

Attachment A

Joint Answer of Staff, Public Counsel, and Complainants and other Staff Issues

Staff, Public Counsel, and the Complainants offer the following answers to the questions and request for comments posed in paragraphs 90 and 92 of the Sixth Supplemental Order in Docket Nos. UE-001952 and UE-001959 (Consolidated). The joint answers and comments are followed by Staff comments on several related issues.

1. How is the \$25/MWh margin proposed to be included in PSE's costs when the Mid-Columbia market index is less than \$25/MWh higher than PSE costs?

The answer depends on the level of the Mid-C Index at the time. If the Mid-C Index is at \$125/MWh or below, the \$25/MWh margin does not come into play. The rate billed to the customer is the index in that situation. The \$25/MWh margin comes into play only in those periods when the Mid-C Index is greater than the initial soft-cap level of \$125/MWh. In that situation, PSE bills at the \$125/MWh cap unless PSE's costs plus the margin exceed \$125/MWh, but only up to the Mid-C Index. This can result in PSE collecting less than a \$25/MWh margin. In those periods in which PSE's costs may increase more than the index, PSE may not collect the full amount of the margin. Example: If the index is at \$130/MWh and PSE's costs are \$120/MWh, the soft cap would increase only to \$130/MWh (the maximum allowed) with an "effective" margin of \$10/MWh. If the market index then rises to \$145/MWh and PSE's costs remain the same (\$120/MWh), the soft-cap would rise to \$145/MWh, allowing for full recovery of the \$25/MWh margin amount. If the index then rose to \$200/MWh and PSE's costs remained the same (\$120/MWh), the billing rate would remain at PSE's costs (\$120/MWh) plus the \$25/MWh margin, or \$145/MWh. Note that in none of these examples did PSE bill above the Mid-C Index.

2. Does the answer depend on whether PSE's proven costs are above or below the soft-cap level?

The answer depends on a comparison of "PSE's cost plus margin" to the market index level in a particular period. The market index acts as a ceiling in all cases, which may result in the margin being "squeezed" if PSE's costs rise at an amount greater than the market index. This would only apply if the market index is above the initial soft-cap level of \$125/MWh. The most drastic example would be a market index of \$126/MWh and PSE costs of \$126/MWh. In this period, no margin would be collected. In the event PSE's cost may be above the market index, the billing rate is equal to the index, as in the present Schedule 48 and Special Contracts. A justification for the potential margin "squeeze" is that as PSE's costs increase to levels approaching the index, PSE should be relying more and more on that market rather than the use and management of its own resources, thus reducing both the need and appropriateness of fixed cost recovery from these customers.

3. Is the soft-cap to be applied on an hourly, daily, or monthly basis?

Staff, Public Counsel, and Complainants propose that the cap mechanism be applied on a DAILY basis (including both off-peak and on-peak hours). This approach maintains the current billing methodology to the fullest extent possible. The market index is a daily index (having both an off-peak and on-peak component). We believe that the application of a daily cap would reflect the most accurate cost information readily available and is the most appropriate method to mitigate daily market index spikes. We believe that a daily cap mechanism (such as set forth below) can be reasonably implemented by PSE with little administrative burden using available information and would be auditable. Using anything other than a daily mechanism, would result in the "smoothing" of market index amounts or of costs. The intent of the Staff/Public Counsel proposal was to "clip" the extreme peaks in the market index, not smooth their effect throughout the billing period. A daily mechanism does is consistent with that intent.

4. What factors are to be included and what factors are to be excluded from PSE's demonstration of costs in the event the Mid-Columbia index exceeds the soft cap? For example, are existing or future contracts with third-parties covering the next several months to be considered as superior or subordinate to costs incurred to serve Schedule 48 and Special Contract customers?

Staff, Public Counsel, and the Complainants believe the "top-down" approach to estimating period costs to serve the Schedule 48 and Special Contract customers is the best balance between accuracy and administrative burden. Therefore, secondary market transactions should be netted against one another as the first step in identifying the incremental resources used to determine the relevant costs. These are the transactions that have been identified and included as "Secondary Purchase" and "Secondary Sales" in the tables contained in Exhibit C-604. This would, in effect, eliminate or at least minimize the potential for secondary market transactions, made independent of serving native load, to affect the determination of appropriate costs. Existing long-term wholesale sales and purchase commitments, to the extent they are in effect during the effective period of this rate cap, should be considered as current firm obligations of PSE, and would be superior to the Schedule 48 and Special Contract customers when evaluating costs to serve. These are the commitments that have been identified and included as "System Load" or as "Contracts" in the tables contained in C-604. Regarding future long-term transactions, only those commitments made as a result of existing extension rights should remain superior to the Schedule 48 and Special Contract customers. Other transactions during the period the rate cap is in effect would be treated in the same manner as the "discretionary short-term" transactions for purposes of implementing the soft cap. Finally, the assumptions regarding the status of long-term wholesale transactions and Schedule 48 and Special Contract customers only apply in the context of implementing this rate cap mechanism.

5. If the Mid-Columbia index exceeds the soft cap, what process is necessary to provide PSE the opportunity to demonstrate the level of its costs?

Staff, Public Counsel and Complainants propose the following methodology for determining the level of PSE's "demonstrable" costs in order administer the Optional Rate Cap Mechanism. We believe that the daily information required under this methodology is readily available to the company and will provide a reasonable estimate of the costs under the rate cap assumptions. Customer load and daily Mid-C Index amounts are used in the current tariff administration process. The only new information to be reported and tabulated is the daily generation and cost information related to the company's resource portfolio, as well as daily market transaction information.

The additional data that Staff, Public Counsel and Complainants propose be used to determine costs is similar in format to the tables in Exhibit C-604. The first column would identify, as in Exhibit C-604, various cost, load, resource, contract, and market transaction components. For each day, we propose that two columns be prepared. The first would include the daily energy amount (in aMWs) associated with the company's system load, owned thermal resources, other generation, existing contracts, and secondary transactions. (see existing columns in Exhibit C-604) The second daily column would include the incremental cost, if any, for each of the resources and contracts identified. For secondary transactions the weighted average rate for sales and purchases should be reported. Mid-C Index and customer load information could also be included as part of this data table.

When the Mid-C Index exceeds the initial rate cap level, the company can determine if its actual costs for that period (including both off-peak and on-peak hours) would result in an increase in the rate cap level using the data described above and the following criteria:

Net the aMW of secondary transactions. If the net result shows a negative amount (sales are greater than purchases) the company is assumed to be in surplus during that period. If the net result is positive (purchases are greater than sales) the company is assumed to be deficit.

If in surplus, the cost to serve the Schedule 48 and Special Contract customers is estimated by first looking at the highest cost resources. The net amount from secondary transactions would be applied to the highest cost resources under the assumption that these resources would be the ones supporting the secondary sales. Otherwise, the availability of resources, in descending order of incremental cost, would first be reduced by the net surplus amount. The cost to serve the Schedule 48 and Special Contract customers would then be estimated by applying their daily loads to the remaining available highest cost resources, in descending order of cost, until the customer load level has been matched. A weighted average cost per aMW should then be calculated using the respective resource costs. Alternatively, if use of actual daily customers loads presents difficulties, a "block" of load that approximates the daily load of these customers could be used to calculate an estimated weighted cost. The weighted average cost would then be used to determine any adjustment to the initial soft cap, if appropriate under the conditions of the rate cap tariff.

If in deficit, it is assumed that the net purchases were made to serve the Schedule 48 and Special Contract customers. Costs are estimated by first applying the net secondary purchase amount to the customer load and then applying their remaining load to the remaining available highest cost resources, in descending order of cost, until the customer load level has been matched. A weighted average cost per aMW should then be calculated by using the respective resource costs. The weighted average cost would then be used to determine any adjustment to the initial soft cap, if appropriate under the conditions of the rate cap tariff.

PSE may, with the approval of the Commission, adopt appropriate simplifications to the “demonstrable cost” calculation as agreed to by the parties. One such simplification may be limiting the required resource availability and cost reporting only to those resources actually deemed to be incremental under various load and resource scenarios. We would anticipate that given such simplification, there may be the need, on occasion, to add or subtract incremental resources as others go in or out of service for various reasons.

6. What are the implications of setting a soft cap at the proposed \$125/MWh, when caps in the California wholesale power market are at \$150/MWh and the Federal Energy Regulatory Commission has under consideration a Western wholesale market-wide cap?

First, the Staff/Public Counsel rate cap proposal was aimed at addressing an immediate need as a result of the "broken" Mid-C Index. Second, the \$150/MWh cap in California is simply a soft-cap that triggers certain reporting requirements. It is not a hard cap and it is not a cap that has been applied to all regional markets. We do not believe the presence of the existing cap in California provides a complete solution to the issues related to Schedule 48 and the Special Contracts in this proceeding.

Regarding the potential for a Western wholesale market-wide cap of \$150/MWh. Staff, Public Counsel, and the Complainants believe the \$125/MWh would remain appropriate. We believe it reflects the current situation in the region today, from both the standpoint of customer generation alternatives and the cost of operating PSE's available resources. The presence of a \$150/MWh cap can, at a minimum, benefit PSE in the form of lower risk in the event the company has to enter into the market to serve any of its load. The Staff/Public Counsel rate cap proposal would allow PSE to recover those costs, if, indeed, it is required to do so. We continue to believe that these non-core customers taking service under PSE tariffs should get the benefit of existing PSE resources BEFORE third-parties receiving non-firm wholesale energy in the discretionary

secondary market. A rate cap level based on both the regional environment and PSE specific resource costs is appropriate. Finally, given the potential for Western market-wide rate caps, we would also encourage the Commission, in any evaluation of rate cap impacts presented by the parties, to consider using as a base level the financial standing of the company WITH THOSE RATE CAPS IN PLACE, rather than financials based on revenues received as a result of the "broken" market. We believe this is consistent with PSE's own pleadings at the FERC in which it advocated a consistently applied regional cap. PSE should have already accepted the financial impacts of that recommendation in regard to the revenues received by the company as well as its effect on costs. We do not believe the implementation of regional wholesale market caps would have a corresponding effect on the companies costs, since the evidence has shown that PSE's entry into the market to serve load is limited.

7. Schedule 49 Rate Floor

We propose that this floor be implemented by comparing the delivered cost of energy under the Optional Rate Cap Mechanism (on a monthly basis) to the delivered cost under Schedule 49 or other applicable tariff (on a monthly basis). The minimum billed amount should be equal to the greater of those two amounts. We believe this would properly implement the Commission's Order.

8. Other issues

There are several additional issues that Staff believes appropriate to bring to the Commission's attention in implementing the rate cap. First, Staff cannot anticipate all potential "gaming" issues that PSE or the customers could partake in as a result of implementing the soft cap proposal. While we are certainly not anticipating any party would undertake such actions, we encourage the Commission to adopt strong language in the event any such action is discovered (after appropriate due process) in any auditing process carried out by Commission Staff or other parties. This rate cap mechanism is

temporary and is meant to address immediate needs. Staff believes the Commission should clearly state that it may, upon its own motion, alter any part of the rate cap mechanism or eliminate the optional rate cap mechanism in its entirety.

The second issue regards the confidentiality of information provided by the PSE in order to demonstrate its costs, if necessary to raise the soft-cap amount. The parties are sensitive to the nature of the cost data required for any such showing. Therefore we propose that Staff retain audit responsibility during the period of time the rate cap is in place, subject to appropriate confidentiality process. The customer's ability to audit the data provided by PSE would be limited to a one-time review upon termination of the Optional Rate Cap Mechanism.

Finally, Staff believes it appropriate that the Commission clarify its intent on the duration of the proposed rate cap mechanism. We proposed that the Optional Rate Cap Mechanism remain in place until all of the Schedule 48 customers have chosen to move to an approved Schedule 448 (Docket No. UE-010038) (at which time the existing Schedule 48 would be closed), or Schedule 48 is replaced with alternative tariffs that may result from the Schedule 48 Review process (Docket No. UE-010046). The Commission may wish to set a different termination date.