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I. INTRODUCTION

1 In its initial brief in this proceeding, Puget Sound Energy (“PSE” or the “Company”) fails to show that its proposed power cost adjustments are appropriate for setting rates in this proceeding. As a result, PSE has not met its burden of proof on these issues. In contrast, the Industrial Customers of Northwest Utilities (“ICNU”) and Staff (collectively, the “Joint Parties”) have provided strong support for their recommendation that the Washington Utilities and Transportation Commission (“WUTC” or the “Commission”) should reduce PSE’s power cost adjustments by approximately \$35.1 million, which includes \$6.5 million of uncontested adjustments.

2 The Commission should adopt the following adjustments to PSE’s power costs:

- Impose an 80% hedging cap, to rectify excess hedging of the Company’s power supply gas requirements, resulting in an \$18.6 million cost reduction, and recover these costs on a kilowatt hour (“KWh”) basis in a separate tariff rider to sunset by the end of the rate year;
- Institute a hydro filtering adjustment, to exclude the effect of extreme water years on power cost calculations, which reduces power costs by \$5.7 million;
- Correct a PSE logic error that underestimates the Westcoast Pipeline capacity basis gain by about \$4.0 million;
- Include a value component associated with Jackson Prairie capacity storage, reducing PSE’s power cost projection by \$0.3 million; and
- Adopt all uncontested adjustments agreed to by the Company and the Joint Parties, amounting to a net power cost reduction of \$6.5 million.

In addition, the Company either does not oppose or has not provided any legitimate grounds against adoption of the further recommendations advanced by the Joint Parties, which would require PSE to:

- Calculate regional load forecast adjustments as part of its AURORA model in all future general and power cost only rate cases;
- Exclude Tenaska amortization costs from baseline rates, and recover such costs on a KWh basis in a separate tariff rider that includes all the provisions agreed upon by the Joint Parties and the Company; and
- Abandon its partial decoupling proposal.

Finally, the Commission should adopt the multi-party rate spread and rate design settlement because it is fair, just and reasonable.

II. ARGUMENT

3 ICNU addressed the rationale behind and the substantive evidence supporting the Joint Parties' adjustments and recommendations in its initial brief. The following reply arguments respond to the Company's arguments in its initial brief, and clarify the Joint Parties proposals.

A. The Commission Should Reduce PSE's Mark-to-Market Adjustment and Exclude Mark-to-Market Costs from the Baseline Rate

4 The Joint Parties have asked the Commission to reject PSE's unprecedented \$45 million Mark-to-Market ("MTM") adjustment.^{1/} The Joint Parties propose to reduce power costs by \$18.6 million, by capping the volume of forward gas purchases for each month at 80% of the AURORA-projected base load need.^{2/}

^{1/} ICNU Initial Brief ¶¶ 8-21.

^{2/} Id. at ¶ 10.

5 In its initial brief, PSE justifies its proposed \$45 million adjustment by relying on an alleged hedging “benefits” argument,^{3/} an argument that ICNU thoroughly discredited in its initial brief on several evidentiary bases.^{4/} Additionally, the Company complains that no party has ever objected to or questioned its hedging policy in the past,^{5/} and that its current MTM proposal is only being challenged because it reflects a cost to customers.^{6/} As an initial matter, this claim is simply untrue, because the Joint Parties empirically established that three of the past six MTM adjustments have resulted in power cost *increases*.^{7/}

6 More importantly, the Company has dramatically altered and expanded its hedging policy, by extending the duration of its hedging strategy to three years and acquiring gas hedges far in excess of Aurora determined power generation needs.^{8/} The Company itself argues that hedges “are used strictly as a means to reduce volatility in costs and rates, which *protects* the customer.”^{9/} But customers are not protected or benefited in anyway by the Company’s recent practice of hedging well in excess of need, regardless of the reasonableness of PSE’s decision to depart from its established practice of leaving some percentage of need open for market purchases.^{10/}

^{3/} PSE Initial Brief ¶¶ 33, 34, 36.

^{4/} ICNU Initial Brief ¶¶ 15-19.

^{5/} PSE Initial Brief ¶ 33.

^{6/} PSE Initial Brief ¶ 36.

^{7/} Buckley and Schoenbeck, Exh. No. JT-1CT at 20:3-5.

^{8/} ICNU Initial Brief ¶¶ 10, 13.

^{9/} PSE Initial Brief ¶ 32 (emphasis added).

^{10/} Mills, TR. 758:12 – 759:10; Mills, Exhibit No. DEM-23C.

7

PSE argues that the “baseline rate should continue to reflect the gas hedges that have been executed under PSE’s hedging program.”^{11/} This argument supports the Joint Parties’ recommended reduction. The Company portrays the huge MTM cost increases as a simple continuation of past hedging policy,^{12/} but ICNU has already demonstrated in its initial brief that this portrayal is not credible.^{13/} In fact, continued reflection of PSE’s actual historic hedging practices *requires* exclusion from the baseline rate of the unprecedented MTM adjustment proposed in this case. Precisely because the current MTM costs are so extraordinary and unprecedented, the Joint Parties’ proposal that MTM costs be excluded from the baseline is in accord with PSE’s historic practices.

8

The Company also criticizes the Joint Parties’ proposed use of Sumas hub prices, on the grounds that the trading volume at the Sumas hub is less than “removed hedges” volume.^{14/} Likewise, PSE argues that the Joint Parties have not provided for pricing AURORA determined gas needs that exceed the proposed 80% cap.^{15/} The problem with both of these arguments is that the Commission has already determined that the three month rolling average Sumas price *is* the appropriate market price for gas supplies used in the Aurora model.^{16/} Thus, it is not only appropriate to use Sumas hub prices generally, but it makes perfect sense to also price gas in excess of the 80% cap at this Commission determined market price standard. In fact, PSE’s proposed MTM

^{11/} PSE Initial Brief ¶ 36.

^{12/} Mills, Exh. No. DEM-12CT at 20:3-4, 6-7.

^{13/} E.g., ICNU Initial Brief ¶¶ 9, 13.

^{14/} PSE Initial Brief ¶ 35.

^{15/} Id.

^{16/} WUTC v. PSE, Docket Nos. UE-040641, et al., Order No. 6 at ¶ 116 (Feb. 18, 2005).

adjustment would replace all of the Sumas priced gas with gas priced at a much higher rate. The Joint Parties proposal merely re-prices 20% of the gas required by Aurora at the 3-month rolling average price that the Commission has determined to be reasonable in previous cases. Finally, the Commission should reject PSE's attempt to pick and choose between Aurora derived costs and actual results.

B. The Joint Parties Hydro Filtering Adjustment Should Be Adopted

9 The Joint Parties have advanced an unbiased hydro filtering adjustment that excludes extreme or outlying water years from normalized power cost determinations, resulting in a power cost reduction of \$5.7 million.^{17/} PSE contends that the Joint Parties proposal is contrary to Commission precedent,^{18/} a claim which is unsupported and even contradicted by the very precedent upon which the Company relies.

10 According to PSE, exclusion of extreme water years “through a filtering process disregards the Commission’s objectives to use all available hydro data;”^{19/} however, “the Commission’s objectives” on hydro filtering cannot be reduced to a simple per se rule that “all available” data must be used. Rather, the Commission has explained that it will recognize “a superior alternative” to a prior filtering methodology when supported by “a clear and convincing argument.”^{20/} To this end, the Joint Parties proposal of a one standard deviation filter is backed by simple, unbiased, and intuitively

^{17/} ICNU Initial Brief ¶¶ 22-30.

^{18/} PSE Initial Brief ¶ 38.

^{19/} Id.

^{20/} WUTC v. PSE, Docket Nos. UE-040641, et al., Order No. 6 at ¶ 126 (*quoting* WUTC v. PSE, Docket Nos. UE-921262, et al., Order No. 11 at 43 (Sept. 21, 1993)).

appropriate logic.^{21/} Indeed, the Commission originally adopted the Company’s present model in recognition of features which are better achieved through the Joint Parties proposal—e.g., “a high correlation between streamflow and hydro generation,” and normally distributed data.^{22/}

11 Moreover, not only is PSE wrong in claiming that “all available” data must be used, but precedent also does not support the notion that larger hydro ranges are axiomatically preferable to shorter ranges. The Company cites to a decision and, indeed, to the very paragraph, in which the WUTC rejected some *70 years* worth of hydro data within a 120-year proposal, ultimately whittling its consideration down to the more recently used 50-year range.^{23/} There is no merit to PSE’s portrayal of an implicit Commission proscription against any filtering of outlying water years within a 50-year range.

12 Likewise, contrary to the Company’s argument, the exclusion of extreme outlier water years for filtering purposes, through a one standard deviation filter, fully accords with Commission objectives “to set the power cost baseline rate as close as practicable to what is likely to be experienced during the rate year.”^{24/} No technical or complex analysis is needed to recognize that the Joint Parties proposal will result in *more* accurate predictions of what is likely to be experienced, simply *because* it filters out extraordinary data from the calculation of baseline power rates. Essentially, PSE is

^{21/} ICNU Initial Brief ¶¶ 22-30.

^{22/} WUTC v. PSE, Docket Nos. UE-040641, et al., Order No. 6 at ¶ 128.

^{23/} PSE Initial Brief ¶ 38 (*citing* WUTC v. PSE, Docket Nos. UE-040641, et al., Order No. 6 at ¶ 131).

^{24/} PSE Initial Brief ¶ 38 (*citing* WUTC v. PSE, Docket Nos. UE-040641, et al., Order No. 6 at ¶¶ 106-08).

taking the opposite position that inclusion of extreme, unrepresentative outlying hydro data will produce the most normalized power costs.

13 The Company complains that the “[c]hief” flaw in the Joint Parties proposal is an alleged “exclusion of 40% of the data.”^{25/} In reality, however, the Joint Parties proposal does not actually exclude *any* hydro data. Under the Joint Parties proposal, outlying water year costs are simply filtered from baseline rate power cost calculations—but there is no ultimate “exclusion,” since costs associated with extreme years are still considered in calculating actual power costs in PSE’s power cost adjustment (“PCA”) mechanism.^{26/} The PCA mechanism allows for consideration when true costs become known, thereby eliminating the effect of forecasting uncertainties.^{27/} Under PSE’s proposal, uncertainties are inescapable because extreme costs are included in baseline rate calculations.

14 In similar fashion, PSE continues to wrongly critique the Joint Parties’ use of Mid-C generation data.^{28/} The Company fails to acknowledge the two steps involved in the Joint Parties’ proposal. First, all Mid-C generation is used in the Joint Parties’ proposal, but for filtering purposes only, in order to capture *regional* variance in water years for the *regional* effect being filtered for in the proposal.^{29/} Second, changes in PSE

^{25/} PSE Initial Brief ¶ 39.

^{26/} ICNU Initial Brief ¶ 30; Buckley and Schoenbeck, Exh. No. JT-1CT at 11:20 – 12:14.

^{27/} Buckley and Schoenbeck, Exh. No. JT-1CT at 12:7-23.

^{28/} PSE Initial Brief ¶ 41.

^{29/} ICNU Initial Brief ¶ 28; Buckley and Schoenbeck, Exh. No. JT-1CT at 10:24 – 11:15.

Mid-C allotment *are* then recognized when actual power cost calculations are made, using the filtered water years.^{30/}

15 In its initial brief, ICNU fully explained the flaws in PSE’s other arguments against the Joint Parties filter proposal, such as the alleged lack of high-level statistical grounding and claims of bias.^{31/} In sum, the Joint Parties have provided sufficient evidence, by clear and convincing argument in testimony and on brief, to establish that the one standard deviation filter more effectively achieves the normalized ends purportedly accomplished by the Company’s methodology.

C. Westcoast Pipeline Capacity Benefit Should Be Recognized

16 PSE invites the Commission to establish potentially harmful long-term precedent in underestimating the West Coast Capacity benefit. First, the Company provides no explanation as to why its reliance on broker quotes is superior to the historical price data relied upon by the Joint Parties in calculating the Westcoast Pipeline capacity benefit.^{32/} Reliance on broker speculation, without more, does not justify Commission preference of the Company’s lower proposed reduction, and WUTC adoption of that proposal would establish poor precedent.

17 Second, there is no rational basis to reject the Joint Parties’ recommendation, merely upon the grounds that capacity benefit exceeds cost. The Company states: “There are no instances where the calculated basis gain is more than the

^{30/} Id.
^{31/} ICNU Initial Brief ¶¶ 27, 30.
^{32/} See PSE Initial Brief ¶¶ 81-82.

cost of the pipeline capacity based on the additional broker quotes obtained.”^{33/} While the accuracy of this claim is questionable, it is not a sound basis to reject the Joint Parties’ proposal because PSE should be *encouraged* to make investments in which the customer benefit ultimately exceeds cost. If the Commission adopts the \$2.4 million PSE-proposed reduction instead of the \$4.0 million proposed by the Joint Parties, the resulting precedent will send the wrong message to utilities concerning prudence of investments. By removing any requirement to show that costs justify benefits, utilities would be encouraged to underestimate benefits.

D. Jackson Prairie Storage Capacity Should Be Recognized

18 The Joint Parties have proposed a \$0.3 million reduction in the Company’s proposed power costs resulting from the benefit associated with Jackson Prairie storage capacity.^{34/} PSE’s arguments on brief echo its testimony: the Company argues that a seasonal capacity benefit opportunity does not exist because the storage “agreement is for year-round reliability.”^{35/} However, the only relevant consideration is whether a benefit due to seasonal price differential has accrued *in fact*, whether fortuitous or intentional.^{36/} The Joint Parties have established that a customer benefit has accrued, and just and fair rates must reflect this benefit. The Company acknowledges that Jackson Prairie capacity provides the power portfolio with “instrumental” access to gas storage,^{37/} and the

^{33/} *Id.* at ¶ 81.
^{34/} ICNU Initial Brief ¶¶ 36-38.
^{35/} PSE Initial Brief ¶ 79.
^{36/} ICNU Initial Brief ¶ 38.
^{37/} PSE Initial Brief ¶ 79.

Commission should adopt the proposed adjustment to account for such instrumental benefit.

E. The Commission Should Require Regional Load Forecast Adjustments in Future Cases

19 The Company offers no explanation in its initial brief as to why regional load forecast reductions should not be addressed in future AURORA modeling.^{38/} Moreover, PSE acknowledges that economic trend data producing a reduction in its own load forecast also “may have an impact on the regional load forecast.”^{39/} Since even the Company realizes that regional forecasts *may* be impacted by its forecasts, the Commission should order PSE to model potential impacts in future rate cases—the Company will be not be adversely affected if no impact occurs, but the potential for customer harm is too significant to simply ignore such consideration.

F. The Commission Should Reject PSE’s Partial Decoupling Proposal

20 PSE’s brief does not explain how its conservation phase-in adjustment is consistent with the merger commitment not to propose decoupling for industrial customers. PSE, however, admits that the purpose of its conservation adjustment is “to remove disincentives” and allow for the recovery of PSE’s “lost margin.”^{40/} As explained in ICNU’s initial brief, programs to remove a utility’s financial disincentive to invest in conservation because of lost margins are the same as decoupling, and PSE’s proposal should be rejected because it is inconsistent with the requirement that PSE

^{38/} See PSE Initial Brief ¶ 80.

^{39/} Id.

^{40/} PSE Initial Brief ¶ 72.

“[w]ill not make any proposals regarding decoupling for electric industrial customers” until February 7, 2011.^{41/}

21 PSE cites the decisions in four other jurisdictions that “have approved lost margin recovery mechanisms or other programs to remove disincentives to promote conservation.”^{42/} PSE’s brief fails to note that each of these decisions was based on a full or multiparty stipulation^{43/} and occurred in states unlike Washington that have a poor history of investing in conservation.^{44/} PSE also does not explain that most of the decoupling programs it cites provided some opportunity for large industrial customers to opt out.^{45/} Most importantly, none of these decoupling programs PSE cites were prohibited under a merger condition that was supposed to prevent PSE from even proposing decoupling.

III. CONCLUSION

22 PSE has not carried its burden of proof to support its proposed power cost increases. ICNU urges the Commission to adopt the power cost adjustments that reflect

^{41/} ICNU Initial Brief ¶¶ 51-57; Re Puget Holdings and PSE, Docket No. U-072375, Order No. 8 at ¶ 95 and Appendix A to Stipulation, page 13 (Dec. 30, 2008).

^{42/} PSE Initial Brief ¶ 72.

^{43/} In re Application of Carolina Power & Light Co., Inc., Order Approving DSM/EE Application, Docket No. 2008-251-E at 25-26 (S.C. Pub. Serv. Comm'n 2009); In re Application by Carolina Power & Light Co., Order Approving Agreement and Stipulation of Partial Settlement, Subject to Certain Comm'n Required Modifications, Docket No. E-2, Sub 931 at 1 (N.C. Utils. Comm'n 2009); Application of Oklahoma Gas and Elec. Co., Order No. 556179, Docket No. PUD 200800059 at page 1 and Attachment 1 at 3, 19-20 (Okla. Corp. Comm'n 2008); In re Application for Recovery of Costs, Lost Margin, and Performance Incentive Associated, Finding and Order, Docket No. 06-91-EL-UNC et al. at page 3 (Ohio Pub. Utils. Comm'n 2007).

^{44/} E.g., In re Application for Recovery of Costs, Lost Margin, and Performance Incentive Associated, Finding and Order, Docket No. 06-91-EL-UNC et al. at page 5.

^{45/} In re Application of Carolina Power & Light Co., Inc., Order Approving DSM/EE Application, Docket No. 2008-251-E at 9; Application of Oklahoma Gas and Elec. Co., Order No. 556179, Docket No. PUD 200800059 at Attachment 1 at 5; In re Application for Recovery of Costs, Lost Margin, and Performance Incentive Associated, Finding and Order, Docket No. 06-91-EL-UNC et al. at page 5.

the actual costs that PSE is expected to incur during the rate year. These adjustments show that a \$35.1 million power cost reduction is justified. ICNU also urges the Commission to adopt all other measures suggested by the Joint Parties, including exclusion of costs from baseline rates, future regional modeling considerations, and rejection of the Company's decoupling proposal.

Dated in Portland, Oregon, this 2nd day of March, 2010.

Respectfully submitted,

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