Exhibit No. T-113 (WAG-T)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Application of PUGET SOUND ENERGY, INC. for (1) Approval of the Proposed Sale of PSE's Share of the Centralia Facilities, and (2) Authorization to Amortize Gain Over a Five-Year Period.	Docket No. UE-991409 APPLICATION

REBUTTAL TESTIMONY OF WILLIAM A. GAINES

December 22, 1999

PUGET SOUND ENERGY, INC.

Rebuttal Testimony of William A. Gaines

Q. Please state your name.

A. My name is William A. Gaines.

Q. What topics will you be covering in your rebuttal testimony?

A. I address issues raised in the testimony of the following witnesses: Jim Lazar, Ken Elgin, Nancy Hirsh, Lincoln Wolverton and Alan Buckley.

Q. Are other witnesses offering rebuttal testimony on behalf of PSE?

A. Yes. Karl Karzmar addresses issues raised in the testimony of Roland Martin and Alan Buckley.

Overview

Q. Please summarize your rebuttal testimony.

A. We take exception to Mr. Lazar's analysis. Our efforts uncovered significant errors in Mr. Lazar's work, including his calculation of market prices from a preliminary and un-published forecast by the NWPPC. This error alone creates a variance of hundreds of millions of dollars, as I explain in more detail below. We found numerous other errors, which are also explained below.

Perhaps more important, Mr. Lazar's analysis ignores the substantial risks posed to PSE and its customers by the very real possibility that the Centralia facilities will be subject to early closure. The risks there are significant; selling the facility eliminates those risks for customers.

Q. Have your conclusions changed with respect to the sale of the facility?

A. No. We are confident that both the sale of Centralia and PSE's proposed accounting treatment of that sale are appropriate.

The Opposition Ignores The Risks Associated With Early Closure

Q. Did Mr. Lazar take account of the risk of early closure of the facilities?

A. Not in the financial analysis he presents to the Commission. To the contrary, he extended the life of the facilities beyond what he has, in the past, recognized as a reasonable life for a coal-fired generation facility.

Q. Why do you believe early closure is a significant possibility?

A. For several reasons, the most important of which is environmental issues. Those issues, combined with the unworkable current divided ownership arrangement make early closure a significant possibility.

Q. Why would early closure harm customers?

A. The risks we have identified with continued ownership of the Centralia facilities would all be accelerated. These risks include: mine closure costs, including reclamation of the site and mine buyout costs; plant closure costs, including write-off of existing facilities and any new investment in the facilities; and possibly House Bill 1257 costs as a result of closure of the mine. The magnitude of these costs are large; any evaluation of the sell / keep decision must take account of them.

The Opposition Ignores The Purpose And Effect Of The Rate Plan

Q. Do you agree with the opposition testimony regarding the effect of the rate plan?

A. No. In general, the opposition cases suggest that because of the rate plan, special accounting treatment is necessary to ensure that the Commission confiscates any benefits of the sale.

Q. Why, if at all, does the fact that PSE is in a rate plan period make any difference in the analysis?

A. In one important respect, it makes no difference at all. The basic premise of the rate plan was that PSE would be free to conduct its business and pursue aggressive management initiatives. The plan itself recognized that customers were getting the benefit of the rate plan by receiving rates lower than otherwise would have been possible. Like a prepaid phone card, the rate plan provided benefits up front. The "payment" in this instance was granting PSE the ability to manage its business for a five-year period and capture all of the benefits of its management decisions during that time period. The opposition parties ignore this basic principle, by attempting to confiscate all of the gain on the sale and any power cost savings. Their position cannot be reconciled with the merger order and is, in large part, the basis for PSE's appeal of the Colstrip order.

Response to Public Counsel

Q. Why shouldn't the Commission rely on Mr. Lazar's presentation, which seems to suggest that the price offered for the Centralia facilities is too low?

A. Although Mr. Lazar presents some startlingly large numbers, they are unreliable. It would be a mistake to place any weight on them. Mr. Lazar's analysis suffers from at least the following defects:

- Mr. Lazar presents his market analysis as if it were the latest and most accurate NWPPC forecast. It is not. The NWPPC continues to improve their forecast of power market prices using the AURORA model. The NWPPC has several versions of their current study. Mr. Lazar selected the September version. There are November and December versions as well.

- It is not so much the version of the study that is troubling, but rather the way that Mr. Lazar manipulated the numbers. He chose to calculate the monthly market price by multiplying the on-peak price by 70% and the off-peak price by 30%. Within AURORA the on-peak hours represent about 57% of the hours and off-peak hours represent 43% of the hours. This mistake alone causes Mr. Lazar's market prices to be erroneously high by 1 mill in the early years to 3.5 mills in the later years and to overstate his projected values of keeping Centralia by approximately $270 million.

- If the November version updated NWPPC numbers are substituted into the PSE analysis, Scenario #1 of Exhibit 114 (WAG-7), the NPV changes less than $9 million. The November version was used in preference to the December because a senior resource analyst at the NWPPC has indicated that the November version (dated 11/29) should be considered the current base forecast.

- Mr. Lazar makes several other analytical mistakes in his model. For example, on page 2 of Exhibit 501, he presents what he represents to be a NWPPC forecast for November 1999, but that forecast is from September and appears to be different from the one he uses on pages 7-12 of Exhibit 501. Moreover, he rests his conclusions in part on his assertion that PSE presented lower market forecasts in this proceeding than in the Colstrip proceeding. This assertion is flat wrong, as will be shown at the hearing.

- In an effort to create more "value" in Centralia, Mr. Lazar extends the life of the Centralia facilities beyond what Mr. Lazar himself has testified is a reasonable life for a coal-fired generation facility. This manipulation adds millions of dollars to Mr. Lazar's value analysis. In addition it is important to note these dollars are a result of the out year forecasts (which are Mr. Lazar's extrapolations of earlier forecasts) and thus are highly uncertain.

- Mr. Lazar gives little more than lip service to the qualitative factors that favor selling the Centralia facilities. And nowhere does Mr. Lazar acknowledge the significant risk that early closure of the facilities poses to PSE's customers.

Q. Explain the mistake Mr. Lazar made with the NWPPC forecast.

A. As mentioned above, he calculated the monthly market price by multiplying the on-peak price by 70% and the off-peak price by 30%. This adjustment cannot be justified. Within AURORA itself, the on-peak hours represent about 57% of the hours and off-peak hours represent 43% of the hours. Mr. Lazar's change results in a higher forecast. The mistake standing by itself causes Mr. Lazar's market prices to be erroneously high by 1 mill in the early years to 3.5 mills in the later years. Using a different allocation, other than one based on the actual on-peak and off-peak hours, might be justified if it were used to reflect the dispatch value of the plant. But in this case, Mr. Lazar is already making a dispatch adjustment. In essence, Mr. Lazar has double counted the dispatch value of the plant and grossly overstated the market price estimate.

In addition, it is important to note that all of the forecasts are a moving target. Although there is a general belief that markets have risen over the past several months, that trend is subject to change at any time. It wasn't that long ago that respected industry analysts were predicting oil would cost $50 / barrel, that inflation would continue at 10% or higher for years, and that the stock market would never break the 3,000 point barrier. Indeed, if any of us could reliably forecast market changes with any precision, neither money nor work would be an issue for us – but that is not the case. Thus, to place too much weight on any given point estimate of the market is dangerous.

Q. **Explain the other mistakes in Mr. Lazar's presentation.**

A. Exhibit 501 drives much of Mr. Lazar's testimony. Yet it is internally inconsistent and, in places, simple unexplainable. On page 2 of Exhibit 501, Mr. Lazar presents column 9 as the "NWPPC 11/99" forecast, but it is not. It is his erroneously calculated summary of the September version of the NWPPC work. Mr. Lazar's analysis also adds 1.0 mill for capacity, but that adjustment makes no sense because the AURORA market prices implicitly include the value of capacity. New generation resources are added to the model because during periods of peak demand and supply scarcity pricing is based on variable costs of very expensive thermal generation or on demand side measures that may exceed the cost of any thermal generation. These high priced peak periods provide justification for new generation facilities – there is sufficient revenue potential to make new resources added to the system economic (including their capital costs or "capacity costs") to place in service. Mr. Lazar's failure to recognize this aspect of the model causes an overstatement in his "value" calculation of approximately $93 million. Similarly, Mr. Lazar includes an overstated shaping adjustment. Applying even conservative assumptions, Mr. Lazar's assumption causes an overstatement of value of at least $46 million. These two mistakes, combined with the mistaken reliance on a set of market numbers that he incorrectly presents as a forecast, results in an overstatement of value in excess of $400 million. Errors of this magnitude call the entire analysis into question.

Q. **Why do you disagree with Mr. Lazar's assumptions regarding life of the plant?**

A. The Centralia facilities are now 27 years old. Our analysis, submitted as part of the application for approval to sell the facilities assumes the plant will last 46 years – which is beyond the reasonable expected life of a coal-fired generation facility. In fact, the anticipated life of the plant was, at the time of installation, and continues to be, 40 years. A 40 year life expectancy is consistent with Mr. Lazar's views before he became involved in this litigation. In 1984, Mr. Lazar published his views about the expected life of coal-fired generation facilities. This is what he said:

"The generally accepted lifetime of a coal plant is about 35-40 years."[1]

By Mr. Lazar's own standards, PSE's 46-year estimated life is too long.

Q. If the Commission disregard's Mr. Lazar's analysis, what analysis should the Commission consider in making its decision?

A. The Commission should rely on an analysis that:

- Assumes an appropriate life for the facility.
- Does not rely on an unendorsed, preliminary, incorrect market estimate by NWPPC.
- Does not contain the mistakes included in Mr. Lazar's analysis.

PSE's model meets these criteria. Mr. Lazar's does not. Exhibit 114 (WAG-7) presents the results of PSE's revised analysis.

Response To Commission Staff

Q. Do you agree with Commission Staff that the Centralia facilities should be sold?

A. Yes. Commission Staff recognizes just as the other sellers do that there are significant benefits to all parties if the sale is approved. Not only does the sale remove a large uncertain contingent risk associated with early plant and mine closure, but it also removes all of the risks associated with an increasingly unworkable joint operating agreement and, more important, with the operation of a facility that is likely to be subject to increasingly strict environmental regulation in the future.

Q. Do you agree with Commission Staff's proposed accounting treatment?

A. No, for several reasons. First of all, it ignores the real economic benefits customers are already receiving. Second, as explained above, Staff's approach ignores the fundamental bargain struck as part of the merger settlement. Third, as explained above, Staff's proposal assumes that customers rather than the company own the facilities – which is not true. Fourth, Staff's suggestion that power cost savings be confiscated is based on an error, i.e., that under the rate plan the Commission can and should confiscate power cost savings. Finally, Staff's "just apply the same approach as Colstrip" position ignores the important differences between Colstrip and Centralia. Although qualitative benefits are, by their very nature, difficult to quantify, they are nevertheless real and important. And the qualitative benefits of selling the Centralia facilities are significant. One of the most important benefits is the elimination of environmental liability risk – including mine shutdown (estimated to be over $100 million) and reclamation risks and the risk of

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[1] Jim Lazar, Should Utility Conservation Efforts Continue During A Surplus? (May 3, 1984) (attached hereto as Exhibit 115 (WAG-8)).

increasingly stringent air regulation. These factors should play a significant role in assessing whether Centralia should be sold *and* how customers are benefiting from the sale. Staff's analysis ignores this point. For all of these reasons, Staff's proposal to confiscate the gain and all savings should be rejected.

Q. Why isn't Mr. Buckley's suggested approach an acceptable method for confiscating power cost savings?

A. Mr. Buckley's approach, as I understand it, is to assume that PSE can achieve better than market results in replacing Centralia power, and then confiscate savings – whether or not those savings are achieved – based on a calculation that incorporates that assumption. There are several problems with this approach. The first and most obvious is that, in light of the economics of the proposed transaction and the terms of the merger order, it is inappropriate to confiscate any power cost savings. Second, it ignores the fact that under current assumptions there are no power cost savings during the rate plan period. There is a significant loss during 2000 and a small gain in 2001. The small gain in 2001 is a result of the significant cost of installing the scrubbers. The important point is that during the rate plan period, applying the forecasts show that there are no net power cost savings to defer. Even putting these issues aside, however, there are several problems with Mr. Buckley's approach, including the following:

- The Commission flatly rejected this approach in the Colstrip proceedings. *See* Fourth Supplemental Order, No. UE-990267, at page 8. The Commission there ruled that to the extent power cost savings were confiscated, only actual achieved savings would be confiscated. Given the highly variable commodity electricity markets, any other result would be unworkable and unjust.

- The approach assumes that PSE will beat the market. PSE takes a great deal of pride in the skills of its employees, including its energy traders and power supply employees, but it would be unreasonable to assume that these employees will constantly beat the market.

Q. Do you agree with Mr. Buckley that PSE's presentation of power replacement alternatives was deficient?

A. No. PSE presented a comprehensive analysis of market scenarios. More important, Mr. Buckley complains that PSE should have undertaken an analysis similar to that done by PacifiCorp, but Mr. Buckley ignores the fact that unlike PacifiCorp, PSE's sale represents only about 70-75 mwh aMW of energy, which is less than two to three percent of annual energy needs. The costs associated with Mr. Buckley's proposal would not produce commensurate benefits or change the results.

<u>Response To Intervenors</u>

Q. Do you agree with the suggestion of the NW Energy Coalition that the Commission should expand these proceedings to impose requirements about the type of energy that must be used to replace Centralia?

A. No, for three independent reasons. First, this suggestion expands the scope of the proceedings beyond the issues necessary for a public interest finding. The question before the Commission is whether selling the Centralia facilities is consistent with the public interest. Questions about types of replacement power can and should be addressed as they arise; those questions do not need to be answered to resolve the question whether the facilities should be sold. Second, the Energy Coalition is proposing a complex RFP process, which will be costly and time-consuming, for a miniscule segment of PSE's overall resource portfolio. The time and cost associated with the process will almost certainly outweigh any benefits. PSE encourages the Commission to set this issue aside for a more appropriate proceeding. Third, it is important to note that the Energy Coalition is proposing replacing Centralia power with uneconomic alternatives. That may change at some future date, but for now, at least, the Energy Coalition is asking the Commission to impose additional costs on customers and the companies.

Q. Do you agree with ICNU's proposal to confiscate the entire gain and all power cost savings for customers?

A. No, for the same reasons set forth above in response to Commission Staff's case.

Conclusion

Q. Please summarize why you believe the sale is in the public interest.

A. As shown in PSE's analysis, the proposed sale greatly reduces risks to customers. In addition, qualitative factors – as recognized by Commission Staff and others – weigh heavily in favor of sale. It would be mistake to block the sale.

Q. Does this conclude your testimony, Mr. Gaines?

A. Yes.

Certificate

STATE OF WASHINGTON,)
)
COUNTY OF THURSTON.)

I hereby certify that the foregoing and attached documents are a full, true and correct copy of Rebuttal Testimony of William A. Gaines in Docket UE-991409, In the Matter of the Application of Puget Sound Energy, Inc. for (1) Approval of the Proposed Sale of PSE's Share of the Centralia Facilities, and (2) Authorization to Amortize Gain Over a Five-Year Period, dated December 22, 1999, and

now on file in the office of the Washington Utilities and Transportation Commission at Olympia.

IN WITNESS WHEREOF, *I have hereunto set my hand and affixed the seal of the Washington Utilities and Transportation Commission, this* 13th *day of May, 2014.*

Secretary of the Washington Utilities and Transportation Commission

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