EXHIBIT NO. ___(KJH-1HCT)
DOCKET NO. UE-07 ___/UG-07___
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-07____** **Docket No. UG-07____**

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

REDACTED VERSION

DECEMBER 3, 2007

PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY (HIGHLY CONFIDENTIAL) OF KIMBERLY J. HARRIS

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PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY (HIGHLY CONFIDENTIAL) OF KIMBERLY J. HARRIS

I. INTRODUCTION

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

A. My name is Kimberly J. Harris. My business address is 10885 N.E. Fourth Street, Bellevue, WA 98004. I am the Executive Vice President and Chief Resource Officer for Puget Sound Energy, Inc. ("PSE" or the "Company").

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

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

Q. What are your duties as Executive Vice President and Chief Resource Officer for PSE?

A. I am responsible for energy resources, including project development and contract management, energy efficiency services, and federal government relations. My duties include oversight of: (i) energy efficiencies resources; (ii) the operation and maintenance of the Company's electric generating facilities and the Jackson Prairie gas storage facility; (iii) purchase and sale of power and natural gas to

meet customer loads in real time and long-term; (iv) contracts for long-term electric supply, transmission service, long-term gas supply, and long-term gas transportation service; (v) generation resource acquisition; (vi) integrated resource planning; (vii) forecasting power costs for planning and rate cases; (viii) the Company's green power program and emerging technologies; and (ix) federal legislative policy issues that impact the Company's existing and future resource decisions.

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

A. My testimony presents a summary of the Company's long-term electric supply portfolio and changes to that portfolio since PSE's 2007 Power Cost Only Rate Case ("PCORC"), as well as a summary of the Company's natural gas supply portfolio.

I then describe the Company's continuing need to acquire new or replacement resources in order to have enough power to meet the projected demands of PSE's electric customers. My testimony outlines the strategies the Company is pursuing to address this need to acquire additional electric resources. I also describe some of the challenges that PSE faces in acquiring resources and the importance of the PCORC process in supporting the Company's efforts.

I then provide an executive summary of the Company's recently acquired resources resulting from the Company's 2005 Request for Proposals ("RFP") and related acquisition activities. This executive summary includes a description of

why the Company's acquisition of these resources complied with the prudence standard set forth by the Commission.

Finally, I provide updates on the status of (i) the relicensing of the Baker River Hydroelectric Project; (ii) the planned maintenance schedule for the Snoqualmie Hydroelectric Project; and (iii) the pending sale of PSE's White River Project assets.

II. PORTFOLIO SUMMARY

A. The Company's Electric Supply Portfolio

Q. Please describe the principal components of the Company's electric supply portfolio.

A. PSE derives most of its electric supply from a generation "portfolio" consisting of a mix of resources, both PSE-owned and purchased, representing technology, fuel, transmission and geographic diversity. This portfolio approach helps mitigate the risks of supply disruption and cost volatility by reducing reliance on any one resource, fuel type or geographic location.

The Company's natural gas-fired resources consist of contracted and owned facilities. Contracted facilities include purchased power agreements ("PPAs") with two non-utility generators ("NUGs"), which are the Tenaska and March Point projects. (PSE no longer has a PPA for the Sumas project due to the default

of the counterparty of the PPA, a development I discuss later in my testimony.) PSE owns three natural gas-fired combined cycle combustion turbine projects: (i) the 169 MW Encogen Generating Station; (ii) the 277 MW Goldendale Generating Station; and (iii) 49.85% of the 276 MW Frederickson 1 Generating Station. All of the Company's natural gas-fueled resources are located in western Washington except the Goldendale Generating Station, which is located near the Oregon border in south-central Washington.

PSE also owns two simple cycle combustion turbine projects and leases units for two other simple-cycle projects. These simple cycle units are generally used to meet PSE's winter peaking needs or during periods of constrained supply. PSE-owned projects include: (i) the 140 MW Frederickson Generating Station and (ii) the 208 MW Fredonia Generation Station. The leased units include: (i) the Fredonia units 3 and 4, approximately 108 MW; and (ii) the Whitehorn units 2 and 3, approximately 140 MW. As discussed in my testimony and further discussed in detail in Roger Garratt's testimony, PSE is seeking recovery of the lease buyout of the Whitehorn units in 2009.

The Company purchases under long-term contracts significant quantities of hydroelectric power from projects located along the middle section of the Columbia River in central Washington (the "Mid-C"). The Company also owns three operating hydroelectric projects: (i) the Baker River project (170 MW); (ii) the Snoqualmie Falls project (42 MW); and (iii) the Electron project (22 MW).

The Company also has long-term purchase power agreements with diverse fuel sources and capacity, such as a 97 MW coal PPA and several small contracts acquired under the Public Utility Regulatory Policy Act ("PURPA").

The Company also owns two recently completed wind facilities: (i) Hopkins Ridge Wind Facility (150 MW) completed in November 2005; and (ii) Wild Horse Wind Facility (229 MW) completed in December 2006. Both are located in Washington State.

The Company also owns a 50% undivided interest in Colstrip Units 1 and 2 and a 25% undivided interest in Colstrip Units 3 and 4. The Colstrip Project is a 2,100 MW pulverized coal/steam electric generating plant located in eastern Montana. The geographic locations of the Company's electric portfolio resources are illustrated in Exhibit No. ___(KJH-3).

Q. To what extent do PSE's resources meet the energy demands of the Company's electric customers?

A. PSE's ownership share and contractual interests in the Colstrip Project provide approximately one quarter of its annual energy requirements. Hydroelectric generation supplies approximately 30% of the Company's annual energy requirements, depending on the availability of water in any given year. Hydro resources also provide valuable ancillary services to "firm" the Company's growing portfolio of wind resources. Natural gas-fired generation resources provide another approximately 30% of PSE's annual energy requirements,

depending on market conditions. The Company's wind projects are expected to supply about five percent of PSE's 2008 energy load in an average wind year. Short-term market purchases and various other purchase power contracts comprise the remaining resources needed to meet the energy requirements of PSE's electric customers.

The relative contributions of these various resources in 2006 are shown in Exhibit No. ___(KJH-4) at page 214. Because the Company's Wild Horse Wind Project did not enter commercial service until December 20, 2006, its energy contribution in 2006 was minimal. Also, the Goldendale Generating Station was acquired by the Company on February 21, 2007, and therefore is not shown among the 2006 resources.

PSE's 2007 Integrated Resource Plan (filed with the Commission in May 2007 under Docket No. UE-071063) presents more current information regarding the Company's electric resource portfolio in Chapter 5 – Electric Resources. A copy is provided as Exhibit No. ___(KJH-5).

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Q. Have there been changes to PSE's long-term electric resource portfolio since the Company's 2007 Power Cost Only Rate Case?

A. Yes. Since the Company's acquisition of the 277 MW Goldendale Generating Station that was presented in the 2007 PCORC, PSE has acquired additional resources, as described briefly below (and more fully described in Mr. Roger Garratt's prefiled direct testimony, Exhibit No. ___(RG-1HCT)). These include: short-term and long-term PPAs, including a 20-year 50 MW wind PPA from the Klondike III wind project and the extension of the Point Roberts power supply contract with Powerex; the acquisition of the Whitehorn Units 2 and 3, which PSE leased from their owner prior to this acquisition; construction of 7.2 MW of additional wind generating capacity at the Hopkins Ridge Wind Facility; and acquisition of the 125 MW Sumas combined cycle cogeneration facility. Regarding the Sumas facility, PSE expects to execute the definitive agreements by mid-December 2007. The transaction is estimated to close in the third quarter of 2008. In addition, the prefiled direct testimony of Mr. Michael L. Jones, Exhibit No. ___(MLJ-1CT), describes a new long-term coal supply contract for the Colstrip facility.

Q. Are there any resource acquisitions that the Company is currently pursuing?

A. Yes, of the seven short-listed projects selected through PSE's 2005 RFP process, PSE has executed on three of the seven projects. Of the remaining projects, three have proven to be unexecutable. PSE is currently in negotiations on the final

short-listed project, which is a 25-year PPA for 15 MW from an Idaho geothermal project. PSE is also in the final stages of negotiations for the acquisition of the Sumas natural gas-fired combined cycle cogeneration facility, a project that did not come to PSE through the RFP process.

Other market opportunities that have arisen and are in various stages of negotiation and documentation, but are not ripe for consideration in this proceeding, include: (i) a 20-year base load PPA with a biomass project; (ii) potential ownership of a 70 MW wind development project located in Skamania County; and (iii) potential ownership of a 45 MW wind development project located in Kittitas County near PSE's Wild Horse Wind Project.

In addition, the Company keeps track of certain opportunities placed on its "watch list" in the event issues identified as potential problems for such projects are resolved such that they merit further consideration. Each of these commercial undertakings involves different types of counterparties, resources, transaction structures and timelines.

Q. Have there been any significant changes to PSE's natural gas transportation supply resources that serve its electric supply portfolio since the 2007 PCORC?

A. Yes. In connection with the Company's acquisition of the Sumas Cogeneration Facility, the Company will enter into a joint ownership and operating agreement with affiliates of the Sumas Cogeneration Company, LP ("SCCLP"), namely

Socco, Inc., and Sumas Pipeline, Inc., to acquire a [redacted] undivided interest in a proprietary natural gas pipeline currently owned by SCCLP originating at the United States-British Colombia border crossing and terminating at the Sumas Cogeneration Facility. Please see the prefiled direct testimony of Mr. Garratt for a more complete discussion of this arrangement.

B. The Company's Natural Gas Supply Portfolio

Q. Please describe the principal components of the Company's natural gas supply portfolio.

A. PSE's natural gas supply portfolio consists of:

(i) a mix of long-term natural gas supply contracts (more than two years) and short-term natural gas supply contracts (two years or less) to meet the average loads of PSE's retail gas customers during different months;

(ii) natural gas peaking supply and capacity resources to meet peaking requirements or short-term operational needs for PSE's retail gas customers;

(iii) natural gas pipeline capacity resources (both "direct connect" capacity, which moves supplies from production areas, storage or interconnections with other pipelines directly into PSE's distribution system, and "upstream" capacity, which accesses production, storage and market centers further upstream from the direct connect capacity);

(iv) natural gas storage resources: Jackson Prairie and Clay Basin; and

(v) natural gas supply and transportation resources for power generation needs for PSE's electric portfolio.

Please see Chapter 6 of PSE's 2007 Integrated Resource Plan, Exhibit

No. ___(KJH-5), for more current information regarding the Company's natural gas resource portfolio.

Q. Have there been any significant changes to PSE's existing natural gas supply portfolio since the Company's 2006 general rate case?

A. Yes. Four long-term fixed-price gas-for-power contracts will expire on June 30, 2008. The Company also plans to acquire a partial interest in a proprietary natural gas pipeline to serve Sumas, as discussed above.

III. THE COMPANY'S NEED TO ACQUIRE ADDITIONAL ELECTRIC RESOURCES

Q. Does the Company need to acquire additional electric resources?

A. Yes. In several proceedings over the past six years, the Company has extensively documented its need to acquire additional power resources now and well into the future. That need was uncontested in the 2003 PCORC, the 2004 general rate case ("GRC"), the 2005 PCORC, the 2006 GRC and the 2007 PCORC. Nevertheless, I provide below an overview of the analyses underlying the Company's determination, prior to making the acquisitions presented in this case, that it needed to acquire additional long-term electric resources. I also describe the Company's continuing need to acquire additional resources over the next several years.

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Q. What analyses did the Company undertake in determining that it needed to acquire the additional electric resources that are presented in this case?

A. PSE engaged in an extensive process to analyze its long term power resource needs prior to acquiring the resources presented in this proceeding. This process is documented in the Company's 2005 Least Cost Plan. *See generally* Exhibit No. ___(KJH-4). Although PSE has, since then, prepared and filed its 2007 Integrated Resource Plan, the need for the resources presented for a prudence determination in this proceeding was documented in the 2005 Least Cost Plan and the acquisition process began shortly after the filing of the 2005 Least Cost Plan.

The Company's 2005 Least Cost Plan concluded that the Company had a present need to acquire resources for approximately 305 aMW by 2008, growing to approximately 739 aMW by 2011 and to approximately 1,471 aMW by 2013. As shown on page 44 of Exhibit No. ___(KJH-4), PSE was short on an energy basis in eight months during 2006, and PSE's short position was projected to grow over time. By 2012, PSE was projected to be short energy in every month, increasing its dependence on the spot markets for both power and short term transmission services. In summary, the Company had a significant near-term need for resources that was projected to grow materially over time. *See* Exhibit No. ___(KJH-4).

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Q. What was driving the growing need for resources?

A. The 2005 Least Cost Plan determined that the growing need for resources was primarily driven by load growth, the need to replace expiring energy supply contracts with non-utility generators, and the need to replace reductions in energy supply per the terms of existing Mid-C hydroelectric contracts. *See* Exhibit No. ___(KJH-4) at 27.

Q. Does the Company need to acquire even more power resources than those presented in this proceeding?

A. Yes. PSE again engaged in an extensive process to analyze its long term power resource needs to prepare the Company's 2007 Integrated Resource Plan.

The Company's 2007 Integrated Resource Plan concluded that the Company has a present need to acquire resources for 480 aMW by winter of 2010, growing to 1,650 aMW by 2015 and to 2,125 aMW by 2020.

Q. Do the same factors continue to drive the growing need for resources?

A. Yes. As stated in the 2007 Integrated Resource Plan, "[t]he combination of economic growth and expiring supply contracts means that PSE faces large electric resource needs in the years ahead." *See* Exhibit No. ___(KJH-5) at page 8.

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Q. What is the Company's strategy to meet the growing needs noted above?

A. The Company determined in its 2005 Least Cost Plan that it should balance exposure to a variety of risks by adopting a strategy of acquiring a diverse portfolio of resources to meet its needs. This portfolio includes a mix of energy efficiency, renewable and thermal resources. *See* Exhibit No. ___(KJH-4) at 279-80. In its 2007 Integrated Resource Plan, the Company's identified strategy employs aggressive increases in demand-side resources (primarily energy efficiency) and aggressive acquisition of wind resources in order to meet renewable portfolio standards, as well as gas-fired generation to make up the balance of energy needs that cannot reasonably be met through demand-side and renewable resources. *See* Exhibit No. ___(KJH-5) at 218-19.

IV. SOME CHALLENGES FACING PSE IN ACQUIRING ELECTRIC RESOURCES

Q. Does the Company face any challenges in acquiring resources to meet the needs of its electric customers?

A. Yes, there are many challenges associated with acquiring such resources. These include many challenges with which the Commission and stakeholders are already familiar, such as the challenges of analyzing the many different types of proposals presented to the Company and their various potential benefits and risks. In my testimony for this proceeding, I highlight only a few such challenges.

A. Energy Independence Act

Q. Are there any newer challenges facing the Company with respect to electric resource acquisition?

A. Yes. Initiative 937, passed by Washington voters in November 2006, and codified as the Energy Independence Act, RCW 19.285, requires electric utilities with more than 25,000 customers to use new renewable energy of certain defined types, such as wind and solar power, to serve at least 15 percent of their customers' needs by 2020, with benchmarks in 2012 and 2016 to demonstrate progress. Other states in the region have enacted similar requirements for their utilities, including California, Oregon and Montana.

The Company determined in its 2003 LCP that including a significant percentage of renewable resources in its electric portfolio made sense for many reasons. However, PSE now faces increasing competition from other utilities when it seeks to acquire renewable electric resources, whether in the form of generating facilities or PPAs that supply energy from renewable resources. This makes it harder to acquire such resources and tends to drive up the prices of such resources.

Q. How is the Company addressing this challenge?

A. PSE continues to invite proposals for renewable resources and is seeking to be a front runner in acquiring renewable resources. The Company hopes that by being

ahead of the curve on this issue, it will acquire a good share of the more attractive renewable resource projects before increasing competition drives prices up even further. PSE is also taking proactive steps to help "expand the pie" in this area by looking for opportunities to support projects that may lead to attractive renewable resource acquisitions in the future. The demonstration solar project that PSE has installed at its Wild Horse wind facility in is an example of this approach.

Q. Do you have an example as to how this could drive up prices?

A. Yes. In early 2007, PSE commissioned an independent study utilizing a third party consultant to analyze and assess the wind generation market. In early 2000, turbine costs were at or near their lowest levels, approximately $600-$800/kW. Since then, costs have steadily risen due to tighter production capacity, demand for turbines, and the current high level of commodity costs setting power prices. This increase in turbine demand has driven costs to approximately $1,000 – 1,200/kW in 2006. The graph below depicts the early mover advantage for wind turbines. (Wind turbine costs represent approximately 60% of the project cost.)

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Wind Turbine Costs

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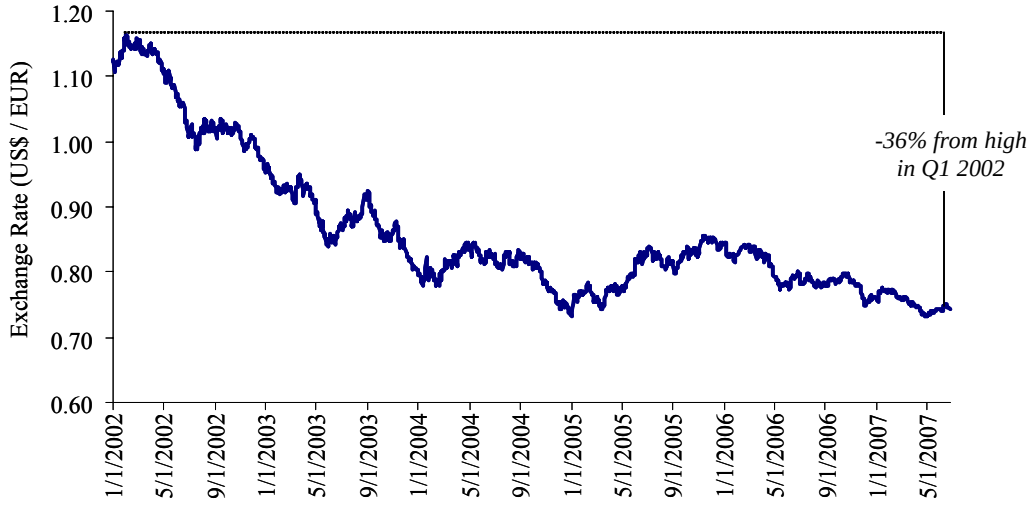
Additionally, the strength of the euro in relation to the U.S. dollar is driving up the cost of wind turbines, as the majority of wind turbine production is controlled by European manufacturers, including Gamesa, Vestas, Enercon, and others. The following chart shows the historical U.S dollar to euro exchange rates for January 2002 through June 2007.

Historical US$ / EUR Exchange Rate
(Jan 2002 - June 2007)



B. Financial Pressures

Q. Are there other challenges facing the Company in acquiring electric resources that are particularly relevant in this proceeding?

A. Yes. Acquisition of resources to meet the continuing, extensive electric resource need summarized above and set forth in PSE's 2007 Integrated Resource Plan will place significant financial pressures on PSE. In addition to the need to raise capital for such acquisitions, PSE must have the financial strength to deal effectively with counterparties, to support long-term power purchases, and to support acquisition of fuel supplies in wholesale markets.

Q. Has the Company projected the potential capital costs associated with meeting its growing energy needs?

A. The Company has projected that potential capital costs of these resource acquisitions could be as much as $1.9 billion dollars over the next six years. This estimate assumes the Company acquires all its needed resources through ownership, not through PPAs. In addition to such direct use of funds, additional credit capacity will likely be needed to provide credit to support portfolio risk management activities, including hedging of fuel supply costs, as described in the testimony of Mr. David E. Mills, Exhibit No. ___(DEM-1CT).

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Q. If the Company were to acquire more PPAs and fewer "hard" assets, would the capital requirement be different than the estimated $1.9 billion?

A. Yes. To the extent the Company is able to meet its resource needs by acquiring PPAs at a lower cost for our customers than owning assets, the Company would acquire such resources. However, PPAs also place capital requirements on the Company. PPAs with terms longer than two years burden the Company with imputed debt and require equity capital support, as discussed in the testimony of Mr. Donald E. Gaines, Exhibit No. ___(DEG-1CT). Furthermore, as described below, the Company must have the financial strength to provide assurance to potential counterparties that it will meet its long-term obligations under such agreements.

Q. Does the Company's financial condition impact its resource acquisition program?

A. Yes. In order to fund the acquisition or construction of additional generation resources, the Company must have the capability to pay cash to asset sellers, contractors, or vendors engaged respectively, in the sale or construction of a facility. To the extent the Company were to wish to partner with others in development and ownership of generating projects, PSE's potential business partners are going to be concerned about the financial strength of the Company and its ability to continue to operate as a strong partner in a project. Similarly, if the Company is the purchaser of energy from a third party in connection with a

PPA, the counterparty must have confidence the Company will be able to perform its obligations under the agreement over the long term. In particular, the Company must have the credit capacity to post cash or other security as may be required as markets move in relation to such purchase obligations.

A company with a strong balance sheet, strong earnings and cash flow and highly rated debt is best positioned to offer such comfort and to transact on favorable terms and conditions. Debt ratings are one of the most widely accepted measures of a company's ability to perform its financial obligations. Generally speaking, the higher one's debt ratings, the more favorable the terms of such debt, including its cost as described by Mr. Gaines and Dr. Roger A. Morin in Exhibit No. ___(RAM-1T).

C. Challenges To The PCORC Process

Q. Have other issues arisen that challenge the Company's resource acquisition efforts?

A. Yes, some of the parties to the Company's 2007 PCORC suggested that the PCORC process should be revisited and potentially eliminated. As part of the settlement of the 2007 PCORC, the Company agreed to participate in a stakeholder review to consider the PCORC process ("PCORC Collaborative"), including whether the PCORC process should continue and, if so, in what form. *See* Docket No. UE-070565, Order No. 07, Settlement Agreement at Section

IV.E. The PCORC Collaborative has concluded and the parties were unable to reach agreement on revisions to the PCORC process. Thus the PCORC process may become an issue in this proceeding.

Q. As Chief Resource Officer for PSE, do you have an opinion regarding whether the PCORC process should continue?

A. Yes, I feel strongly that the PCORC process should continue in something very close to its present form.

Q. Why do you believe that the PCORC process should continue?

A. The Company is allowed to begin collecting the costs of a newly acquired resource in its electric rates only as of the time it submits a request for a rate change and obtains Commission approval for the requested rates. This is true even if the new resource is already providing power to customers. Because it takes more than a year to prepare and complete a general rate case, there can be a significant lag between the time a resource is placed in service and the time the Company begins collecting the costs of providing the power from this resource.

While a Commission order authorizing the Company to defer the costs of the resources for later recovery can prevent the Company from having to entirely absorb the costs of the resource during the lag, this does not prevent the cash flow problems created in the interim. *See* the prefiled direct testimony of John H. Story, Exhibit No. ___(JHS-1CT).

As Chief Resource Officer for PSE, I want my team and the Company's officers to be able to consider and recommend for approval acquisition of resources that are attractive as compared to other alternatives, without regard to whether the exact timing of the resources' placement into service in PSE's portfolio will result in adverse financial consequences for the Company. The PCORC has been very helpful in this regard, because it offers the possibility for much faster approval of resource acquisitions than a general rate case. I believe the PCORC, as presently constituted, is a win-win solution to one of the classic problems of regulatory lag, and helps to align the interests of PSE's shareholders and customers.

Q. What was the original intent of the PCORC?

A. When the Power Cost Adjustment mechanism ("PCA") was created as part of the settlement of the Company's 2001 general rate case, it was intended to true up the Power Cost Rate to all power costs. Paragraph 25 of the Twelfth Supplemental Order states that the PCORC "will look at all costs included within the PCA mechanism."[1] Additionally, page 5 of Exhibit A to the Settlement Stipulation for the 2001 general rate case states that there would be a periodic proceeding specific to power costs that true up the Power Cost Rate to *all power costs* (italics in original document) identified in the Power Cost Rate. Exhibit A goes on to state that "[t]he Company can also initiate a power cost only proceeding to add new resources to the Power Cost Rate." *See* Exhibit No. ___(JHS-8). Thus, in

[1] *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-011570 & UG-011571, Twelfth Supp. Order (2002).

fact, the PCORC has always been as much about updating the level of power costs recovered in rates generally as about bringing the costs of new resources into rates on an expedited basis.

Q. Is this an appropriate time to restrict or materially revise the PCORC?

A. No, I do not believe it is. The Company is facing a large need for additional power resources. The Company's present portfolio of long-term contracts, market purchases and gas-fired power contracts is subject to significant change in the years immediately ahead. Indeed, some of the key drivers to cost changes in this case relate to changes to the current supply portfolio that have occurred just since the recently completed PCORC. Our resource portfolio is highly dynamic and will remain so for years to come. The PCORC process is an essential mechanism to get portfolio cost changes timely reflected in rates. Moreover, the PCORC is an integral component of the PCA, and thus was subject to review by the parties in the 2006 general rate case. The same parties who are now calling for revisions to, or elimination of, the PCORC testified just last year that the PCA was working and should remain unchanged except for the inclusion of gas hedging costs as an allowable PCA expense.[2] Given the testimony that the PCA is working as planned and the opportunity to review the entire PCA (including the PCORC) was explored just one year ago, I see no demonstrated need for wholesale reconsideration of this mechanism at this time.

Q. Does the Company continue to need the PCORC?

A. Yes, the Company continues to need the PCORC mechanism, both as a means of bringing in new generation resources and to true up the Power Cost Rate for all power costs.

V. THE COMPANY'S ACQUISITION OF THE ADDITIONAL ELECTRIC RESOURCES PRESENTED IN THIS CASE WAS PRUDENT

A. Overview

Q. What are the new electric portfolio resources for which the Company is seeking a prudence determination from the Commission in this case?

A. PSE seeks a prudence determination in this proceeding with respect to the following power purchase agreements and acquisition projects, including their associated capital costs, operating costs, transmission costs and other related costs:

- Acquisition of Whitehorn Units 2 and 3 through a lease buyout with Public Service Resource Corporation ("PSRC").
- Four-year winter on-peak power purchase of 150 MW from [redacted]
- 20-year power purchase for 50 MW of the 221-MW Klondike III wind project from PPM Energy.

[2] *See WUTC v. PSE*, Docket Nos. UE-060266 and UG-060267 (Prefiled Joint Testimony of Jim Lazar, Donald Schoenbeck and Yohannes Mariam, on behalf of the Staff of the Washington Utilities and Transportation Commission, Public Counsel and Industrial Customers of Northwest Utilities, p. 28.)

- Two-year extension of a full requirements PPA to serve the Point Roberts load from Powerex Corp.

- Addition of 7.2 MW of wind capacity at the Hopkins Ridge Wind Facility.

- An approximate four-year power purchase agreement with Lehman Commodity Services Group for 50 MW of replacement energy due to the Sumas PPA default.

- An approximate four-year power purchase agreement with Sempra Energy Trading Company for the remaining energy replacement quantity due to the Sumas PPA default.

- Acquisition of the Sumas natural gas-fired combined cycle cogeneration facility, including acquisition of an interest in the natural gas pipeline that serves the facility.

In the following testimony, I sometimes refer to these resources collectively as the "Acquired Resources".

Q. What is your understanding of the Commission's prudence standard?

A. In the Company's 2003 PCORC proceeding, Docket No. UE-031725, the Commission reaffirmed the standard it applies in reviewing the prudence of power generation asset acquisitions:

> The test the Commission applies to measure prudence is what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision. This test applies both to the question of need and the appropriateness of the expenditures. The company must establish that it adequately studied the question of whether to purchase these resources and made a reasonable decision, using the data and methods that a reasonable management would have used at the time the decisions

were made.[3]

In addition to this generic reasonableness standard, the Commission has cited several specific factors that inform the question whether a utility's decision to acquire a new resource was prudent. These factors include the following:

- Acquisition of the Sumas natural gas-fired combined cycle cogeneration facility, including acquisition of an interest in the natural gas pipeline that serves the facility.

- First, the utility must determine whether new resources are necessary.[4]

- Once a need has been identified, the utility must determine how to fill that need in a cost-effective manner. When a utility is considering the purchase of a resource, it must evaluate that resource against the standards of what other purchases are available, and against the standard of what it would cost to build the resource itself.[5] The utility must analyze the resource alternatives using current information that adjusts for such factors as end effects, capital costs, impact on the utility's credit quality, dispatchability, transmission costs, and whatever other factors need specific analysis at the time of a purchase decision.[6]

- The utility should inform its board of directors about the purchase decision and its costs. The utility should also involve the board in the decision process.[7]

- The utility must keep adequate contemporaneous records that will allow the Commission to evaluate its actions with respect to the decision process. The Commission should be able to follow the utility's decision process; understand the elements that the utility used; and determine the manner in which the utility valued these

[3] Order No. 12, Docket No. UE-031725, at ¶ 19.

[4] *See e.g., WUTC v. Puget Sound Power & Light Co.,* Docket No. UE-921262, *et al.,* Nineteenth Supplemental Order (September 27, 1994) ("*Prudence Order*") at 11.

[5] *Id*.

[6] *Id.* at 2, 33-37, 46-47.

[7] *Id.* at 37, 46.

elements.[8]

Q. Did the Company's acquisition of the Acquired Resources meet this standard?

A. Yes. The Company had a clear, documented need for power in both the near and long term. The Company also performed the analyses, decision-making and documentation processes expected by the Commission, as summarized below and explained in more detail in the prefiled direct testimony in this case of Mr. Garratt, Exhibit No. ___(RG-1HCT) and Mr. W. James Elsea, Exhibit No. ___(WJE-1HCT).

B. The Company's Resource Acquisition Strategy Was Informed By The Least Cost Planning Process

Q. What analyses did the Company undertake in determining that it needed to acquire additional power resources?

A. The acquisitions that the Company is presenting for approval in this proceeding were evaluated contemporaneously with the 2005 RFP process that began shortly after the Company filed its 2005 Least Cost Plan with the Commission. As I described earlier in my testimony, the 2005 Least Cost Plan showed that the Company had a significant and growing need for new resources.

During the course of the 2005 RFP process, the Company continued to inform

[8] *Id.* at 2, 37, 46.

itself about developments and opportunities in the marketplace, worked to improve its analytical tools and updated analyses such as long-term resource needs, updated projected development and construction costs of generation technologies, and projected wholesale natural gas and electric prices for use in its on-going long-term planning process. Such data, estimates, and analyses informed the acquisitions presented in this case.

C. The Company Issued a Request For Proposals To Meet Its Resource Needs

Q. How did the Company implement its strategy to meet the growing electric supply needs noted above?

A. Shortly after completion and filing of its 2005 Least Cost Plan, the Company commenced the 2005 RFP process by filing with the Commission a draft "All-Source" RFP under the Commission's competitive bidding rules (WAC Chapter 480-107). The Commission received and considered public comment on the draft RFP and ultimately approved its issuance, with some revisions, in Order No. 01, Docket No. UE-051162.

Q. What response did PSE receive to its RFP?

A. PSE received 48 project proposals from 38 different owners/developers in response to the 2005 All Source RFP. Many of the All-Source proposals contained multiple offers such as purchased power agreements, asset ownership,

and hybrid options. Considering all the options offered under each proposal, more than 120 different proposals were submitted. Mr. Garratt's prefiled direct testimony presents the results of the RFP in greater detail.

Q. How did the response to the 2005 RFP compare to the response to PSE's previous RFP?

A. While PSE was generally pleased with the number of proposals, there was a noticeable upward shift in proposed prices and costs and many faced considerable development and execution challenges. From a review of the resources presented, it appears that much of the "low-hanging fruit" is gone and renewable resources, especially, are going to be difficult to obtain in sufficient quantity to meet the requirements of the Energy Independence Act.

Q. Could you elaborate on renewable resources that were proposed in response to the 2005 RFP?

A. Yes. The Company received a proposal for one small geothermal project, but no proposals for any biomass, commercial solar, wave or tidal power projects. Projects powered by wind energy, the most abundant renewable resource, face many challenges with respect to permitting, acquisition of transmission service, acquisition of integration service and timely and economic acquisition of turbines and construction services.

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D. The Company Evaluated The Resource Alternatives Proposed In Response To The RFP Using Current Information That Adjusted For Appropriate Factors And Risks

Q. How did the Company evaluate the proposals that were submitted in response to the All Source RFP?

A. Because this Commission and stakeholders are already generally familiar with the Company's evaluation process, I summarize that process at a very high level. Generally, the Company engaged in a comprehensive process to evaluate the costs and risks associated with each proposal, both as individual projects and when viewed as potential additions to the Company's resource portfolio. PSE evaluated the proposals in two stages based on the criteria set forth in its RFP. These criteria were designed to take into account qualitative and quantitative factors impacting the decision whether to acquire a potential resource. They included consideration of end effects, dispatchability, transmission costs, capital costs, impact on the Company's credit quality, and project feasibility, among other factors.

A more detailed description of the Company's 2005 RFP process is presented in this case in the prefiled direct testimonies of Messrs. Garratt and Elsea.

Q. Would you please summarize the estimated costs and benefits of each of the Acquired Resources?

A. Yes.

1. Acquisition of the Whitehorn Units 2 and 3 provides benefit to PSE's customers through ownership control of this capacity resource. The lease buyout is estimated to produce an economic benefit of approximately $2 million to PSE's portfolio. As compared with other capacity offers, this acquisition was among the most competitive. By owning this asset, potential synergies may be gained among PSE's natural gas-fired generation fleet.

2. The four-year winter on-peak power purchase of 150 MW from [redacted] provides PSE with on peak power that is shaped to PSE's highest deficit months, December, January, and February. The estimated portfolio benefit is approximately $11.9 million.

3. The 20-year power purchase for 50MW of the 221-MW Klondike III wind project from PPM Energy provides additional renewable energy in PSE's portfolio and helps the Company meet the renewable standards set forth in the Energy Independence Act. The PPA purchase is estimated to provide a portfolio benefit of approximately $22.8 million.

4. The two-year extension of a full requirements PPA to serve the Point Roberts load from Powerex Corp. provides PSE time to explore the potential for a wholesale distribution tariff with BC Hydro. Point Roberts is electrically isolated from PSE's service territory. Without a BC Hydro wholesale distribution tariff, PSE does not have the ability to physically supply power to Point Roberts.

5. Addition of 7.2 MW of wind capacity at the Hopkins Ridge Wind Facility provides PSE with an opportunity to optimize additional permitted land in return for incremental power generation. The estimated portfolio benefit of this infill project is approximately $5 million.

6. The approximately four-year power purchase agreement with Lehman Commodity Services Group for 50 MW of replacement energy due to the Sumas PPA default replaces a portion of the estimated lost energy. This PPA purchase was the most competitive offer in PSE's initial solicitation for replacement power.

7. The approximately four-year power purchase agreement with Sempra Energy Trading Company for the remaining energy replacement quantity due to the Sumas PPA default provides PSE with the remaining Sumas replacement energy. This energy is shaped to reflect, as much as possible, the estimated monthly average energy that would have been provided under the PPA. Sempra was the most competitive offer in this final round of bidding.

8. Acquisition of the Sumas natural gas-fired combined cycle cogeneration

facility [redacted]

E. The Company Informed and Involved its Board of Directors

Q. Has PSE actively involved its Board of Directors in its resource acquisition process?

A. Yes. PSE's Energy Resources Group made several presentations to the Board of Directors and the Company's Energy Management Committee regarding the status of the Company's analyses of the many potential resource opportunities it was considering to meet its need for additional resources. *See* Exhibit No. ___(KJH-6HC) for presentations to the EMC and Exhibit No. ___(KJH-7HC) for presentations to the Board. The Board was thereby advised of the management team's evaluation methods, key assumptions, and preliminary conclusions as the RFP evaluation progressed.

F. The Company Kept Contemporaneous Records of its Evaluation and Decision Processes

Q. Did the Company keep contemporaneous records of its evaluation and decision processes?

A. Yes. The exhibits submitted with my testimony and with the respective testimonies of Messrs. Garratt and Elsea demonstrate the Company's

contemporaneous documentation.

VI. UPDATE ON BAKER RIVER PROJECT, SNOQUALMIE PROJECT AND WHITE RIVER SALE

A. Relicensing of the Baker River Hydroelectric Project

Q. Please provide an update on the current status of the relicensing of the Baker River Hydroelectric Project.

A. The Company is still waiting for the Federal Energy Regulatory Commission ("FERC") to act on the Company's offer of settlement that was submitted to FERC in November of 2004 ("Baker Settlement"). The Baker Settlement was reached through an extensive collaborative process that included numerous federal and state agencies, Indian tribes, municipalities and environmental groups. Since the Baker Settlement was submitted to FERC in 2004, the Company has been working with the parties to the Baker Settlement to obtain various federal, state and local regulatory approvals, which must be secured before FERC can approve the Baker Settlement and issue a new license.

Q. What is the status of the Company's efforts to secure these regulatory approvals?

A. All but one of the required approvals have been obtained. The approvals obtained include the following:

- Final Environmental Impact Statement issued by FERC in September 2006;
- Shoreline permits issued by Town of Concrete in May 2007; and
- Water Quality Certification ("WQC") and Coastal Zone Management Act consistency determination ("CZMA Determination") issued by the Washington State Department of Ecology ("Ecology") in May 2007.

Additionally, in November 2007, the Company reached a settlement with certain cities and dike districts in Skagit County that had appealed various permitting and Ecology decisions relating to the Baker project. With the settlement of these appeals, there are no further appeals pending.

The one regulatory approval still pending is the National Oceanic and Atmospheric Administration ("NOAA") Fisheries Biological Opinion that must be submitted to FERC pursuant to Section 7 of the Endangered Species Act. We understand that NOAA Fisheries is very near to completing its Biological Opinion and will be submitting this document to FERC in the near future. Once NOAA Fisheries submits its Biological Opinion, all prerequisite regulatory review and approvals will have been completed, and FERC will be able to act upon the Baker Settlement and issue a new license.

Q. Have any of these regulatory approvals materially altered the Baker Settlement?

A. No. The hard work and involvement of these agencies in the collaborative process that led up to the Baker Settlement yielded regulatory results that are fair and well within the expectations of the parties to the Baker Settlement.

B. Snoqualmie Falls Redevelopment Work

Q. Please provide an update on the redevelopment work scheduled for the Snoqualmie Falls Hydroelectric Project.

A. On June 29, 2004, FERC issued a license to operate the Snoqualmie Falls Hydroelectric Project, FERC Project No. 2493. The project consists of a dam and two powerhouses located on the Snoqualmie River in the City of Snoqualmie and King County, Washington. PSE began implementing the License in 2004 and commenced work in July 2004 when it initiated upgrades to Plant 2.

Concurrent with these efforts the U.S. Army Corps of Engineers ("Corps") implemented a flood control project that removed natural obstructions to the river channel upstream of the PSE facilities. Technological advancements identified through the process of detailed engineering and design, coupled with changes to the river hydrology and channel alignment attributable to the Corps project, led to re-examination of alternative means to replace the diversion dam and refurbish Plant 1.

To address these changed circumstances, PSE is proposing revisions to the diversion dam and to the proposed modifications to Plant 1 as contemplated in the license. PSE is also proposing further modifications to the Plant 2 powerhouse and gatehouse that are necessary to implement improvements to these facilities that are required by the license. The Company has prepared and will submit to FERC in December 2007 an Application for Non-Capacity License Amendment,

reflecting these proposed modifications. In order to accommodate the regulatory filing and approval of the proposed amendment application, the outage schedule has been updated to reflect an April 2009 start date as as shown in Exhibit No. ___(KJH-8C).

C. Sale of Surplus White River Assets

Q. What is the status of the Company's efforts to dispose of its surplus White River Assets?

A. PSE retired the White River Hydroelectric Project in January of 2004. Since then, the Company has been pursuing a range of alternatives and working with various interested parties within the region to effect a sale of these surplus assets on commercially reasonable terms. Marshalling these assets to a point where they can be sold on reasonable commercial terms has taken years of hard work and close attention to the interests of a large number of stakeholders. Also, an appeal of Ecology's 2003 decision to issue a new municipal water right has complicated the Company's efforts to sell this asset, the reservoir and the properties required to maintain and develop a municipal water supply project. Ecology's 2003 water right decision was remanded, and no firm date has been established for Ecology's final decision following the appeal and remand.

At the time of Ecology's initial decision, the Company negotiated a memorandum of understanding that proposed terms of a potential sale of these assets to a

consortium of municipalities known as the Cascade Water Alliance ("Water Alliance"). Over the ensuing four year period, the Water Alliance has conducted extensive due diligence investigations into the characteristics and conditions of the Company's water rights, the reservoir, the 11 dikes that impound the waters of Lake Tapps, and the property it will require to operate a municipal water supply project in the future. Concurrent with these due diligence efforts, the Water Alliance has sought to resolve the issues underlying the appeal of the 2003 water right, working with the Muckleshoot Indian Tribe, the Puyallup Indian Tribe, Pierce County, the Lake Tapps Community Council, and various other interested parties.

While these efforts move forward, the Water Alliance has been working with the Company to finalize the terms and conditions of a sale of the surplus assets. This includes all water rights for maintenance and operation of the reservoir, the reservoir, and approximately 3,500 acres of land that include the diversion dam, the flow line, the old power house and the tailrace properties. The Water Alliance has indicated that it hopes to be in a position to execute an agreement with the Company in January 2008. Additionally, PSE continues to work with other parties to maximize the value of the lands that the Water Alliance does not need.

Q. Are there any other developments?

A. Yes. The Company continues to work with the Corps to address its interest in acquiring certain rights that the Corps needs for fish passage facilities. At this

time, it is most likely that the assets the Corps is seeking will be transferred to the Water Alliance and the Water Alliance and the Corps are cooperating with the Company to effect this transfer.

Q. What has the Company done to limit its costs while seeking to dispose of these assets?

A. Costs associated with pursuing the municipal water right have been shared with the Water Alliance on a going-forward basis. The Company will be fully reimbursed for all of these costs when the transaction closes. The agreement with the Water Alliance also covers the cost of certain capital improvements needed to maintain the reservoir in a safe condition. For example, at the direction of Ecology's Dam Safety Office, the Company was required to make improvements to certain dikes at Lake Tapps, at a total cost of $4 million. This cost was shared with the Water Alliance and will be fully reimbursed when the transaction closes

The Company also has a contract with the Corps to cover the operation and maintenance costs of the White River diversion dam. Corps payments cover the cost to operate the dam in support of the Corps' fish passage operations.

VII. CONCLUSION

Q. Would you please summarize your testimony?

A. PSE continues to have a significant need to acquire resources to serve its electric customers. The Company faces challenges in its efforts to acquire new resources

as competition for attractive projects, particularly for renewable resources, is increasing. Acquisition of new resources will also continue to require very large investments of capital. The Company must also have the financial strength to support its negotiating position with counterparties to PPAs and with project developers. The PCORC process helps to address the financial pressures faced by the Company in acquiring resources for its customers, and should be retained.

In the meantime, PSE's acquisition of the resources identified in my testimony has helped to meet this resource need and clearly met the Commission's standard for prudency. The Company's long-term electric acquisition program continues to succeed in bringing into the Company's portfolio acquisitions that meet the customers' load requirements, that have been thoroughly analyzed in a process that meets the Commission's prudence standard and that accordingly should be approved for recovery in rates.

Q. Does that conclude your prefiled direct testimony?

A. Yes, it does.