EXHIBIT NO. ___(JHS-1T)
DOCKET NO. UE-11____
PCA 9 COMPLIANCE
WITNESS: JOHN H. STORY

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of **PUGET SOUND ENERGY, INC.** **For Approval of its March 2011 Power Cost Adjustment Mechanism Report**	**Docket No. UE-11____**

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
JOHN H. STORY
ON BEHALF OF PUGET SOUND ENERGY, INC.

MARCH 31, 2011

PUGET SOUND ENERGY, INC.

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PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY OF JOHN H. STORY

I. INTRODUCTION

Q. Please state your name, business address and present position.

A. My name is John H. Story. My business address is 10885 N.E. Fourth Street, P.O. Box 97034, Bellevue, Washington 98009-9734. I am the Director of Cost and Regulation for Puget Sound Energy, Inc. ("PSE").

Q. What is your educational and professional experience?

A. Exhibit No. ___(JHS-2) describes my educational and professional experience.

Q. What are your duties as Director of Cost and Regulation for PSE?

A. As Director of Cost and Regulation, I am responsible for the Revenue Requirement department at PSE.

Q. What is the purpose of this filing?

A. In accordance with the Commission's Twelfth Supplemental Order in Docket No. UE-011570, PSE must file an annual report detailing the power costs included in its deferral calculation under the Power Cost Adjustment ("PCA") Mechanism. The Settlement Agreement in the Fourth Order in PSE’s power cost only rate case, Docket No. UE-050870, incorporated an amendment to the annual reporting period for the PCA Mechanism from a June 30 fiscal year to a calendar year. In compliance with the order approving the settlement in Docket No. UE-050870 and the Sixteenth Supplemental Order in Docket Nos. UE-011570 and UG-011571, the annual PCA true-up filings are due by the end of each March for the prior PCA calendar year. Through its Petition, PSE is requesting approval of its PCA Mechanism Report for the Twelve Months Ended December 31, 2010 ("PCA Annual Report"). The PCA Annual Report is provided in this filing as the Second Exhibit to the Prefiled Direct Testimony of John H. Story, Exhibit No. ___(JHS-3).

II. BACKGROUND REGARDING THE PCA MECHANISM

Q. Please provide a brief summary of the Power Cost Adjustment Mechanism.

A. As authorized by the Commission, PSE's PCA Mechanism accounts for differences in PSE's modified actual power costs relative to a power cost baseline. This mechanism accounts for a sharing of costs and benefits that are graduated over four levels of power cost variances. The Settlement Stipulation approved in the Commission's Twelfth Supplemental Order in Docket No. UE-011570 defines the specific sharing levels and conditions. It is attached as Exhibit A to the Petition.

Q. Please describe the categories of power costs that are included in the PCA Mechanism.

A. The following fixed and variable power costs are included. These costs are adjusted as described below.

Fixed Costs:

For PCA calculation purposes, fixed costs are power production related costs and rate of return. Power production related costs from the most recent general rate case or power cost only rate case are included and do not change during the PCA period. These costs include depreciation, property taxes for production plant, and specifically identified transmission plant. Other fixed costs include FERC Accounts 557 Other production expense, Hydro and Other Production O&M, and 500 KV O&M. Regarding the rate of return, the rate from the most recent general rate case is applied as appropriate in the PCA period.

Variable Costs:

PCA variable costs include actual monthly amounts recorded in FERC Accounts 501 – Steam generation fuel, 547 – Other power generation fuel, 555 – Purchased power, 447 – Sales for resale, 565 – Transmission of electricity by others. In addition, variable costs and credits for sales of non-core gas, Transmission Revenue for Colstrip 1-4 lines, Third AC and Northern Intertie, and costs related to the hedging line of credit are included. Allowed regulatory return on and of regulatory assets and liabilities associated with the types of items that have been approved by order to be recovered through the PCA are also included in variable costs. A listing of these regulatory assets and liabilities are included in Exhibit D to the PCA Annual Report, Exhibit No. ___(JHS-3).

Adjustments to Variable Costs:

The following are adjustments as determined in Docket No. UE 011570:

1) Prudence disallowance from Docket No. UE-921262, disallowing a portion of the power costs associated with March Point 2 (3%) and Tenaska (1.2%) are shown in Schedule X, "NUG Prudence Adjustments";

2) Colstrip Availability adjustment if the actual availability factor for the four plants at Colstrip falls below a 70% equivalent availability factor. This adjustment would be reflected on PCA Exhibit F, "Colstrip Availability Adjustment"; and

3) New long-term resource pricing adjustment to bring the variable cost of the new resource to the lower of actual unit cost or the average embedded cost. This adjustment is reflected on PCA Exhibit G, "New Resource Adjustment." The specifics behind the calculation of this adjustment are further discussed below.

The following adjustment is also necessary as determined in Docket No. UE-031725:

1) Disallowance of costs associated with the Tenaska Benchmark Disallowance.

Additionally, test year variable costs may be adjusted for items pursuant to the Methodology for Adjustments of Costs Outside of the PCA Period ("true-up methodology"), which is provided as Exhibit No. ___(JHS-4). Discussion of the adjustments applicable to PCA Period 9 is included in Section IV, below.

III. PCA PERIOD 9 ACCOUNTING

Q. Please explain how PSE has tracked its PCA Period 9 power costs.

A. There were no significant changes to the PCA Mechanism during 2010 other than including Schedule 133 the Tenaska Regulatory Asset Tracker ("Tenaska Tracker") in the baseline power cost rate discussed in more detail below. Each month PSE calculates the power costs subject to PCA sharing using the same methodology shown in PCA Exhibit B from the original PCA Mechanism filing.[1] Allowed power costs include the fixed and adjusted variable costs, net of the adjustments discussed above. Total allowable costs are then compared to the baseline power cost rate set forth in the approved Exhibit A-1, multiplied by the actual delivered load, and any difference is allocated to PSE or customers based on the different levels of sharing defined in the PCA Mechanism. Any difference allocated to the customers is recorded in FERC Account 182.3, Other regulatory assets or Account 254, Other regulatory credits depending on whether the accumulated balance is a debit or credit at the end of a PCA period.

Under the PCA Mechanism, the deferred amount at the time of the next PCA annual true-up filing, along with the projected variable and fixed costs through the next proposed rate year could be considered in the determination of any rate change for the subsequent PCA period. Amounts deferred, when authorized, will be amortized to FERC Account 407.3, Regulatory debits or 407.4, Regulatory

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[1] *See* Docket No. UE-031725.

credits as they are recovered from or refunded to customers. At the time of the filing of this petition such a request is not necessary.

PSE accrues interest monthly on any deferred balance (debit or credit) at the interest rate calculated in accordance with WAC 480-90-233(4).

Q. Did the baseline power cost rate change during PCA Period 9?

A. Yes, from January 1, 2010 through April 7, 2010, the baseline power cost rate was $62.841 per Megawatt hour (MWh) as established in Docket No. UE-072300, PSE's 2007 general rate case. The calculation of this baseline power cost rate and supporting schedules for PCA Period 8 are found on pages 10 through 16 of the 2010 PCA Mechanism Annual Report, Exhibit No. ___(JHS-3).

From April 8, 2010 through December 31, 2010, the baseline power cost rate was $64.387 per MWh, including the Tenaska Tracker, as established in Docket No. UE-090704, PSE's 2009 general rate case. The calculation of this baseline power cost rate and supporting schedules for this period are found on pages 18 through 28 of Exhibit No. ___(JHS-3).

Historically, recovery of the baseline power cost rate has been included in either general rates or, in the event of implementation of rates from a power cost only rate case, the incremental portion is included in Schedule 95. As a result of PSE's 2009 general rate case, costs associated with the Tenaska Regulatory Asset were set in the Tenaska Tracker. PSE's 2009 general rate case compliance filing contained a copy of the baseline power cost rate. The baseline power cost rate is also provided in Exhibit No. ___(JHS-3), showing inclusion of the Tenaska Tracker. Additionally, the costs associated with Tenaska continue to be included in actual variable costs, therefore, ensuring true-up of the revenues and costs associated with the Tenaska Regulatory Asset.

Q. What is the actual average power cost rate experienced for PCA Period 9?

A. As shown on page 5 (Exhibit A-1 Power Cost Rate Updated) of Exhibit No. ___(JHS-3), the average power cost rate experienced for the twelve month period ended December 31, 2010 is $65.769 per MWh.

Q. Why did the actual average power cost rate differ from the baseline power cost rate in effect during PCA Period 9?

A. The actual average power cost rate differed from the baseline power cost rate in effect during PCA Period 9 due to changes in variable components of the PCA Mechanism, which are discussed in the testimony of David Mills, Exhibit No. ___(DEM-1CT).

Q. How did the actual power costs compare to the average baseline power cost rate in effect during PCA Period 9?

A. Actual power costs exceeded the average baseline power cost rate in effect during the PCA Period 9 by $38,312,461 (after adjustment for Firm Wholesale). PSE's share of this under-recovery of power costs was $29,156,231. As discussed in more detail below, the customers' share of this under-recovery of power costs was $9,156,231.

Q. What is the distribution of the resulting cumulative imbalance for sharing at the end of PCA Period 9?

A. Considering the activity that occurred in PCA Period 9 along with the revisions to the beginning balance made pursuant to the true-up methodology, the cumulative imbalance for sharing at the end of PCA Period 9 was $66,052,689. PSE's share of this imbalance was $51,573,829, with the remaining $14,478,860 attributable to the customer: *See* Exhibit No. ___(JHS-3), page 4.

Q. Please explain Exhibit G and its purpose in the PCA Mechanism.

A. Under the PCA Mechanism, new resources with a term *less* than or equal to two years are included in allowable PCA costs. The prudence of such resources is determined in the Commission's review of the annual PCA true-up. Power costs related to a new electric resource with a term of *greater* than two years are included in allowable PCA costs through a bridge mechanism, known as PCA Exhibit G, "New Resource Adjustment". Exhibit G reduces the variable costs of the new resources to the lower of actual unit cost or the baseline rate until the prudence of such resources can be reviewed and approved in a power cost only or general rate case.

Q. Were there any PCA Exhibit G adjustments necessary in PCA Period 9?

A. Yes, as discussed in the Prefiled Direct Testimony of Mr. Mills, Exhibit No. ___(DEM-1CT), there were two resources included in PCA Period 9 that required adjustment under Exhibit G. These resources are summarized as follows:

Resource	Effective	Rates in Effect	Actual variable unit cost > Baseline Rate?	PCA Exhibit G Adjustment?
Credit Suisse PPA	1/01/2009	4/07/2010	Yes	Yes
Qualco PPA	3/09/2009	4/07/2010	Yes	Yes

Q. How was the amount of the PCA Exhibit G adjustment determined?

A. The period that each resource was analyzed for purposes of PCA Exhibit G was the period between the effective date of the new resource and the date that the new resource would be included in rates (the bridge period). Each month during the bridge period, the resource's estimated variable costs were determined for the bridge period. The estimated generation attributable to that resource for the bridge period was then used to determine the estimated variable unit cost. This unit cost was compared to the baseline power cost rate in effect during the bridge period. When the estimated variable unit cost exceeded the baseline power cost rate in effect, the excess unit cost was multiplied by the ratio of the current month's actual generation to the estimated bridge period generation to determine the amount of the PCA Exhibit G adjustment attributable to that month. By the end of the bridge period, the resources variable unit cost would be based on actuals and would include no estimates, thereby truing up the Exhibit G adjustments within the PCA period that the resource is included in rates. Exhibit G adjustments totaled $40,515 in PCA Period 9. There were two resources—the Credit Suisse and Qualco purchase power agreements ("PPAs")— that resulted in Exhibit G adjustments during PCA Period 9. Adjustments associated with these two resources resulted in a total reduction to total allowable costs of $66,383: $47,587 for the Credit Suisse PPA and $18,796 for the Qualco PPA. Additionally, a correction to remove $25,868 of Exhibit G adjustments for the Farm Power Rexville PPA that was previously included in PCA Period 8 was made in PCA Period 9. During PCA Period 9, the PCA Period 8 Exhibit G adjustment was determined to be unnecessary because Farm Power Rexville is a Qualifying Facility and the energy under the PPA was purchased under PSE's electric tariff rate schedule 91. Accordingly, the mandated rate paid under the PPA should not have been subject to an Exhibit G adjustment. The resulting total Exhibit G adjustment of $40,515 is included in the Updated Power Cost Rate in Exhibit No. ___(JHS-3), page 5, line 25. Detailed support for how each Exhibit G adjustment was calculated is included in Mr. Story's workpapers for this filing.

Q. Were there new resources that were not subject to adjustment under Exhibit G?

A. Yes. There were several new resources that were not subject to adjustment under Exhibit G. They were Mint Farm, Wild Horse Expansion and two Schedule 91 contracts. PSE excluded Mint Farm and Wild Horse Expansion from analysis for adjustment under Exhibit G because costs associated with these resources were deferred pursuant to RCW 80.80.060(5), as described in PSE's 2009 general rate case in WUTC Docket No. UE-090704. Furthermore, Mint Farm and Wild Horse Expansion variable unit cost as of April 7, 2010, prior to being included in rates, were not greater than the baseline rate and therefore did not require adjustment under Exhibit G. Schedule 91 contracts are excluded from analysis on Exhibit G as these contracts are entered into with Qualifying Facilities as outlined in PSE's electric tariff rate schedule 91. Because the mandated contract rates are set by tariff, they should not be subject to an Exhibit G adjustment.

IV. ADJUSTMENT OF COSTS OUTSIDE OF THE PCA PERIOD

Q. Please describe in more detail the four adjustments made in PCA Period 9.

A. 1) **<u>BPA Loss Return Settlement:</u>** A $5.6 million settlement refund was received from BPA to compensate PSE for a net over-return to BPA of 127,721 MWh by PSE under multiple contracts during the period from July 1, 2001 through August 31, 2009. The portion of the $5.6 million settlement refund related to periods after July 1, 2002, the inception of the PCA Mechanism, was $5.4 million. The $5.6 million was booked to FERC Account 555 in November 2010 because this is the FERC account to which the original payments were expensed and included in total allowable costs for PCA purposes when paid. Because this refund was greater than $1 million and related to the time period between July 1, 2001 (one year prior to the start of the PCA Mechanism) and

August 31, 2009, it was excluded from actual power costs in calculating the PCA deferral for PCA Period 9. A revised version of the summary schedules for PCA Periods 1 through 8 that incorporates the impact of the BPA Loss Reserve Settlement on the PCA Periods to which it relates has been provided in the workpapers related to this filing.

2) **Colstrip Reclamation Dispute Settlement:** A $1.6 million refund was received for a dispute between the coal supplier, Western Energy Company ("WECo") and the owners , including PSE, of Colstrip Units 3 and 4. The dispute related to a request for a refund for reclamation work, the costs for which were included in the price of coal purchased in 2007. This settlement payment was booked to FERC Account 501 in March 2010 which is the FERC account to which the original payments were expensed and included in total allowable costs for PCA purposes when paid. The $1.6 million settlement refund, which is not related to inventory pricing, was removed from total allowable costs in PCA Period 9 and included in a revised version of the summary schedules for PCA Period 6 that incorporates the impact of the refund in the period to which it relates. This revised summary schedule has been provided in the workpapers related to this filing.

3) **Receivable from California Independent System Operators:** In June 2010, PSE wrote-off the unrecovered portion of its receivable from the California Independent System Operators in the amount of $17.8 million. The write off was booked to FERC Account 447 as an expense. However, for purposes of

calculating the PCA deferral, this expense was not included in PCA Period 9 as it relates to events which occurred in 2000 which was prior to inception of the PCA Mechanism.

4) **WECo Settlement Agreement:** In November 2010, PSE and other Colstrip 3 and 4 unit owners reached a settlement agreement in which PSE paid $0.3 million to WECo for royalties and pricing for the period 1996 through 2001. The payment was booked to FERC Account 501 as an expense. Because the settlement payment, which was not connected to inventory pricing, was related to a period prior to inception of the PCA Mechanism, it was not included in total allowable costs for PCA Period 9.

Q. Does this conclude your testimony?

A. Yes, it does.