, the Company proposes to amortize the deferred costs plus accrued interest over three years or another period to be determined in this rate case. In accordance with these proposals, PSE started deferring power costs associated with Mint Farm and will continue to defer costs until this GRC is concluded and new rates take effect.

Q. Did the Commission authorize the deferral of Mint Farm costs?

A. Yes. On April 17, 2009, the Commission issued Order 03 in Docket UE-082128, authorizing deferred accounting treatment with respect to the fixed and net variable cost components of Mint Farm. The Commission's Order reserved the rights of all interested parties to challenge the prudence and recovery of Mint Farm costs in rates, the deferral methodology used, and other issues for consideration in this general rate case.

Q. Does Staff contest any aspects of PSE's deferral of Mint Farm costs?

A. Yes. Staff opposes PSE's proposal to include carrying costs on the deferred amounts and the proposed three-year amortization period. In addition, Staff opposes suspension of Schedule G of the PCA in determining the variable power costs to be deferred.

1. Mint Farm Carrying Costs

Q. Please explain why Staff excludes Mint Farm carrying costs from the deferred amount proposed for recovery in rates.

A. Staff excludes carrying costs for the following reasons:

1. A portion of the Mint Farm fixed costs is return on net rate base consisting of plant balance, accumulated depreciation, and deferred income tax. In the 2007 GRC, the Commission authorized a rate of return of 8.25 percent or 7.00 percent net of tax.[5] When carrying costs are added to the authorized return for the same period of time, the total return exceeds the authorized level. This directly contradicts the Commission's prior determination of the fair rate of return in the last GRC and is tantamount to double recovery.

2. In addition to the return on net rate base, PSE proposes to defer certain expenses consisting of fixed operation and maintenance expenses, depreciation, property insurance, and taxes. Similar to the return on rate base, PSE accrues carrying costs on the deferred balance of these expenses under the theory that recovery of the deferred costs will be in the future and the interest will make the Company whole.[6] PSE's reasoning presumes that recovery of the cost of service is instantaneous and that any delay should be compensated by accruing interest. In other words, PSE seeks to eliminate all effects of regulatory lag.

The Company's presumption has no support. The authorizing statute pertinent to Mint Farm cost deferral does not eliminate or ignore the essence of regulation to provide only the opportunity, rather than guarantee, of cost recovery and risk insulation. On the contrary, RCW 80.80.060(6) provides that creation of a deferral account does not by itself determine actual costs, whether recovery of any or

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[5] *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-072300 and UG-072301, Order 12 at ¶¶51 and 101 (October 8, 2008).
[6] Exhibit No. JHS-1T at 73.

all costs is appropriate, or other issues decided by the Commission in a general rate case.

3. Finally, including carrying costs in the deferred amount is unnecessary because the primary costs directly related to Mint Farm, including cost of invested capital and operating expenses, are already deferred during expressly limited period not to exceed twenty-four months or the effective date of the Commission decision in an appropriate proceeding. *Ibid.*

2. Amortization Period

Q. Please explain why Staff opposes the three-year amortization period proposed by the Company.

A. PSE proposes that deferred Mint Farm costs should be amortized over three years, which is the same amortization period for Goldendale deferred costs, or over another appropriate period to be determined in this rate proceeding. The magnitude of deferred Mint Farm costs is more significant than Goldendale (approximately five times greater), so it is reasonable to amortize the balance over 15 years in order to mitigate the impact on rates.

3. Suspension of PCA Exhibit G

Q. Staff opposes suspending Exhibit G of the PCA in determining variable power costs to be deferred. How does Exhibit G of the PCA potentially affect Mint Farm's level of costs subject to deferral and recovery?

A. Section 7 of the settlement terms for the PCA addresses the acquisition of new resources by the Company:

> **<u>New Resources:</u>** New resources with a term of less than or equal to two years will be included in the allowable PCA costs. The prudence of these resources will be determined in the Commission's review of the annual PCA report.[7]

Thus, the Company can include costs for true-up purposes only if those costs are associated with resources with a term of two years or less. Since Mint Farm is a long-term resource, this part of the PCA does not apply.

Instead, Section 7 of the PCA settlement terms also provides that Mint Farm resource costs may be included in the PCA allowable cost:

> . . . at the lesser of the actual cost or the average embedded cost in the PCA (including transmission into PSE's Puget Sound system) as a bridge mechanism, until the then future costs of these new resources can be reviewed in a Power Cost Only Rate review.[8]

Exhibit G of the PCA compares the actual variable costs of the new resource with the baseline Power Cost Rate and determines whether a new resource pricing adjustment is warranted. Thus, if Mint Farm's actual variable cost exceeds the approved baseline Power Cost Rate, the cost difference lowers the allowable cost in the periodic determination of imbalance for sharing between the Company and ratepayers. A negative balance of the ratepayer share reduces rates when the cumulative customer share of the credit reaches $30 million or more. If the balance is positive, PSE can increase rates when the balance of the deferral account is approximately $30 million.

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[7] *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-011570 and UG-011571, Twelfth Supplemental Order, Appendix, Exhibit A to Settlement Stipulation at 5, Section 7 (June 20, 2002).
[8] *Id.*

Q. Why does PSE propose that the restriction in Exhibit G on the level of recoverability of new resource costs not apply to Mint Farm?

A. The Company wants to recover all variable costs associated with Mint Farm that are deferred and not just the costs after application of Exhibit G.[9]

Q. Does RCW 80.80 or Commission rules in WAC 480-100, Part VII related to deferred cost treatment restrict the operation of a cost recovery mechanism such as the PCA?

A. No. Exhibit G is a vital structural component of a complex PCA mechanism with a specific function. As stated before, a bridge mechanism addresses the treatment of costs associated with a long-term resource during the period between the acquisition and the inclusion of the costs in rates. Suspending Exhibit G disturbs the operation of the mechanism. For this reason, Staff recommends that Exhibit G not be suspended and, if triggered, the effect should be applied against the variable power costs that are not deferred and should be used in determining the power cost imbalance subject to sharing. That way, PSE's concern that it will be unable to defer all variable costs associated with Mint Farm is addressed.

Q. Based on available information, is Exhibit G going to be triggered during the Mint Farm deferral period?

A. No. However, it is necessary for the Commission to now decide to reject PSE's proposal because of the reasons stated above.

[9] Exhibit No. JHS-1T at 69.

Q. Does Staff agree with the Company's proposal to calculate and apply a credit to any deferred Mint Farm variable costs when there is an over-collection of power costs under the PCA in addition to the credit associated with market power?

A. Yes. Applying a credit to any deferred variable costs keeps the costs of the deferral down, as stated in the Company's Response to Staff Data Request No. 166.

Q. Does this conclude your testimony?

A. Yes, it does.