

**EXHIBIT NO. ___(KJH-1T)
DOCKET NO. UE-11___/UG-11___
2011 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-11___
Docket No. UG-11___**

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

JUNE 13, 2011

PUGET SOUND ENERGY, INC.

**PREFILED DIRECT TESTIMONY OF
KIMBERLY J. HARRIS**

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1 **I. INTRODUCTION**

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

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

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

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

10 **Q. What are your duties as President and Chief Executive Officer for PSE?**

11 A. I have overall management responsibility for PSE. In consultation with our
12 executive team and Board of Directors, I set the Company’s strategic business
13 goals and direct our efforts to achieve those goals.

14 **Q. What is the purpose of your testimony?**

15 A. My testimony provides a high level overview of the rate increases being requested
16 by the Company and the reasons for these requests. I also introduce the
17 Company’s other witnesses in the case and briefly describe the topics that each
18 witness addresses in his or her prefiled direct testimony.

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II. NEED FOR RATE INCREASE

Q. Please explain why it is necessary for PSE to seek rate relief at this time.

A. PSE is acutely aware of the state of the local and national economy and recognizes there is no good time to seek a rate increase. The Company understands the impact to our customers, has taken steps to cut expenses and, as a result, has not filed an electric general rate case in over two years. Since the last electric rate filing in 2009, the Company has invested over \$1.1 billion in new gas and electric facilities that are currently in use serving customers. The costs of these necessary investments are not currently included in rates charged to customers. Having thoughtfully evaluated the necessity of filing for rate relief at this time, we concluded that PSE must balance the near term rate pressures with its obligation to invest in, and operate, its natural gas and electric systems in a safe and reliable manner at all times. At the same time, this rate case filing incorporates savings from cost-cutting efforts and passes through to our customers the benefits of lower commodity expenses.

Q. Given the earnings PSE reported for the first quarter of this year, why is a rate increase necessary?

A. As the Commission has noted, the need for rate relief is not evaluated on the basis of any one single issue but on a comprehensive review of a wide variety of factors that bear on a company's financial performance and its ability to provide reliable service to its customers:

1 The Commission generally will not engage in single issue or "piecemeal"
2 ratemaking. The ultimate determination to be made by the Commission in
3 a rate proceeding is whether the proposed rates and charges are fair, just,
4 reasonable, and sufficient. The Commission has consistently held that
5 these questions are resolved by a comprehensive review of the company's
6 rate base and operating expenses, determining a proper rate of return, and
7 allocating rate changes equitably among ratepayers.¹

8 The timing of a rate case is always difficult to determine since it takes at least 14
9 months to prepare, file and complete, and the process is driven by many moving
10 factors. More specifically as to the Company's first quarter earnings, current
11 ratemaking principles place a high percentage of revenue recovery on the volume
12 of electricity and gas sold. Simply put, weather and, more particularly, variations
13 from average weather used to set rates drive short-term vulnerability and
14 volatility in rates and corresponding revenue.

15 For example, the last two years present a stark contrast of the effect of this
16 weather variability on the Company's earnings. During the first quarter of 2010,
17 the Company's earnings were negatively impacted by lower sales and higher
18 power costs in the first quarter, when temperatures were some of the warmest on
19 record and hydrological conditions were 76 percent of normal at the Grand
20 Coulee basin.

21 In contrast, during the first quarter of 2011, PSE's earnings were positively
22 impacted by increased energy sales volumes attributable to temperatures that were

¹ MCI Telecom Corp. v. GTE Northwest, Inc. Docket No. UT-970653, Second Supplemental
Order (Oct. 1997) (citations omitted).

1 colder than historic averages and lower power costs resulting from hydrological
2 conditions that were 117 percent of normal at the Grand Coulee basin.

3 The rate increase PSE is requesting in this filing will not be effective until May
4 2012. As the foregoing examples from the past two years demonstrate, any given
5 quarter's revenues is not a good predictor of the Company's revenues in the future.

6 **Q. Please summarize PSE's rate request in this case.**

7 A. PSE requests a rate increase for electric customers of \$160.7 million, which is an
8 average 8.13 percent increase over the electric rates set in the Company's 2009
9 general rate case, Docket No. UE-090704, that became effective on April 8, 2010.
10 PSE requests a rate increase for natural gas customers of \$31.8 million, which is
11 an average 3.0 percent increase over the natural gas rates set in the Company's
12 2010 gas tariff increase filing, Docket No. UG-101644, that became effective
13 April 1, 2011. As described in the testimony of Mr. Gaines, this requested
14 increase is based on a capital structure comprised of 48 percent regulatory equity
15 and a rate of return on equity of 10.8 percent.

16 **Q. What are the main drivers for the relief that is being requested in this**
17 **proceeding?**

18 A. This request is driven primarily by a need to recover the costs of the Company's
19 \$1.1 billion in new infrastructure investment since the last rate proceeding. Listed
20 below are the major drivers of the relief requested in this proceeding:

1 **New generation resources:** The largest single cost factor placing upward
2 pressure on electric rates is the Company's investment in a new wind generation
3 facility, the Lower Snake River Wind Project. As described in the prefiled direct
4 testimony of Mr. Roger Garratt, the 2009 Integrated Resource Plan ("IRP") that
5 determines PSE's long-term needs for capacity and renewable resources identified
6 that the Company has a need for both capacity and renewable resources. The IRP
7 projected that PSE continues to have a significant need to acquire resources to
8 serve its electric customers despite the current weakness of the economy. It also
9 projected that PSE will need to acquire additional renewable resources to meet the
10 requirements of the Energy Independence Act. In response to this documented
11 need, PSE is in the process of constructing the Lower Snake River Wind Project
12 that will allow PSE to meet its renewable energy target set forth in the Energy
13 Independence Act through 2019.

14 Fortunately, other power cost related expenses have declined and will mitigate
15 some of the costs attributable to the Lower Snake River Wind Project. As
16 discussed in the prefiled direct testimony of Mr. David Mills, reflected in the
17 Company's request is a decrease in production related costs of almost \$88
18 million.

19 **Investment in Transmission and Distribution Plant:** The next largest single
20 cost factor placing upward pressure on electric and natural gas rates in this
21 proceeding is investment in the transmission and distribution system. Since rates
22 were last updated, the Company has invested over \$320 million in new gas and

1 electric delivery facilities. Depreciation expense increases with this investment as
2 do capital costs required to fund such investment. The related operations and
3 maintenance costs to operate the system are also increasing despite cost
4 management efforts. Ms. McLain elaborates on these factors in her prefiled direct
5 testimony.

6 **Compliance:** Costs related to reliability, safety and compliance are higher
7 because the number of programs to which PSE is subject is growing, and their
8 requirements are increasingly stringent. Ms. McLain elaborates on these factors
9 in her prefiled direct testimony.

10 **Q. What activities are giving rise to the Company's investment needs?**

11 A. In addition to the Lower Snake River Wind Project discussed above, some of the
12 activities giving rise to PSE's investment needs include:

- 13 • implementation of planned reliability projects that are needed to comply
14 with evolving laws and regulations and to maintain reliable gas and electric
15 systems;
- 16 • implementation of unplanned reliability projects occasioned by public and
17 worker safety needs and by the need to restore and reduce outage frequency
18 and duration;
- 19 • construction of distribution infrastructure to serve new natural gas and
20 electric customers, and relocation projects required of PSE to accommodate
21 public entity infrastructure programs such as road and bridge construction;
22 and
- 23 • major reconstruction of PSE's Lower Baker Hydroelectric Plant and its
24 Snoqualmie Falls Hydroelectric Plant consistent with new FERC licensing
25 requirements.

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Q. Has the Company taken steps to manage its operations and maintenance costs and capital expenditure choices to mitigate the need for rate relief?

A. Yes. PSE has taken, and will continue to take, steps to manage operating costs and reduce and defer capital expenditures. These steps are consistent with slow customer growth as a result of the slow economy. For example, as described in more detail in the prefiled direct testimony of Ms. McLain, PSE reduced its capital spending by approximately \$23 million in 2010 as compared to budgeted amounts by cutting back on natural gas infrastructure projects which were tied to expected growth in demand. Similarly, PSE reduced capital spending by approximately \$56 million in electric infrastructure projects tied to expected growth in demand. PSE eliminated 52 positions related to these projects, which resulted in the layoff of a number of employees.

PSE has also kept costs down by renegotiating labor contracts and service provider contracts. PSE's non-represented employees received no pay increases last year, and PSE's officers' salaries have been frozen in rates since 2008. PSE is not requesting recovery of officer salary increases or annual incentive costs for its officers in this proceeding. As discussed in the prefiled direct testimony of Mr. Thomas M. Hunt, PSE believes that these costs should be recoverable in rates, but is foregoing recovery in this case in recognition of the difficult economic times facing our customers.

1 **Q. Do these actions eliminate the need for the proposed rate increase?**

2 A. No. The effect of these steps is to moderate rather than eliminate the growth in the
3 Company's costs.

4 **Q. How does PSE compare to other utilities in terms of costs per customer?**

5 A. When looking at natural gas and electric operations and maintenance costs per
6 customer, PSE remains one of the lowest cost providers among investor-owned
7 utilities in the United States, as is reflected in Exhibit No. ___(SML-3).

8 **Q. Has PSE been earning its authorized rate of return since its last general rate
9 case?**

10 A. No. As discussed in the prefiled direct testimony of Mr. Gaines, PSE's actual
11 regulated return on equity for calendar year 2010 was 4.8 percent compared to the
12 weighted 10.11 percent return on equity authorized by the Commission for the
13 period.

14 **Q. Can you elaborate on the reasons for PSE's failure to earn its authorized
15 return on equity?**

16 A. Yes. The bulk of both electric and natural gas "distribution" capital (e.g., pipes,
17 wires and poles) is spent on replacing aging infrastructure. The new plant is more
18 expensive than the plant that is being replaced. For example, as Ms. McLain
19 testifies, the cost to purchase and install four-inch diameter plastic gas main has
20 increased from \$9 per foot in 1980 to \$124 per foot in 2010. The replacement of

1 aging distribution assets does not result in new revenues until the costs are picked
2 up in a general rate case, which can be a year or more in the future. This delay
3 contributes significantly to PSE's under-earning.

4 **Q. What is PSE proposing in this proceeding to address its under-earning?**

5 A. In addition to seeking recovery of its significant investments since the last rate
6 proceeding, the Company is also requesting that it be allowed to recover the lost
7 revenues associated with its aggressive conservation investments using a
8 Conservation Savings Adjustment Mechanism discussed in the prefiled direct
9 testimony of Mr. DeBoer.

10 **III. INTRODUCTION OF COMPANY WITNESSES**

11 **Q. Would you please describe briefly the Company witnesses and the topics**
12 **presented by each witness in this case?**

13 A. The following additional witnesses present direct testimony on PSE's behalf:

14 **Ms. Susan McLain**, the Company's Senior Vice President, discusses the
15 Company's work to control costs related to its electric and natural gas
16 transmission and delivery systems while providing high quality service and
17 reliability. She also describes the cost pressures the Company is facing to replace
18 and maintain its aging infrastructure and to expand that infrastructure to serve
19 new customers.

1 **Mr. Donald Gaines**, Vice President Finance and Treasurer, presents PSE's
2 requested capital structure and overall rate of return. He also discusses the impact
3 of the merger on the cost of debt and PSE's credit rating and that the Company
4 has met certain merger commitments. He describes the Company's cost of short-
5 term and long-term debt and discusses the Company's recent and expected
6 financings.

7 **Dr. Charles Olson**, Professor of Finance at the Robert H. Smith School of
8 Business at the University of Maryland, presents his appraisal of the just, fair,
9 reasonable and sufficient rate of return on the Company's combined gas and
10 electric utility operations, with particular emphasis on the fair return on the
11 Company's common equity capital committed to that business.

12 **Mr. Roger Garratt**, Director of Resource Acquisition and Emerging
13 Technologies within the PSE Energy Resource Group, presents: PSE's strategy to
14 fulfill long-term capacity and renewable resource needs; challenges and
15 opportunities that affect PSE's ability to acquire electric resources; the
16 development and construction of the 343 MW Lower Snake River Wind Project,
17 Phase 1, located in Southeast Washington; and the acquisition of the 100 MW
18 Klamath four-year winter seasonal power purchase agreement.

19 **Ms. Aliza Seelig**, PSE Consulting Energy Resource Planning & Acquisition
20 Analyst, describes the quantitative and qualitative evaluation of Phase 1 of the

1 Lower Snake River Wind Project and the Klamath power purchase agreement, for
2 which PSE seeks cost recovery in this case.

3 **Mr. David E. Mills**, Director, Energy Supply & Planning, describes the
4 structures and policies the Company has in place to manage the risks and
5 volatility in its electric and natural gas portfolios and the manner in which such
6 policies are implemented. Additionally, Mr. Mills presents the Company's
7 projection of power costs for this case and compares them to those the
8 Commission approved in the 2009 general rate case.

9 **Mr. Michael L. Jones**, Manager, Colstrip Project Operations & Fuels for PSE,
10 discusses the Colstrip coal contract, forced outage rate, line losses, and the
11 settlement of the litigation alleging pond leakage at Colstrip.

12 **Mr. Clay Riding**, Director, Natural Gas Resources, describes the assumption of
13 BNP Paribas capacity on West Coast Pipeline and the transaction with Occidental
14 Energy Marketing, Inc., which provides PSE with additional natural gas
15 transportation capacity on Northwest Pipeline.

16 **Mr. Salman Aladin**, Director, Structuring, Asset Optimization and Analytics for
17 PSE, responds to questions raised by the Commission in PSE's 2009 general rate
18 case as to whether there are asymmetrical risks in the distribution of power costs
19 that may affect the sharing of risks and benefits accomplished by the PCA sharing
20 bands.

1 **Mr. Thomas Hunt**, Director, Compensation and Benefits, describes PSE's
2 compensation and benefits programs and how they are competitive and benefit the
3 Company's customers.

4 **Mr. Tom DeBoer**, Director, of Federal and State Regulatory Affairs, describes
5 the Conservation Savings Adjustment Rate tariff that PSE is proposing in this
6 case as a means of tracking conservation savings that occur after the historical test
7 year and adjusting rates to reflect the decrease in electric and natural gas usage
8 resulting from conservation.

9 **Mr. John Story**, Director, of Cost and Regulation, presents the electric results of
10 operations and revenue requirement.

11 **Mr. Mike Stranik**, Assistant Controller for PSE, presents the gas results of
12 operations and revenue requirement.

13 **Mr. Jon Piliaris**, Manager of Pricing and Cost of Service for the Company,
14 presents the Company's electric cost of service, rate spread and rate design and
15 more detail on PSE's proposal for a Conservation Savings Adjustment Rate
16 mechanism.

17 **Ms. Janet K. Phelps**, Regulatory Consultant in Pricing and Cost of Service for
18 the Company, presents the Company's gas cost of service study, the gas rate
19 spread and the gas rate design proposals.

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Dr. Chun K. Chang, Regulatory Consultant in Pricing and Cost of Service, presents PSE's electric and gas temperature adjustment methodologies and results used to develop the pro forma electric and gas sales for the test year in this proceeding.

Mr. Matthew Marcellia, Director of Taxes for PSE, presents the electric and gas tax pro forma and restating adjustments. He presents new tax treatment for (a) capitalized property taxes, (b) injuries and damages, and (c) bad debts. He presents the ratemaking treatment of accounting method changes related to taxes and the impact of bonus depreciation and tax net operating losses on ratemaking.

Q. Does that conclude your prepared direct testimony?

A. Yes, it does.