EXHIBIT NO. MLJ-5CT
DOCKET NOS. UE-090704/UG-090705
2009 PSE GENERAL RATE CASE
WITNESS: MICHAEL L. JONES

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-090704** **Docket No. UG-090705**

PREFILED REBUTTAL TESTIMONY (CONFIDENTIAL) OF MICHAEL L. JONES ON BEHALF OF PUGET SOUND ENERGY, INC.

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VERSION

DECEMBER 17, 2009

PUGET SOUND ENERGY, INC.

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PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

Q. Are you the same Michael L. Jones who provided in this proceeding prefiled direct testimony, Exhibit No. MLJ-1T, on May 8, 2009 on behalf of Puget Sound Energy, Inc. ("PSE")?

A. Yes.

Q. What is the purpose of your prefiled rebuttal testimony?

A. To correct misunderstandings and to comment on the testimonies of Ms. Kathryn Breda, testifying on behalf of Commission Staff ("Staff") and Mr. James Dittmer, testifying on behalf of Public Counsel regarding recommendations for adjustments to reduce the Colstrip Generating Station ("Colstrip") production operations and maintenance ("O&M") costs included in the rate year.

Q. Please summarize Staff's and Public Counsel's proposed adjustments to the rate year Colstrip production O&M costs.

A. Staff proposes to reduce rate year Colstrip production O&M costs $5.2 million by using a cost based on the average of the last five years' costs. Public Counsel proposes to reduce rate year production O&M by $3.0 million, setting the rate year cost equal to the test year costs.

Q. Do you agree with Staff's or Public Counsel's adjustments?

A. No. As I discuss below, neither parties' proposed adjustments are consistent with the practice used by PSE and accepted in past rate cases, and both adjustments will likely result in a significant under-recovery of costs by PSE.

II. COLSTRIP OPERATIONS AND MAINTENANCE COSTS

Q. Please summarize Staff's and Public Counsel's proposed adjustments to the rate year Colstrip production O&M costs.

A Staff's proposal eliminates the Company's use of a budget forecast prepared by the operator of the Colstrip plant, PPL Montana, and replaces it with a "five year normalized level of expense," which is the average of five years of historical costs incurred by the Company. As described later in my rebuttal testimony, Staff incorrectly asserts that the use of a budget or projection does not meet the definition of a known and measurable change, and that, "History proves that forecasts can be significantly different from actual results." (see Exhibit No. KHB-1TC, page 21, lines 7-8). Staff's proposal would reduce rate year O&M costs by $5.2 million. Public Counsel proposes to set the rate year cost equal to the test year costs, which would reduce rate year production O&M by $3.0 million.

Q. Does the Company agree with Staff's proposal?

A. No. As discussed in the prefiled rebuttal testimony of John H. Story, Exhibit No. JHS-14T, "known and measurable changes that are not offset by other factors" often include reasonable *estimates*. This is especially critical for units that are operated by a third party rather than the Company itself. For its last six rate cases, PSE has deferred to PPL Montana's budgets for a reasonable estimate of rate year O&M costs for Colstrip because:

- They are prepared by expert staff closest to and most familiar with how the plants are operated and maintained;
- Before adoption, the budget is thoroughly reviewed by all owner representatives and must be approved by a majority of owners;
- History proves that these budgets are quite close to actual results but historical five-year average costs vary significantly from actual results.

Q. Why is the use of historical costs inferior to the use of budgeted costs?

A. The use of historical costs to set future cost recoveries ignores the effects of technology changes, changes in maintenance cycles, changes in regulatory requirements and changes in costs for labor, materials and contracts.

Q. Please explain.

A. The use of historical costs to predict future costs incorrectly assumes that the future will duplicate the past. For example, Colstrip is subject to changing emission control requirements such as the lower nitrogen oxides ("NOx") emission levels effective for Colstrip Units 3 & 4 in 2008 and 2010, respectively, and the Best Available Retrofit Technology evaluation being conducted by the U.S. Environmental Protection Agency on Colstrip Units 1 & 2. Additionally, Colstrip uses large amounts of lime, fuel oil, propane, sulfuric acid, steel piping and copper wire, all of which are subject to market price fluctuations. Further, most employees of the plant operator, PPL-Montana, are covered by labor agreements that establish known and measurable annual wage and benefit increases.

Another significant cause of fluctuations in annual cost levels is planned major maintenance. The number of units undergoing scheduled major maintenance overhauls changes from year to year. In this proceeding's rate year, April 1, 2010 through March 31, 2011, there [redacted]. By comparison, during calendar year 2009, two of the four Colstrip units underwent major scheduled overhauls. PSE incurs several millions of dollars of maintenance expense for each scheduled overhaul, but the Company incurs no such expense in a non-overhaul year.

Because of these year-to-year fluctuations in operating and maintenance costs, rates based on historical costs are less accurate than rates based on actual budgeted costs. As stated above, the Company has used rate year budgeted costs provided by the Colstrip plant operator, PPL-Montana, in PSE's last six rate proceedings. This metho

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etween the way the Colstrip units are operated wer costs of Colstrip generation because both are based on actual major maintenance outage schedules.

Q. Are there other known and measurable operating costs that would be overlooked if PSE were to apply a historical cost methodology?

A. Yes; in my prefiled direct testimony, Exhibit No. MLJ-1T, I discussed the new regulatory requirement for control of mercury emissions, which goes into effect January 1, 2010. The equipment to meet this requirement has been installed at Colstrip and is undergoing final testing. The costs surrounding this requirement are known, but it is a new addition over historical costs because the rule was not in effect during the test year. The operating costs for the chemical oxidizer and activated carbon sorbent used for mercury control would not be included if a methodology using prior year's costs were employed, yet there is no question that PSE will incur such costs during the rate year.

These changes reflecting scheduled maintenance overhauls and new regulatory requirements for control of mercury emissions are known and documented in budgets and business plans prepared by PPL-Montana, in consultation with other Colstrip owner representatives. They are based on known operating conditions and maintenance plans, the most current commodity, material and labor costs, and current environmental compliance obligations. Each Colstrip owner company must review PPL-Montana's budgets and business plans, and a majority of owners must approve them before the budgets are adopted.

Q. How does Staff's proposal to use a five year average of historical cost to estimate rate year O&M for Colstrip compare with PSE's actual O&M costs for Colstrip?

A. Exhibit No. MLJ-6 contains a graph comparing PSE's actual Colstrip operations and maintenance costs included in the rate year for each of the past six rate cases to the average of the prior five years of historical costs, the methodology recommended by Staff. If Staff's methodology had been utilized in the past six rate proceedings, actual Colstrip O&M costs would have been underrecovered by an average of over $5 million per year, or nearly 20 percent per year.

In stark contrast to the disparity resulting from Staff's proposed normalized historical cost methodology, the methodology PSE has used in the past rate cases has resulted in rate year O&M costs that are very close to the actual expenses incurred by PSE for the rate year period. Exhibit No. MLJ-7 compares the costs included in rates with the actual Colstrip O&M expenses incurred by PSE for the proceeding's rate year. This comparison clearly demonstrates that PSE's proposed approach is superior to Staff's because the difference between the projected and actual costs is much smaller with PSE's proposed methodology than using Staff's recommended methodology. PSE's *cumulative* underrecovery for the last six rate cases has averaged only 1.4 percent using budget forecasts in rates.

Q. Do you agree with Staff's position that including the costs to develop and implement a contingency plan for dealing with a possible strike upon a labor contract termination cannot be accurately audited?

A. No, I do not. The collective bargaining agreement with the Teamsters expires in December 2010, and the budgeted amount of the strike contingency is a total $500,000 for all Colstrip owners. PSE's ownership share of this amount is $175,000. While a strike may or may not occur, the contingency expenses are certain. Planning to ensure that major generating units such as Colstrip remain available during periods of labor contract negotiation is prudent planning, and PSE must incur these costs whether an actual strike occurs or not.

Q. Does the Company agree with Public Counsel's proposal?

A. No; Public Counsel witness James Dittmer recommends an aggregate reduction of $2.995 million of Colstrip costs (see page 29 of Exhibit No. JRD-2C). This would set the rate year amount equal to the amount PSE incurred in the test year, after deduction of the costs for the Colstrip legal settlement, which was discussed in my prefiled direct testimony, Exhibit No. MLJ-1T. As stated above, such a methodology ignores significant changes between the test year and the rate year. These changes are documented in the PPL-Montana budgets and have been approved by a majority of owners.

III. CONCLUSION

Q. Please summarize your conclusions.

A. The rate year production operations and maintenance costs for the Colstrip units used by PSE in its power cost projections—$19,847,628 for Units 1 & 2 and $15,149,015 for Units 3 & 4—are based upon known and measurable proforma adjustments and are appropriate. These amounts are based on budgets and business plans provided by the plant operator and approved by other owners. PSE's use of these budgets is consistent with prior rate cases, tracks closely with PSE's actual expenses, and is superior to the use of backward-looking estimates suggested by Staff and the test year methodology suggested by Public Counsel. PSE urges the Commission to adopt PSE's rate year Colstrip production O&M costs and reject Staff's and Public Counsel's adjustments to Colstrip production O&M costs.

Q. Does that conclude your prefiled rebuttal testimony?

A. Yes.