

**EXHIBIT NO. \_\_\_(KJH-9CT)  
DOCKET NO. UE-072300/UG-072301  
2007 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-072300  
Docket No. UG-072301**

**PREFILED REBUTTAL TESTIMONY (CONFIDENTIAL) OF  
KIMBERLY J. HARRIS  
ON BEHALF OF PUGET SOUND ENERGY, INC.**

**REDACTED**

**JULY 3, 2008**

**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY (CONFIDENTIAL) OF  
KIMBERLY J. HARRIS**

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1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED REBUTTAL TESTIMONY (CONFIDENTIAL) OF**  
3 **KIMBERLY J. HARRIS**

4 **I. INTRODUCTION**

5 **Q. Are you the same Kimberly J. Harris who provided prefiled direct testimony**  
6 **in this proceeding on December 3, 2007 on behalf of Puget Sound Energy,**  
7 **Inc. (“PSE” or “the Company”)?**

8 A. Yes. On December 3, 2007, I filed direct testimony, Exhibit No. \_\_\_(KJH-  
9 1HCT), and seven exhibits supporting such direct testimony, Exhibit  
10 No. \_\_\_(KJH-2) through Exhibit No. \_\_\_(KJH-8C).

11 **Q. Please summarize the purpose of your prefiled rebuttal testimony.**

12 A. In my testimony, I rebut Public Counsel’s and ICNU’s criticisms of the Power  
13 Cost Only Rate Case (“PCORC”) process and the Power Cost Adjustment  
14 Mechanism (“PCA”) and their proposal that the PCORC should be discontinued.  
15 I am pleased to see that Commission Staff, by contrast, recommends continuing  
16 the PCORC and PCA processes. I express the Company’s support for and accept  
17 the Commission Staff’s recommendations that PSE (i) modify certain elements of  
18 the PCORC process (with one clarification), and (ii) undertake a study of the PCA  
19 prior to the next general rate case.

20 My rebuttal testimony also notes that no party has challenged the prudence of the

1 Company's acquisition of new resources that are presented in this proceeding for  
2 recovery in rates. Commission Staff has affirmatively concluded that these  
3 acquisitions meet the Commission's prudence standard. I therefore renew PSE's  
4 request that the Commission determine that the acquisition of these resources was  
5 prudent. I also request that the Commission add to the list of prudently-acquired  
6 resources one contract that the Company presented and described with Mr. Mills'  
7 prefiled direct testimony, but which was inadvertently left off the list of resources  
8 set out in my prefiled direct testimony for prudence determination.

9 Finally, I rebut Public Counsel's recommended costs disallowances for several  
10 items under my area of supervision. No costs should be disallowed for Whitehorn  
11 Units 2 or 3 or the Goldendale Generating Station. Nor should the costs of my  
12 salary for time allocated to federal regulatory matters nor my staff's salaries that  
13 work on these issues be disallowed, as federal regulatory efforts are undertaken  
14 on behalf of the Company's customers.

15 **II. THE PCA AND PCORC SHOULD REMAIN IN PLACE,**  
16 **WITH SOME MODIFICATIONS TO THE PCORC**

17 **A. Introduction**

18 **Q. What is your reaction to the position of Public Counsel and ICNU that the**  
19 **PCORC should be eliminated?**

20 A. Their positions did not surprise me—only because these parties have already  
21 expressed this sentiment in the context of the PCORC collaborative that was

1 described in my prefiled direct testimony. Still, I find it disturbing that these  
2 parties are now seriously advocating that the Commission end the PCORC  
3 process. The PCORC has been, and remains, critical to the Company's efforts to  
4 acquire the resources needed to provide electric customers with reliable service  
5 over the long term. The PCORC also continues to be an important mechanism  
6 through which our electric customers' rates stay in synch with the costs of  
7 generating or purchasing the power that they consume.

8 **Q. What is your opinion of other parties' criticisms of the PCA?**

9 A. This is also disturbing because the PCA is such an important mechanism in that it  
10 addresses the variability of power costs that are, to a great extent, beyond the  
11 Company's ability to control. The fact that this region has been very fortunate  
12 over the past several years to avoid a repeat of the extreme drought conditions and  
13 price volatility seen during the Western Power Crisis of 2000-2001 does not, by  
14 any means, make the PCA obsolete.

15 **Q. What is your reaction to the testimony on the PCA and PCORC by**  
16 **Commission Staff?**

17 A. It is encouraging that Commission Staff recognizes the continued importance of  
18 the PCORC and the PCA to the Company and its customers. Commission Staff  
19 make a number of suggestions related to the PCORC and PCA. The Company is  
20 prepared to accept most of these recommendations, as described below.

1 **B. The PCORC is Critical to PSE’s Resource Acquisition Efforts**

2 **Q. Why is the PCORC critical to the Company’s resource acquisition efforts?**

3 A. As discussed at pages 10 through 13 of my direct testimony, Exhibit  
4 No. \_\_\_(KJH-1HCT), PSE’s 2005 Least Cost Plan (“LCP”) and the 2007  
5 Integrated Resource Plan (“IRP”) document the Company’s need to acquire a  
6 significant amount of additional power resources in the next ten years. The 2007  
7 IRP concluded that the Company has a present need to acquire resources of 480  
8 average megawatts (“aMW”) by winter 2010, growing to 1,650 aMW by 2015  
9 and to 2,125 aMW by 2020. The Company plans to meet its power resource  
10 needs through a combination of energy efficiency and commercially available  
11 resources such as natural gas and renewable energy, most notably wind power.  
12 See Exhibit No. \_\_\_(KJH-5) for the 2007 IRP.

13 **Q. What are some of the challenges PSE faces in fulfilling the resource needs?**

14 A. As described in my direct testimony, Exhibit No. \_\_\_(KJH-1HCT) at pages 13-  
15 19, the Company faces a multitude of challenges in acquiring such resources,  
16 including:

- 17 (i) a new renewable energy portfolio standard, also known as  
18 the Energy Independence Act, which requires the Company  
19 to meet 15% of customers’ needs by 2020 with renewable  
20 energy resources, as defined in RCW Chapter 19.285;
- 21 (ii) increasing cost pressures as a result of high demand for  
22 renewable and gas resources, price increases in the  
23 commodities markets, and a marked decline in the Dollar  
24 exchange rate with the Euro and other currencies; and

1 (iii) increasing financial pressures, as the Company must invest  
2 approximately \$1.9 billion to acquire the necessary energy  
3 resources to meet our customers' needs. This significant  
4 amount of financial investment will strain the Company's  
5 ability to make such investments.

6 **Q. Would you please explain more about these financial pressures?**

7 A. In order for the Company to acquire the resources needed to serve customers, it  
8 will be very important for the Company to maintain a strong balance sheet, strong  
9 earnings and cash flow and highly rated debt to attract financial investors.

10 Financial investors are needed to help finance the Company's resource  
11 acquisitions—even if the pending merger is approved—as efficient financing of  
12 such acquisitions includes a reasonable percentage of debt financing.

13 Cash flow is also a significant concern. As I mentioned on pages 18-19 of my  
14 direct testimony, Exhibit No. \_\_\_(KJH-1HCT), PSE must have the ability to pay  
15 cash to asset sellers, contractors or vendors engaged in the sale or construction of  
16 a facility. Any enterprise with which the Company partners or from which the  
17 Company purchases a resource will be concerned about the Company's ability to  
18 make such payments in a timely manner.

19 **Q. How is the PCORC process related to the challenges you have described?**

20 A. The PCORC process is critical to ensuring that the Company can manage these  
21 challenges from a financial perspective. In order to minimize cash flow  
22 constraints, it is important that new resource acquisitions be included in rates at  
23 the same time (or very shortly after) the new resources are placed into service.

1 The PCORC is the mechanism PSE relies on to reduce the delay between the time  
2 the Company invests in a project and the time the Company begins to recover that  
3 investment through rates.

4 The availability of the PCORC process, and the resulting timely inclusion and  
5 recovery of new resource investments, also provides current and future investors  
6 with the confidence that PSE will be able to pay back borrowed capital in a timely  
7 manner. This is especially important in conditions such as the current tight  
8 financial markets. If the capital markets view the Company as a risky investment  
9 because the Company may have trouble raising cash or recovering its investments  
10 in a consistent and timely manner, investors will demand more return for their  
11 investment (*i.e.* in the form of higher interest rates on debt). This will only make  
12 investments more costly for our customers.

13 **Q. ICNU’s witness, Mr. Schoenbeck, states on page 8 of his testimony that “it is**  
14 **impossible for PSE to argue that a PCORC filing is the only way to receive**  
15 **timely recovery of the costs of new resources” Do you agree?**

16 A. No. This statement is misleading and misses the point. Theoretically, a resource  
17 might be acquired at exactly the right time so that it may be included in rates at  
18 the end of a general rate case. In such a situation, a PCORC filing would not be  
19 “the only way” to receive timely recovery of the costs of this resource. Only in  
20 that sense is ICNU correct. In the real world, however, the Company cannot time  
21 the acquisition of new resources such that they exactly align with the filing of  
22 general rate cases every couple of years. Instead, the Company is constantly

1 reviewing potential new resources, engaging in negotiations for their purchase,  
2 and acquiring favorable resources as quickly as it can. In these circumstances, it  
3 is very important to have the ability to file a PCORC between general rate cases  
4 to avoid a significant delay in the recovery of resources that are acquired during,  
5 or just after, a general rate case.

6 **Q. Won't an accounting petition requesting deferral of a new resource cost until**  
7 **it could be recovered in a general rate case address your timing concerns?**

8 A. When approved, deferred accounting treatment can be very helpful, as it was in  
9 the case of the Goldendale Generating Station. Because Goldendale was already  
10 constructed and in operation, there was no lead time for PSE to file and complete  
11 a general rate case or even a PCORC between the time it committed to acquire the  
12 plant and the time the plant was placed in service in PSE's electric portfolio. But  
13 there is no assurance that accounting petitions will be granted and, even if one is  
14 granted, there is no assurance that the deferred costs, together with the current  
15 yearly costs, ultimately will be recovered. The Commission has consistently  
16 ruled the prudence of the recovery must be determined in a general rate case or a  
17 filing such as a PCORC. The uncertainty regarding whether an accounting  
18 petition will be granted and the delay of several months or more before an  
19 acquisition is determined to have been prudent are risks to PSE's recovery of  
20 invested funds and are thus unsettling to financial markets.

21 In addition, deferral of costs for later recovery does not address the cash flow  
22 concerns I described earlier in my testimony. Contrary to what ICNU suggests,

1 deferred accounting treatment does not speed up the time PSE begins recovering  
2 investments in rates. The recovery of costs deferred through an approved  
3 accounting petition only begins at the completion of the next PCORC or general  
4 rate case. In the meantime, the Company has had to allocate or borrow cash to  
5 fund the resource acquisition. Until revenues are collected to repay the  
6 investment, the Company has to turn to other sources of cash for its operations or  
7 for acquiring additional resources. The Company does not have, and cannot  
8 reasonably acquire, large enough credit facilities to fund its operations and  
9 acquire resource after resource at the level and pace needed to meet current and  
10 future resource needs absent timely recovery.

11 **Q. Why is recovery after the completion of a general rate case not fast enough?**

12 A. A general rate case process takes at least twice as long as a PCORC to prepare  
13 and litigate to conclusion. As Commission Staff point out, the PCORCs the  
14 Company has filed have resulted in a time savings of about six months to bring  
15 new resources into rates. “This savings in months helps the Company match  
16 more closely the in-service date of new resources with retail rates.” Exhibit  
17 No. \_\_\_T(MPP-1T) at page 5.

18 If the PCORC were eliminated, PSE would experience longer, more difficult cash  
19 flow constraints because it can take up to a year and a half to two years before an  
20 investment that has been acquired and put into service for customers can be  
21 included in rates through a general rate case. The Company simply cannot tie up  
22 the credit facilities, which were sized to meet its short-term working capital

1 needs, to fund long-term resource acquisitions at the levels that are needed in the  
2 coming years.

3 **Q. Public Counsel’s witness Lee Smith responds to the Company’s cash flow**  
4 **concerns by stating at page 27 of her testimony, “A new owned generating**  
5 **unit will result in increased depreciation and capital costs and will often**  
6 **produce increased revenues from increased retail or wholesale electricity**  
7 **sales.” Do you agree?**

8 A. No. When PSE acquires a generation facility, the Company incurs large up-front  
9 financial outlays, often 100% of the acquisition price, to purchase the resource  
10 from the developer. Also, there are additional cash outlays for fixed operation  
11 and maintenance costs. The marginal cost of new plant investments is much  
12 higher than the average historic plant costs included in rates and the amount  
13 needed to recover the total costs are higher than the market power purchases it is  
14 replacing. Mr. John Story addresses this issue in more detail in his prefiled  
15 rebuttal testimony, Exhibit No. \_\_\_(JHS-14T).

16 **C. The Regular Updating of Other Power Costs Is Another Important**  
17 **Function of the PCORC**

18 **Q. Mr. Schoenbeck claims that the main objective of the PCORC is to provide a**  
19 **timely inclusion of the costs of new resource in rates as opposed to updating**  
20 **other power costs. Do you agree?**

21 A. To the extent Mr. Schoenbeck’s comment is limited to setting forth one of the

1 main objectives of the PCORC, I agree with him. But to the extent he implies  
2 that the updating of other power costs is somehow not an important function of  
3 the PCORC or was not intended by the parties or Commission when the PCORC  
4 was created, I strongly disagree.

5 **Q. Why do you disagree?**

6 A. First, the text of the PCA itself provides that the update of the PCA baseline rate  
7 that occurs through the PCORC process is *not* limited to the costs of new  
8 resources. It expressly states,

9 In addition to the yearly adjustment for power cost variances, there  
10 would be a periodic proceeding specific to power costs that would  
11 true up the Power Cost Rate to *all power costs* identified in the  
12 Power Cost Rate. The Company can also initiate a power cost  
13 only proceeding to add new resources to the Power Cost Rate.<sup>1</sup>

14 In addition, as one of the Company's representatives involved in the cooperative  
15 development of the PCA and PCORC with other parties to PSE's 2001 general  
16 rate case, it is simply not correct to claim that the parties were concerned only  
17 about the costs of new resources and not other power costs.

18 **Q. Would you please explain?**

19 A. It might help to recall that during the Company's 2001 general rate case, when the  
20 PCA and PCORC were created, the western United States had just experienced

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<sup>1</sup> *Wash. Utils. & Transp. Comm'n. v. Puget Sound Energy, Inc.* Docket No. UE-011570, *et. al.* Final Order, (June 20, 2002) ("Settlement Stipulation"), ¶ 8 (emphasis in original).

1 the devastating financial consequences of a failed experiment in deregulation and  
2 market economics. Mr. Gaines describes the impact of this on the Company's  
3 equity capitalization ratio in his prefiled rebuttal testimony, Exhibit No.

4 \_\_\_\_ (DEG-8CT). Electric utilities in California had been forced to sell their  
5 generation assets and replace them with wholesale market power acquired via  
6 short-term day-ahead and real-time ("spot market") auction systems.

7 During the late 1990s, it had been an open question whether such steps would  
8 also be mandated by the Washington State legislature, or even by the federal  
9 government. The so-called Western Power Crisis seemed to confirm the wisdom  
10 of Washington State in not following California's lead in tossing out the model of  
11 vertically-integrated utilities who produce their own power or obtain it under  
12 long-term Purchased Power Agreements ("PPA") and sell it to their customers at  
13 rates that are set by a utilities' commission.

14 It was clear to the parties involved in the 2001 general rate case, as well as the  
15 Commission, that rather than facing forced divestment of its generation assets, the  
16 Company would, for the foreseeable future, need to continue to generate power  
17 for its customers and enter into long-term (*i.e.*, 20-year) PPAs. The Western  
18 Power Crisis had taught everyone a harsh lesson in the risks of relying too much  
19 on purchasing power in short-term wholesale markets to serve load. Because  
20 many of the Company's generation and long-term PPA resources were expiring  
21 during the coming decade and because demand for power in the Company's

1 service territory was continuing to grow, the parties and Commission also knew  
2 that the Company was facing an extended period in which it would need to  
3 acquire a large number of new resources.

4 **Q. How does this relate to the PCORC?**

5 A. It was in the interest of all of the parties, the customers they represent, and the  
6 Commission to develop and approve some regulatory means by which the  
7 Company could better deal with the financial pressures associated with bringing  
8 new resources into PSE's power portfolio. As I described earlier in this  
9 testimony, the PCORC serves as a bridge between general rate cases and  
10 minimizes the cash flow constraints the Company experiences during acquisitions  
11 and long-term changes to its power costs.

12 My earlier testimony focused on new resource acquisitions and not on the  
13 PCORC's function as a bridge between general rate cases with respect to changes  
14 to other power costs. This is also an important element of the PCORC. By 2001,  
15 the utility industry had experienced natural gas prices that were extremely high by  
16 historic standards (although still relatively low compared to current prices). The  
17 promise that deregulation and short-term wholesale power markets would  
18 inevitably result in lower power costs had proved to be elusive.

19 It seemed at the time, and has since proven true, that power costs would generally  
20 continue to trend higher and would be an additional financial pressure that the  
21 Company would have to deal with. Thus, a stated purpose of the PCORC was to

1 adjust rates for long-term trends in production related costs and fixed and variable  
2 power costs, in addition to allowing for the timely inclusion of resource  
3 acquisitions in rates. *See* Settlement Stipulation, ¶ 8.

4 **Q. Does your description of the context in which the PCORC was developed also**  
5 **relate to the PCA?**

6 A. Yes. The lessons of the Western Power Crisis were not limited to the importance  
7 of acquiring new generation or long-term purchased power resources. They  
8 included the realization that the increasing importance of the short-term wholesale  
9 power market in the industry added significant new levels of variability and risk.  
10 The industry saw extreme price increases in the spot and day-ahead markets, and  
11 financially devastated utilities were forced to purchase power in the market to  
12 meet load at the time these high prices were in effect. Such utilities, having  
13 purchased the power to meet customer load, then had no choice but to recover  
14 such costs from their customers. Regulatory bodies that oversaw the rates of  
15 these utilities also had little choice but to approve the requested pass-through of  
16 these very high prices.

17 In addition, the Western Power Crisis was fueled in part by spikes in natural gas  
18 prices at a time of extreme drought conditions. Industry participants were well  
19 aware of the increase in and variability of gas prices and its impact on generation  
20 costs.

21 This background context led the parties in the 2001 general rate case to also

1 design and recommend that the Commission approve the PCA. The PCA, with its  
2 annual true-up accounting and sharing bands, was created to address short-term  
3 imbalances between power cost recoveries and actual power costs—costs that  
4 reflect current market issues and risks such as hydro and price risks—that are  
5 largely uncontrollable. The PCA allows short-term risk-sharing of these market  
6 disturbances so that neither the customer nor the Company are unfairly subjected  
7 to the costs of such volatilities. At the same time, potential financial windfalls  
8 from occurrences such as favorable hydro or market conditions that the Company  
9 neither caused nor controls are shared between the Company and customers.

10 **Q. Do you agree with Public Counsel or ICNU that the Company’s regular**  
11 **PCORC filings have prevented the PCA from accomplishing most of the**  
12 **objectives for which it was designed, or circumvented the PCA?**

13 A. I do not agree. As described above, the PCA and PCORC do not exist in  
14 isolation. They were developed at the same time to work hand-in-hand and were  
15 part of the same stipulation in the 2001 general rate case. The PCA assumes that  
16 a regular updating of projected power costs—the PCA baseline rate--will be  
17 undertaken, including through the PCORC process.

18 At the time the PCA and PCORC were created, the parties knew that the  
19 Company would be coming in on a regular basis to update its baseline rate. In  
20 fact, the concern was that the Company would begin filing PCORC after PCORC  
21 and never come in for a general rate case. That concern was specifically  
22 addressed in the PCA stipulation, which requires PSE to file a general rate case

1 within three months of the effective date of any rate increase resulting from a  
2 PCORC. *See* Settlement Stipulation, ¶ 10. The Company's practice since 2001  
3 of repeatedly filing PCORCs followed by general rate cases is completely  
4 consistent with the underlying intent of the PCA.

5 **Q. Does it still make sense to update all power costs in a PCORC?**

6 A. Yes. It made sense in the context of the 2001 general rate case and it still makes  
7 sense today. In the aftermath of the Western Power Crisis, due in part to efforts  
8 to address various problems with wholesale market auction systems, we have not  
9 experienced the extreme conditions or price excursions of that time. However,  
10 natural gas prices have generally only increased since that time. This has placed  
11 nearly constant upward pressure on the cost of providing electric service to our  
12 customers.

13 Furthermore, the wholesale power and gas markets provide inherent opportunities  
14 and risks that must be addressed. Given the dynamic nature of the gas and power  
15 markets, PSE's electric portfolio, customer load demand and our ability to  
16 manage the risks and opportunities of the power portfolio, all of PSE's power cost  
17 drivers are constantly changing. The power costs embedded in rates (which is the  
18 PCA baseline rate) reflects projections for the rate year from the last rate case as  
19 of a point in time.

20 It is entirely appropriate that customers pay the costs of the electricity they  
21 consume, and that electric rates reflect as closely as possible the projected costs of

1 providing such service as of the time rates are set. The PCORC provides an  
2 excellent, efficient means by which to do so.

3 **Q. What about Public Counsel’s concerns that because of PCORC filings, (i) the**  
4 **Company is not incented to hold down costs, and (ii) the Company and**  
5 **customers are not treated symmetrically?**

6 A. Ms. Smith did not participate in the Company’s 2006 general rate case, Docket  
7 Nos. UE-060266 & UG-060267. The Company presented extensive analysis in  
8 that proceeding showing that the Company is subject to significant financial risk  
9 under the PCA and its sharing bands that the Company cannot control (*i.e.* hydro  
10 risk). The Company requested changes to the sharing bands that would have  
11 relieved some of this risk. The Commission denied PSE’s request, finding that  
12 “the current PCA adequately addresses this risk.” *Wash. Utils. & Transp.*  
13 *Comm’n v. Puget Sound Energy, Inc.*, Docket Nos. UE-060266 & UG-060267,  
14 Order 08 at ¶ 18 (Jan. 5, 2007).

15 Because of the sharing bands and the uncontrollable nature of much of the  
16 financial risk to which the Company is exposed, the Company is absolutely  
17 incented to control its power costs (as well as its other costs) to the greatest extent  
18 reasonably possible. This holds true regardless of whether the power cost  
19 baseline rate is updated every year or more frequently. In addition, PSE’s  
20 operations and hedging strategies, which are reflected in PSE’s short-term power  
21 costs, were deemed prudent in each of PSE’s five PCA Compliance filings that  
22 have been completed to date – proof that PSE is properly and reasonably

1 addressing the costs of the power to meet customer demand.

2 **Q. Do you have any other reaction to Public Counsel's testimony on the**  
3 **PCORC?**

4 A. I find it odd that Public Counsel suggests that known increases in the costs of  
5 providing power that electric customers consume should not be reflected in their  
6 rates in order to incent the Company to contain its costs. There are real limits to  
7 what the Company can do to hold down its power costs. Preventing the Company  
8 from passing through the basic costs of providing electric service to customers is  
9 inconsistent with the fundamental regulatory compact that a regulated utility be  
10 given the opportunity to recover its costs. While there may be some short-term  
11 rate relief gained from such an approach, I do not believe it is in the long-term  
12 interest of our customers.

13 **D. The Intervenors' Other Concerns About The PCORC**

14 **Q. What about the criticisms of ICNU and Public Counsel that the PCORC**  
15 **process is too short?**

16 A. In order to serve its fundamental purposes, the PCORC process must be  
17 significantly shorter than a general rate case. Furthermore, PSE, Commission  
18 Staff and other parties have completed three successful PCORCs since its 2002  
19 inception. I think it is fair to say that all interested parties are now very familiar  
20 with the PCORC process, the Company's resource acquisition process and the

1 methodologies underlying rate year power cost projections, such that the process  
2 is efficient and focused.

3 Nonetheless, the PCORC requires many resources and it can be challenging to  
4 meet deadlines, especially if power and production-related costs need refreshing  
5 during the filing. This is why, as I describe at the end of this section of testimony,  
6 the Company supports Commission Staff's recommendations to (i) extend the  
7 PCORC procedural schedule from five to six months, (ii) shorten the data request  
8 process to five days, and (iii) limit the number of filing updates. I believe this  
9 compromise adequately addresses the process concerns raised by ICNU and  
10 Public Counsel.

11 **E. The PCA Remains an Important Regulatory Mechanism**

12 **Q. Do you agree with the various criticisms of the PCA by the other parties?**

13 A. No, I do not. As their criticisms were combined with criticism of the PCORC  
14 process, I have already responded to most of their assertions earlier in this  
15 testimony.

16 **Q. Do you believe the PCA continues to serve the purpose for which it was  
17 created?**

18 A. Absolutely. I have already discussed the context in which the PCA was  
19 developed and approved. Since the PCA was created, the region has been  
20 fortunate not to have experienced extreme market disruptions such as occurred

1 during the Western Power Crisis. But as Commission Staff appropriately  
2 observes: “[T]he Company is still subject to extreme volatility of power supply  
3 costs, such as short term market purchases associated with drought or low water  
4 runoff, which would not be recovered or reflected in base rate changes.” The  
5 PCA remains a very important bulwark against extreme power market and power  
6 cost events that could be financially devastating to the Company.

7 **Q. Why should ratepayers care about potential financial harm to the Company?**

8 A. When extreme cost events occur, the Company is entitled to request emergency or  
9 interim rate relief from the Commission. Having an approved regulatory  
10 mechanism in place to deal with such situations is calming to financial markets,  
11 and thus lowers the cost of the capital PSE needs to provide service to customers.  
12 The PCA's ongoing benefits are at little cost to customers because in any case,  
13 they may have to shoulder extreme cost events.

14 **Q. Are there other benefits to customers of the PCA?**

15 A. Yes. Under traditional ratemaking principles, if very favorable cost events occur,  
16 such as very good hydro or market conditions, the Company would not typically  
17 be required to pass through the resulting financial benefits to customers,  
18 especially if the benefits were short-term. Under the PCA, such benefits reduce  
19 power costs, flow through the PCA sharing bands and may result in refunds to  
20 customers. For example, during PCA period 6 (calendar year 2007), PSE booked  
21 a \$3.3 million credit to the customers due to cost over-recoveries flowing through

1 the PCA sharing bands. This is an important potential benefit of the PCA for  
2 customers.

3 **F. Commission Staff's Recommendations to Modify the PCORC Process**  
4 **and to Study the PCA Mechanism**

5 **Q. What is your reaction to Commission Staff's proposed modifications to the**  
6 **PCORC process?**

7 A. I am pleased to see that Commission Staff recognizes the importance of the  
8 PCORC process. Commission Staff has clearly focused its efforts on developing  
9 and suggesting positive modifications to the PCORC process to alleviate some of  
10 its challenges, given the parties experience with PCORCs. The following is a  
11 summary of the recommendations made by Commission Staff:

- 12 1. Extend the expected procedural schedule from five to six  
13 months.
- 14 2. Shorten data request response time from ten to five  
15 business days at the outset. Any further reduction can be  
16 considered during the pre-hearing conference.
- 17 3. Limit filing updates to one update per PCORC, with an  
18 additional update allowed as part of the compliance filing if  
19 the Commission determines the update is necessary due to  
20 increased gas costs and orders that such update be made as  
21 part of the compliance filing. Commission Staff also  
22 recommends that this limitation be applied in future general  
23 rate cases (*see* Exhibit No. \_\_\_T(APB-1T) at page 5).
- 24 4. Mandate that there can be no overlap of PCORC and  
25 general rate case filings, except for interim rate relief.

1 **Q. Does the Company support these proposed changes to the PCORC process?**

2 A. Yes, with a clarification to No. 3, above. Generally, the Company agrees with the  
3 proposed changes and believes they are a positive way to remedy other parties'  
4 concerns with the current PCORC process.

5 That said, Commission Staff's proposal that an additional power cost update may  
6 be made at the time of the compliance filing should not be the result solely of an  
7 increase in gas prices. Updating power costs is advisable if gas prices decrease as  
8 well as if they increase.

9 In addition, when the Company updates its power costs with new gas prices, this  
10 typically causes other elements of the power cost projection to change. For  
11 example, when the power cost model is updated for gas prices, AURORA-  
12 modeled rate year resource costs and generation change. For consistency, power  
13 costs are also updated to include rate year short-term power and gas for power  
14 contracts at the date of the gas price forecast. Thus, the Company clarifies that  
15 the update for more recent gas prices should include all changes in power costs  
16 that are triggered by changes in gas prices. The methodology for updating power  
17 costs with new gas prices is discussed in Mr. Mills' prefiled direct and rebuttal  
18 testimonies.

19 **Q. Did Commission Staff recommend any changes to the PCA?**

20 A. No, the Commission Staff did not propose any changes to the PCA. However,  
21 Commission Staff recommends that PSE study the effectiveness of the PCA as a

1 risk-sharing mechanism between customers and the Company. The Company  
2 would then present its findings in the next general rate case. If the study  
3 illustrates that changes are necessary, Commission Staff asks the Company to  
4 propose suggestions for PCA improvement in the next general rate case.

5 **Q. Do you agree with Commission Staff's recommendation that the PCA should**  
6 **be studied?**

7 A. Yes. PSE agrees to study the efficacy of the PCA and, if warranted, proposed  
8 modifications to the PCA in its next general rate case.

9 **III. NO PARTY CHALLENGES THE PRUDENCE OF ANY**  
10 **POWER PURCHASE AGREEMENT OR**  
11 **GENERATION RESOURCE**

12 **Q. Have any of the Parties raised concerns regarding the reasonableness of the**  
13 **Company's acquisition of the power resources that are presented for a**  
14 **prudency determination in this proceeding?**

15 A. No. None of the other Parties has challenged the reasonableness of the resource  
16 acquisitions the Company has completed since the last rate case.

17 **Q. Do any of the other Parties support the Company's request for a**  
18 **determination that its acquisition of these resources was prudent?**

19 A. Yes. After conducting an examination of the Company's resource acquisitions  
20 presented for a prudency determination in this case, Commission Staff has  
21 concluded that these acquisitions meet the Commission's prudence standard. Mr.

1 Garratt's prefiled rebuttal testimony, Exhibit No. \_\_\_(RG-55CT), summarizes  
2 Mr. Kilpatrick's prudency review of these resources.

3 **IV. ADDITIONAL REQUEST FOR PRUDENCY**  
4 **DETERMINATION**

5 **Q. Does the Company have any additional requests related to the prudency of**  
6 **its resource acquisitions?**

7 A. Yes. The Company has realized that while Mr. Mills' pre-filed direct testimony  
8 presented a new 3 1/2 year Locational Exchange Agreement with TransAlta  
9 Energy Marketing (US) Inc., my pre-filed direct testimony did not include a  
10 request that the Commission determine that it was prudent for PSE to enter into  
11 this agreement. This was an oversight. The Company therefore requests at this  
12 time that the Commission include the TransAlta Energy Marketing Locational  
13 Exchange Agreement in its list of the resources determined to be prudent in this  
14 proceeding.

15 **Q. What basis does the Commission have to approve this request?**

16 A. Mr. Mills' prefiled direct testimony included a discussion of and support for the  
17 Company's decision to enter into the TransAlta Energy Marketing Locational  
18 Exchange Agreement. *See* Exhibit No. \_\_\_(DEM-1CT) at pages 35-37.  
19 Likewise, the Company's request for rate relief included this resource. None of  
20 the other Parties has challenged the reasonableness of this acquisition.

21 Under these circumstances, the Commission should explicitly approve the

1 prudency of PSE's acquisition of this resource. The Commission has recognized  
2 in the past that the prudence of a resource acquisition should be examined as close  
3 in time to the acquisition as possible. Doing so better allows the Commission and  
4 parties to view the resource in the context and under the circumstances that  
5 existed at the time the decision was made. It will also avoid the burden to the  
6 Company, the other parties and the Commission of presenting, reviewing and  
7 making a prudence determination on this resource in a future proceeding.

8 **V. THE COSTS OF ALL OF PSE'S PRUDENTLY-ACQUIRED**  
9 **RESOURCES SHOULD BE APPROVED FOR RECOVERY IN**  
10 **RATES**

11 **Q. Does any party propose to disallow the costs of any PPA or generation**  
12 **resource included in PSE's proposed rates?**

13 A. Yes. Public Counsel does not challenge the prudence of PSE's acquisition of  
14 Whitehorn Units 2 and 3, but asks the Commission to disallow the costs of the  
15 acquisition in this case because the change of ownership does not occur until  
16 February 2009. In addition, Public Counsel proposes that the Commission  
17 disallow part of the costs associated with the Goldendale Generating Station,  
18 which the Commission determined that PSE prudently acquired in the 2007  
19 PCORC, Docket No. UE-070565.

1 **A. Whitehorn Units 2 and 3**

2 **Q. Please briefly summarize Public Counsel's objection to the inclusion of costs**  
3 **associated with the acquisition of Whitehorn Units 2 and 3.**

4 A. Public Counsel proposes to disallow the acquisition and operational costs  
5 associated with Whitehorn Units 2 and 3 because PSE's acquisition of these units  
6 occurs in February 2009. Mr. Majoros justifies this result by setting an arbitrary  
7 deadline of October 2008 by which he argues an event should occur in order for  
8 its costs to be deemed known and measurable. Please see the Prefiled Rebuttal  
9 Testimony of John H. Story, Exhibit No. \_\_\_(JHS-14T), for a discussion of why  
10 Mr. Majoros' disallowance is inappropriate and inconsistent with prior  
11 Commission decisions.

12 **Q. Do you agree with this proposed disallowance of costs associated with**  
13 **Whitehorn Units 2 and 3?**

14 A. No, the acquisition of Whitehorn Units 2 and 3 is a known event and the  
15 associated expected costs are measurable.

16 **Q. Please explain.**

17 A. As Mr. Garratt discusses more thoroughly in Exhibit \_\_\_(RG-55CT) at pages 4-6,  
18 PSE signed the Asset Purchase Agreement to acquire Whitehorn Units 2 and 3 on  
19 October 16, 2006. The acquisition date was set for February 2, 2009, because that  
20 is when the current lease expires. The Federal Energy Regulatory Commission

1 (“FERC”) approved the Asset Purchase Agreement under section 203 of the  
2 Federal Power Act on December 22, 2006. A copy of the FERC order approving  
3 the Asset Purchase Agreement was provided in Exhibit No. \_\_\_(RG-31). The  
4 \$█ million purchase price is known, measureable and should be included in  
5 rates.

6 **Q. Is Mr. Majoros' proposed disallowance consistent with the Commission's**  
7 **treatment of PSE's past resource acquisitions?**

8 A. No. The Commission has approved this same type of proforma adjustment with  
9 respect to the acquisition of Fredrickson 1, the Wild Horse wind farm and the  
10 Goldendale Generating Station. The Commission has more discretion to  
11 determine whether a cost is reasonable for inclusion in a rate proceeding than  
12 Mr. Majoros would have others believe. The Commission has exercised this  
13 discretion reasonably in determining that when the Company has signed a  
14 contract committing itself to the acquisition of a resource that will (or is likely to)  
15 become part of the Company's power portfolio during the rate year, the costs of  
16 that resource are properly included in the rates that are set by reference to  
17 projected power costs for that rate year.

**REDACTED**

1 **B. The Goldendale Generating Station**

2 **Q. Does Public Counsel disallow costs associated with any other resource**  
3 **acquisition?**

4 A. Yes. Mr. Majoros proposes to disallow costs associated with Goldendale. As  
5 discussed more thoroughly by Mr. Story in his prefiled rebuttal testimony, Exhibit  
6 No. \_\_\_(JHS-14T), there is no basis for Mr. Majoros' disallowance. It is  
7 inconsistent with past Commission procedure. Mr. Majoros ignores the fact that  
8 Goldendale was approved for recovery in the 2007 PCORC, Docket UE-070565,  
9 is currently included in rates, and the generation from the plant is included in  
10 power costs for the full rate year.

11 **VI. PSE'S FEDERAL REGULATORY EFFORTS ARE**  
12 **UNDERTAKEN ON BEHALF OF ITS CUSTOMERS**

13 **Q. Do the other Parties propose any other disallowances that are within your**  
14 **areas of responsibility?**

15 A. Yes. Public Counsel's witness Mr. Majoros argues that ratepayers should not bear  
16 the portion of the cost of my salary nor my staff's salaries that can be allocated to  
17 federal regulatory efforts. He asserts that this work does "not provide a direct  
18 benefit to the ratepayers." See Exhibit No. \_\_\_(MJM-1TC) at page 35.

19 **Q. Do you agree?**

20 A. No. The federal regulatory work that I oversee is directly related to the

1 Company's provision of electric service to its customers.

2 **Q. How so?**

3 A. As Mr. Markell and Mr. Tom Hunt discuss in their rebuttal testimonies, Exhibit  
4 No. \_\_\_(EMM-13T) and Exhibit No. \_\_\_(TMH-9T), respectively, there are  
5 numerous federal-level issues I am involved in that have already realized value  
6 for our customers or will bring value and cost savings to our residential,  
7 commercial and industrial customers, through changes in future federal  
8 legislations and policies. These issues include, but are not limited to the  
9 following:

- 10 i. The creation of a federal climate policy framework. PSE is  
11 working with Congress to address a federal carbon  
12 emissions cap and trade system, additional caps on other  
13 emissions, cost containment of new environmental policies,  
14 and implementation of such a framework. Being involved  
15 allows the Company to impact policy regulations in efforts  
16 to minimize cost impact to customers.
- 17 ii. The creation of legislation to extend the federal Production  
18 Tax Credits ("PTCs") for wind beyond December 31, 2008.  
19 PTCs are a critical element in securing affordable renewable  
20 energy resources for our customers. Additionally, PSE is  
21 working with legislators and twelve other utilities nation-  
22 wide to change a clause in the Solar Investment Tax Credit  
23 bill that will enable utilities and their customers to capture  
24 ITC benefits associated with solar investment.
- 25 iii. Establishing legislation that will allow utilities to monetize  
26 additional PTCs beyond the Company's PTC appetite, by  
27 partnering with tax investors on future renewable  
28 acquisitions.
- 29 iv. As Mr. Markell mentions in his rebuttal testimony, Exhibit  
30 No. \_\_\_(EMM-13T) at page 11, working to protect the BPA  
31 Residential Exchange benefits that flow dollar-for-dollar to

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PSE’s residential and small farm customers that since 2001 amount to well over \$900 million.

- v. Providing leadership in the region on the evolution of a workable region-wide transmission grid system (“Columbia Grid”);

**VII. CONCLUSION**

**Q. Does that conclude your prefiled rebuttal testimony?**

A. Yes.