

EXHIBIT NO. __ (RG-1HCT)
DOCKET NO. UE-12__
WITNESS: ROGER GARRATT

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

Petition of

PUGET SOUND ENERGY, INC.

**for Approval of a Power Purchase Agreement
for Acquisition of Coal Transition Power, as
Defined in RCW 80.80.010, and the Recovery
of Related Acquisition Costs**

Docket No. UE-12__

**PREFILED DIRECT TESTIMONY (HIGHLY CONFIDENTIAL) OF
ROGER GARRATT
ON BEHALF OF PUGET SOUND ENERGY, INC.**

**REDACTED
VERSION**

AUGUST 20, 2012

1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED DIRECT TESTIMONY (HIGHLY CONFIDENTIAL) OF**
3 **ROGER GARRATT**

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1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED DIRECT TESTIMONY (HIGHLY CONFIDENTIAL) OF**
3 **ROGER GARRATT**

4 **I. INTRODUCTION**

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

7 A. My name is Roger Garratt. My business address is 10885 N.E. Fourth Street
8 Bellevue, WA 98004. I am employed by Puget Sound Energy, Inc. ("PSE") as
9 the Director of Financial Planning & Strategic Initiatives.

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

12 A. Yes, I have. It is Exhibit No. ___(RG-2).

13 **Q. What are your duties as the Director of Financial Planning & Strategic**
14 **Initiatives?**

15 A. My present responsibilities include oversight of: (i) the acquisition and
16 development of electric resources for PSE; (ii) contracts for long-term electric
17 supply; (iii) PSE's emerging technology investigations and strategies;
18 (iv) PSE's five-year financial plan; and (v) PSE's 20-year load forecast.

1 **Q. What is the nature of your prefiled direct testimony in this proceeding?**

2 A. This prefiled direct testimony generally provides a description of the proposed
3 11-year power purchase agreement (the “Coal Transition PPA”) with TransAlta
4 Centralia Generation LLC (“TransAlta Centralia”) for up to 380 megawatts (MW)
5 of coal transition power supplied from Centralia Transition Coal Facility and the
6 approvals and determinations sought by PSE in this proceeding.

7 **II. APPROVALS AND DETERMINATIONS SOUGHT**

8 **Q. What approvals and determinations is PSE seeking from the Commission in**
9 **this proceeding?**

10 A. First, PSE seeks approval of the Coal Transition PPA for varying amounts of coal
11 transition power up to 380 MW supplied from Centralia Transition Coal Facility
12 beginning on December 1, 2014 and ending December 31, 2025, upon the terms
13 set forth in the petition filed concurrently with this testimony. Please see Exhibit
14 No ___(RG-3C) for a copy of the Coal Transition PPA. As part of such approval,
15 PSE seeks approval of the calculation and recovery methodology of the equity
16 component authorized by RCW 80.04.570(6).

17 Second, PSE seeks a prudence determination with respect to the Coal Transition
18 PPA, including any and all associated costs (operating, transmission, etc.) related
19 to such agreement. For a discussion regarding the Coal Transition PPA and
20 PSE’s decision to enter into the Coal Transition PPA, please see this prefiled
21 direct testimony and supporting exhibits and the Prefiled Direct Testimony of Mr.

1 Chris Bevil, Exhibit No. ___(CB-1HCT), and supporting exhibits thereto, and the
2 Prefiled Direct Testimony of Ms. Aliza Seelig, Exhibit No. ___(AS-1T), and
3 supporting exhibits thereto.

4 Finally, PSE seeks to defer the initial costs of the Coal Transition PPA until such
5 costs can be included in rates and incremental increases in volume and price
6 during the term of the Coal Transition PPA from the time such increases occur
7 until PSE can include such volumes and price increases in its next regulatory
8 proceeding to true up power costs. Please see the Prefiled Direct Testimony of
9 Ms. Katherine J. Barnard, Exhibit No ___(KJB-1T), for a discussion of PSE's
10 proposed recovery methodology for costs associated with the Coal Transition
11 PPA.

12 **Q. If the Coal Transition PPA does not begin delivery until December 1, 2014,**
13 **why should the Commission approve it now?**

14 A. The Commission should approve the Coal Transition PPA now so that PSE can
15 adequately plan to meet future capacity need. As demonstrated in the testimony
16 and exhibits filed in this proceeding, PSE has an existing and growing capacity
17 need. The Coal Transition PPA helps PSE to meet this growing capacity need in
18 December 2014. All of the evidence necessary to approve and issue a prudence
19 determination regarding the Coal Transition PPA exists, and there is no need for
20 delay. Indeed, quick resolution of the uncertainty regarding the status of the Coal

1 Transition PPA will facilitate PSE's efforts in projecting and meeting its capacity
2 needs during the term of the Coal Transition PPA.

3 Furthermore, as discussed below, TransAlta Centralia may terminate the
4 Memorandum of Agreement with the State of Washington if, as of December 15,
5 2012, TransAlta Centralia or an affiliate has failed, despite the exercise of its
6 commercially reasonable efforts, to negotiate and execute one or more power
7 purchase agreements including terms and conditions relating to force majeure,
8 outages and resupply rights, for the sale of at least 500 megawatts of the baseload
9 electrical output of the Centralia Transition Coal Facility. The Memorandum of
10 Agreement further provides that during the five business day period following
11 such notice of termination, the State of Washington and TransAlta Centralia may
12 agree to extend the term of the Memorandum of Agreement for an additional year.
13 Resolution of the status of the Coal Transition PPA prior to December 15, 2012,
14 would provide TransAlta Centralia and the State of Washington with additional
15 information as to whether to continue, extend, or terminate the Memorandum of
16 Agreement.

17 **III. EVENTS LEADING UP TO THE PROPOSED**
18 **COAL TRANSITION PPA**

19 **Q. Please describe the Centralia Transition Coal Facility.**

20 A. The Centralia Transition Coal Facility is a coal-fired power plant located five
21 miles northwest of the City of Centralia, in Lewis County, Washington. The

1 facility consists of two identical coal-fired generating units that have a combined
2 capacity of 1,340 MW. The units began commercial operation in 1972 and 1973.

3 Originally, eight Northwest utilities, including PSE, owned interests in the
4 facility, and PacifiCorp served as the operator of the facility. In 2000, the eight
5 Northwest utilities sold their respective interests in the facility to TransAlta
6 Centralia.

7 **Q. How has the state's emissions performance standard affected the Centralia**
8 **Transition Coal Facility?**

9 A. As originally enacted in 2007, Chapter 80.80 RCW imposed a greenhouse gas
10 emissions performance standard on baseload electric generation in the State of
11 Washington. Electric utilities (as defined in RCW 80.80.010(12)) generally may
12 not enter into long-term financial commitments for baseload electric generation
13 on or after July 1, 2008, unless the generating plant's emissions are the lower of:

- 14 • 1100 pounds of greenhouse gases per megawatt-hour; or
- 15 • the average available greenhouse gases emissions output as
16 updated by the Department of Commerce.

17 This standard effectively prohibited TransAlta Centralia from entering into a
18 contract with a utility in Washington for the output of the Centralia Transition
19 Coal Facility with a term of five years or longer, until the statute was amended in
20 2011 to address coal transition power.

1 **Q. Please describe what has changed since enactment of the emissions**
2 **performance standard in 2007.**

3 A. On May 21, 2009, Governor Gregoire issued Executive Order 09-05,
4 Washington's Leadership on Climate Change, which, in part, directed the
5 Department of Ecology to work with TransAlta Centralia Generation LLC to
6 establish an agreed order to apply the emissions performance standard to the
7 facility by no later than December 31, 2025. On April 26, 2010, Governor
8 Gregoire and TransAlta Centralia entered into a memorandum of understanding to
9 enter discussions on an agreement to reduce gas emissions from the Centralia
10 coal-fired plant and provide replacement capacity by 2025. This effort lead to
11 subsequent legislation modifying, among other statutes, Chapter 80.80 RCW.

12 **Q. Please describe this legislative change.**

13 A. On April 29, 2011, Governor Gregoire signed Engrossed Second Substitute
14 Senate Bill 5769 (the "Coal Transition Energy Bill"), which provides certain
15 deferrals of the greenhouse gas emissions performance standard to encourage the
16 early closure of coal plants in Washington in a manner that ensures reliability of
17 the state's electrical grid, ensures appropriate cleanup and site restoration upon
18 decommissioning of these facilities, and provides assistance to host communities
19 to mitigate the economic impacts of the closure of these facilities. The Coal
20 Transition Energy Bill authorized Governor Gregoire to enter into a
21 Memorandum of Agreement that required specified emissions reductions with the

1 owners of coal-fired baseload facilities in Washington—such as TransAlta
2 Centralia—by January 1, 2012.

3 **Q. What deferrals of the emissions performance standard does the Coal
4 Transition Energy Bill provide?**

5 A. The Coal Transition Energy Bill amended the emissions performance standard to
6 allow coal-fired baseload facilities in Washington—such as the Centralia
7 Transition Coal Facility—to comply with greenhouse gas emissions performance
8 standards by shutting down one of its two boilers by the end of 2020 and the other
9 by the end of 2025.

10 **Q. What related provisions does the Coal Transition Energy Bill provide?**

11 A. The Coal Transition Energy Bill addressed the technology that such coal-fired
12 baseload facilities would implement for control of nitrogen oxides. The Coal
13 Transition Energy Bill also removed limitations on the sale of the output of such
14 coal-fired facilities and established a process that allows electric utilities to
15 petition this Commission for approval of a power purchase agreement for coal
16 transition power. If such a contract is approved, the utility is allowed to earn the
17 equity component of its authorized rate of return in the same manner as if it had
18 purchased or built an equivalent plant and to recover the cost of the coal transition
19 power under the power purchase agreement.

1 **Q. Did Governor Gregoire enter into a Memorandum of Agreement with**
2 **Transalta Centralia?**

3 A. Yes. On December 23, 2011, Governor Gregoire and TransAlta Centralia entered
4 into a Memorandum of Agreement, which confirmed the arrangements set forth in
5 the Coal Transition Energy Bill in contractual form.

6 **Q. What is the term of the Memorandum of Agreement?**

7 A. The Memorandum of Agreement between TransAlta Centralia and the State of
8 Washington is effective as of April 1, 2012, and expires no earlier than
9 December 31, 2025, unless terminated earlier pursuant to its terms.

10 TransAlta Centralia may terminate the Memorandum of Agreement effective
11 upon five (5) business days' written notice to the State of Washington if, as of
12 December 15, 2012, TransAlta Centralia or an affiliate has failed, despite the
13 exercise of its commercially reasonable efforts, to negotiate and execute one or
14 more power purchase agreements including terms and conditions relating to force
15 majeure, outages and resupply rights, for the sale of at least 500 megawatts of the
16 baseload electrical output of the Centralia Transition Coal Facility. The
17 Memorandum of Agreement further provides that during the five business day
18 period following such notice of termination, the State of Washington and
19 TransAlta Centralia may agree to extend the term of the Memorandum of
20 Agreement for an additional year.

1 **IV. THE COAL TRANSITION PPA**

2 **Q. What product does PSE propose to purchase under the terms of the Coal**
3 **Transition PPA?**

4 A. The Coal Transition PPA contemplates that PSE will purchase, beginning on
5 December 1, 2014, firm, flat (7x24) electrical energy delivered by TransAlta
6 Centralia to any of the delivery points specified in the Coal Transition PPA. *See*
7 Exhibit No ___(RG-3C) at page 16.

8 The contract quantity varies over time. Starting on December 1, 2014, the initial
9 quantity is 180 MWh/hr. The quantity increases to 280 MWh/hr on December 1,
10 2015, and to 380 MWh/hr on December 1, 2016. The delivery rate thereafter
11 remains steady through December 31, 2024. On January 1, 2025, the contract
12 quantity decreases to 300 MWh/hr through December 31, 2025. Exhibit
13 No ___(RG-3C) at pages 16, 45. Please see Table 1 below for the Coal Transition
14 PPA contract quantities.

15 **Table 1. Coal Transition PPA Contract Quantities**

Starting	Ending	MWh/hr
December 1, 2014	November 30, 2015	180
December 1, 2015	November 30, 2016	280
December 1, 2016	November 30, 2017	380
December 1, 2017	November 30, 2018	380
December 1, 2018	November 30, 2019	380
December 1, 2019	November 30, 2020	380
December 1, 2020	November 30, 2021	380
December 1, 2021	December 31, 2022	380
January 1, 2023	December 31, 2023	380
January 1, 2024	December 31, 2024	380
January 1, 2025	December 31, 2025	300

1

[REDACTED]

2

[REDACTED]

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[REDACTED]

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[REDACTED]

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[REDACTED]

6

[REDACTED]

7

Exhibit No ___(RG-3C) at pages 28-29.

8

Q. At what prices would PSE purchase the contract product?

9

A. [REDACTED]

10

[REDACTED]

11

[REDACTED]

12

[REDACTED]

13

[REDACTED]. Exhibit No ___(RG-3C) at

14

pages 16-17. Please see Table 2 below for the Coal Transition PPA contract

15

prices.

1 **Q. Please describe the transmission arrangements made by PSE with respect to**
2 **the Coal Transition PPA.**

3 A. Both PSE and the Bonneville Power Administration (“BPA”) provide
4 transmission service from the Centralia Transition Coal Facility. PSE contracts
5 with BPA for 100 MW of long-term firm transmission service from the Centralia
6 Transition Coal Facility through October 1, 2016. The 100 MW BPA contract
7 contains renewal provisions allowing the term of the 100 MW contract to be
8 extended to match the term of the Coal Transition PPA. In addition, PSE has
9 280 MW of long-term firm transmission capacity between BPA’s C.W. Paul
10 substation and PSE’s Tono facilities.

11 PSE transmission is the most cost effective solution for delivering energy from
12 the Centralia Transition Coal Facility directly to system load. PSE currently
13 markets (posted on OASIS), sells, and uses 280 MW of long-term firm
14 transmission capacity between the Centralia Transition Coal Facility and PSE’s
15 system. At the time of execution of the Coal Transition PPA, the 280 MW was
16 currently available to all transmission customers, and PSE could not secure this
17 transmission on PSE’s system until execution of the Coal Transition PPA. At that
18 time, there were no reservations for any portion of the 280 MW past January 1,
19 2013.

1 **Q. Subsequent to the execution of the Coal Transition PPA, did PSE secure the**
2 **280 MW of transmission on PSE's system for deliveries under the Coal**
3 **Transition PPA.**

4 A. Yes. PSE confirmed the transmission service requests for 280 MW of
5 transmission on PSE's system for deliveries under the Coal Transition PPA on
6 OASIS on August 10, 2012, and has completed the designation of network
7 resource process.

8 **Q. Please describe any key credit terms contemplated by the Coal Transition**
9 **PPA.**

10 A. [REDACTED]
11 [REDACTED]
12 [REDACTED]. Exhibit
13 No ___(RG-3C) at page 32. [REDACTED]
14 [REDACTED]. *Id.* at pages 24,
15 30. [REDACTED]
16 [REDACTED]. *Id.* at pages 32, 48-51.

17 **Q. Does the Coal Transition PPA contain provisions applicable in the event of a**
18 **change of law with respect to new or revised greenhouse gas standards?**

19 A. Yes. If new or revised emission performance standards or operational or financial
20 requirements related to greenhouse gas emissions are imposed by law,

1 section 10.1 of the Coal Transition PPA provides that PSE and TransAlta
2 Centralia would modify the agreement to the mutual satisfaction of the parties.
3 Any such modification would be subject to review and approval by this
4 Commission. If PSE and TransAlta Centralia are unable to agree upon any such
5 modification, either party (if it is adversely affected by the new standard or
6 requirement) would have the right to terminate the Coal Transition PPA without
7 liability. Exhibit No ___(RG-3C) at page 30.

8 **Q. Does the Coal Transition PPA contain provisions applicable in the event of a**
9 **change of law other than a change in law related to greenhouse gas**
10 **emissions?**

11 A. Yes. [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 [REDACTED]. Exhibit
15 No ___(RG-3C) at pages 30-31. [REDACTED]
16 [REDACTED]
17 [REDACTED]. Exhibit No ___(RG-3C) at
18 page 7 (definition of [REDACTED]). [REDACTED]
19 [REDACTED]. [REDACTED]
20 [REDACTED]
21 [REDACTED]

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[REDACTED]

[REDACTED]. Exhibit No ___ (RG-3C) at pages 30-31.

V. PSE’S DECISION TO ENTER INTO THE COAL TRANSITION PPA WAS PRUDENT

A. Overview

Q. Is PSE seeking a prudence determination in this proceeding with respect to the Coal Transition PPA?

A. Yes. PSE seeks a prudence determination in this proceeding with respect to the Coal Transition PPA, including any and all associated capital costs, operating costs, transmission costs, equity component costs, and other costs related to these resources.

Q. What is PSE’s understanding of the Commission’s prudence standard?

A. In PSE’s 2003 Power Cost Only Rate Case proceeding, Docket No. UE-031725, the Commission reaffirmed the standard it applies in reviewing the prudence of power generation asset acquisitions:

The test the Commission applies to measure prudence is what a reasonable board of directors and company management would have decided given what they knew or reasonably should have known to be true at the time they made a decision. This test applies both to the question of need and the appropriateness of the expenditures. The company must establish that it adequately studied the question of whether to purchase these resources and made a reasonable decision, using the data and methods that a reasonable management would have used at the time the decisions were made.

1 *WUTC v. Puget Sound Energy, Inc.*, Docket No. UE-031725, Order No. 12 at
2 ¶ 19.

3 In addition to this generic reasonableness standard, the Commission has cited
4 several specific factors that inform the question of whether a utility’s decision to
5 acquire a new resource was prudent. These factors include the following:

- 6 • First, the utility must determine whether new resources are
7 necessary. *See e.g., WUTC v. Puget Sound Power & Light*
8 *Co.*, Docket No. UE-921262, *et al.*, Nineteenth
9 Supplemental Order (September 27, 1994) (“*Prudence*
10 *Order*”) at 11.
- 11 • Once a need has been identified, the utility must determine
12 how to fill that need in a cost-effective manner. When a
13 utility is considering the purchase of a resource, it must
14 evaluate that resource against the standards of what other
15 purchases are available, and against the standard of what it
16 would cost to build the resource itself. *Prudence Order* at
17 11.
- 18 • The utility must analyze the resource alternatives using
19 current information that adjusts for such factors as end
20 effects, capital costs, impact on the utility’s credit quality,
21 dispatchability, transmission costs, and whatever other
22 factors need specific analysis at the time of a purchase
23 decision. *Id.* at 2, 33-37, 46-47.
- 24 • The utility should inform its board of directors about the
25 purchase decision and its costs. The utility should also
26 involve the board in the decision process. *Id.* at 37, 46.
- 27 • The utility must keep adequate contemporaneous records
28 that will allow the Commission to evaluate its actions with
29 respect to the decision process. The Commission should be
30 able to follow the utility’s decision process; understand the
31 elements that the utility used; and determine the manner in
32 which the utility valued these elements. *Id.* at 2, 37, 46.

1 **Q. Did PSE’s decision to enter into the Coal Transition PPA meet this**
2 **standard?**

3 A. Yes. PSE had a clear, documented need for capacity resources in both the near
4 and long term. PSE also performed the analyses, decision-making and
5 documentation processes expected by the Commission, as summarized in this
6 prefiled direct testimony and in the Prefiled Direct Testimony of Mr. Chris Bevil,
7 Exhibit No ___(CB-1HCT).

8 **B. The 2011 Integrated Resource Plan Informed PSE’s Resource Need**
9 **for Capacity and Renewable Resources**

10 **Q. How did PSE determine its need for capacity and renewable resources?**

11 A. PSE determined its need for capacity and renewable resources based on the
12 analyses performed for PSE’s 2011 Integrated Resource Plan (the “2011 IRP”),
13 which PSE filed with the Commission in May 2011. Please see Exhibit
14 No ___(RG-4) for a copy of the 2011 IRP. PSE subsequently updated its need for
15 capacity resources, as described in the Prefiled Direct Testimony of Mr. Chris
16 Bevil, Exhibit No ___(CB-1HCT).

1 **C. PSE Issued a Request For Proposals To Meet Its Resource Needs**

2 **Q. How did PSE implement its strategy to meet its capacity and renewable**
3 **resources needs?**

4 A. After completing and filing the 2011 IRP, PSE commenced the 2011 RFP process
5 by filing a draft 2011 RFP with the WUTC on August 1, 2011. The WUTC
6 subsequently approved the draft 2011 RFP on October 13, 2011. PSE released
7 the 2011 RFP on October 17, 2011. Please see Exhibit No ___(RG-5) for a copy
8 of the 2011 RFP.

9 The 2011 RFP requested proposals from power producers, marketers, and power-
10 plant developers to help PSE procure approximately 385 MW of resources.

11 Exhibit No ___(RG-5) at page 6. Although PSE anticipates that energy
12 efficiency, renewable power, and gas-fired generation will continue to be its
13 dominant sources of new power supply in coming years, the 2011 RFP sought any
14 viable power-supply offer or technology that could be in operation by 2016. PSE
15 also indicated that it would consider various contract arrangements, such as
16 investment in existing power plants, ownership of new plants, or long-term PPAs.
17 *Id.* at pages 13-15.

18 Please see the Prefiled Direct Testimony of Mr. Chris Bevil, Exhibit No ___(CB-
19 1HCT), for a detailed description of the 2011 RFP process and evaluation.

1 **D. PSE Evaluated Resource Alternatives Using Current Information**
2 **That Adjusted For Appropriate Factors and Risks**

3 **Q. How did PSE evaluate proposals submitted in response to the 2011 RFP?**

4 A. PSE engaged in a comprehensive process to evaluate the costs and risks
5 associated with each proposal, both as individual projects and when viewed as
6 potential additions to PSE's resource portfolio. PSE evaluated the proposals in
7 two stages based on the criteria set forth in its 2011 RFP. PSE designed these
8 criteria to take into account qualitative and quantitative factors impacting the
9 decision whether to acquire a potential resource. They included consideration of
10 end effects, dispatchability, transmission costs, capital costs, impact on PSE's
11 credit quality, and project feasibility, among other factors.

12 **Q. How did PSE evaluate self-build opportunities and unsolicited proposals**
13 **submitted after the commencement of the 2011 RFP?**

14 A. PSE examined its self-build opportunities and unsolicited proposals submitted
15 after the commencement of the 2011 RFP using the same due diligence criteria,
16 analytic rigor, and models as it did for the other 2011 RFP proposals to find the
17 resources with the lowest levelized costs, highest portfolio benefits, and lowest
18 risk profiles. PSE reviewed the projects to determine if they fit PSE's need, and
19 the costs were compared to other reasonably executable alternatives.

1 **E. PSE Informed and Involved its Board of Directors and Energy**
2 **Management Committee**

3 **Q. Has PSE actively involved its Board of Directors and Energy Management**
4 **Committee in its resource acquisition process?**

5 A. Yes. PSE involved its Board of Directors (the “Board of Directors”) and Energy
6 Management Committee (“EMC”) in the resource acquisition process. The
7 Resource Acquisition Group made several presentations to the Board of Directors
8 and the EMC regarding the status of PSE’s analyses of the many potential
9 resource opportunities it was considering to meet its need for additional resources.
10 The Board of Directors and the EMC were thereby advised of the management
11 team’s evaluation methods, key assumptions, and results as the 2011 RFP
12 evaluation progressed, including evaluations and conclusions regarding self-build
13 opportunities and resources that came to PSE’s attention outside of the 2011 RFP
14 process.

15 **F. PSE Informed and Involved its Board of Directors and EMC in the**
16 **Decision to Execute the Coal Transition PPA**

17 **Q. Please describe the internal approval process for the Coal Transition PPA.**

18 A. PSE staff regularly kept both PSE’s EMC and Board of Directors informed and
19 involved in the 2011 RFP process and the decision to enter into the Coal
20 Transition PPA. Please see Exhibit No ___(RG-6HC) for a compilation of
21 pertinent presentations made to the EMC.

1 **Q. Did PSE undertake any additional evaluation of proposals before requesting**
2 **approval of the EMC and Board of Directors to enter into the Coal**
3 **Transition PPA?**

4 A. Yes. On or about June 13, 2012, PSE notified bidders of their selection status in
5 the 2011 RFP. In response, by June 22, 2012, PSE received three revised offers
6 from three counterparties not selected in the 2011 RFP. Additionally, the
7 evaluation team identified a new transmission risk for the Coal Transition Power
8 PPA (#11102) that could limit PSE's ability to purchase contract volumes in
9 excess of 380 MW.

10 Before recommending to the Energy Management Committee and the Board of
11 Directors that PSE sign the Coal Transition Power PPA (#11102), the RFP
12 evaluation team:

- 13 • reevaluated all revised offers received after completing and
14 identifying the 2011 RFP short list to determine if the short
15 list should be updated; and
- 16 • considered the impacts of limited PSE transmission transfer
17 capability for the Coal Transition Power PPA (#11102).

18 The reevaluation showed that the Coal Transition Power PPA (#11102) at the
19 2011 RFP volumes was no longer least cost in four of five scenarios. On June 27,
20 2012, PSE discontinued its pursuit of the Coal Transition Power PPA (#11102) at
21 the 2011 RFP volumes.

1 On July 5, 2012, TransAlta revised the commercial structure of the Coal
2 Transition Power PPA (now denoted as project #11102-r) to a smaller volume and
3 later delivery start date. PSE reevaluated this revised commercial structure along
4 with the revised offers received in mid-June 2012.

5 After reevaluation, the 2011 RFP comparative analysis identified the revised Coal
6 Transition Power PPA (#11102-r) as a lowest reasonable cost and lowest risk
7 capacity resource to acquire to meet need, PSE sought the approval of the EMC to
8 request approval of the Board of Directors to enter into the Coal Transition Power
9 PPA (#11102-r).

10 On July 20, 2012, the EMC approved the request to recommend to the Board of
11 Directors that PSE enter into the Coal Transition Power PPA (#11102-r). Please
12 see Exhibit No ___ (RG-7HC) for a copy of the presentation to and minutes of the
13 EMC meeting dated July 20, 2012.

14 **Q. Did the Board of Directors approve the recommendation to enter into the**
15 **Coal Transition PPA?**

16 A. Yes. On July 24, 2012, PSE's Board of Directors approved the recommendation
17 to enter into the Coal Transition Power PPA (#11102-r). Please see Exhibit
18 No ___ (RG-8HC) for a copy of the presentation to and minutes of the Board of
19 Directors meeting dated July 24, 2012.

1 **Q. What activity followed the approval of the Board of Directors to enter into**
2 **the Coal Transition PPA?**

3 A. PSE and TransAlta Centralia executed the Coal Transition PPA on July 24, 2012.

4 **G. PSE Kept Contemporaneous Records of its Evaluation and Decision**
5 **Processes**

6 **Q. Did PSE keep contemporaneous records of its evaluation and decision**
7 **processes?**

8 A. Yes. The exhibits submitted with this prefiled direct testimony and with the
9 Prefiled Direct Testimony of Mr. Chris Bevil, Exhibit No ___(CB-1HCT),
10 demonstrate PSE's contemporaneous documentation, including but not limited to
11 documentation presented to the Board of Directors and the EMC.

12 **VI. PROPOSED EQUITY COMPONENT**

13 **Q. Does state law allow an electrical company to earn the equity component of**
14 **its authorized rate of return on a power purchase agreement for acquisition**
15 **of coal transition power?**

16 A. Yes. RCW 80.04.570(6) provides that, upon Commission approval of a power
17 purchase agreement for acquisition of coal transition power, an electrical
18 company, such as PSE, is allowed to earn the equity components of its authorized
19 rate of return in the same manner as if it had purchased or built an equivalent
20 plant:

1 (a) Upon commission approval of an electrical company's power
2 purchase agreement for acquisition of coal transition power in
3 accordance with this section, the electrical company is allowed to
4 earn the equity component of its authorized rate of return in the
5 same manner as if it had purchased or built an equivalent plant and
6 to recover the cost of the coal transition power under the power
7 purchase agreement. Any power purchase agreement for
8 acquisition of coal transition power that earns a return on equity
9 may not be included in an imputed debt calculation for setting
10 customer rates.

11 (b) For purposes of determining the equity value, the cost of an
12 equivalent plant is the least cost purchased or self-built electric
13 generation plant with equivalent capacity. In determining the least
14 cost plant, the commission may rely on the electrical company's
15 most recent filed integrated resource plan. The cost of an
16 equivalent plant, in dollars per kilowatt, must be determined in the
17 original process of commission approval for each power purchase
18 agreement for coal transition power.

19 (c) The equivalent plant cost determined in the approval process
20 must be amortized over the life of the power purchase agreement
21 for acquisition of coal transition power to determine the recovery
22 of the equity value.

23 (d) The recovery of the equity component must be determined and
24 approved in the review process set forth in this section. The
25 approved equity value must be in addition to the approved cost of
26 the power purchase agreement.

27 RCW 80.04.570(6).

28 **Q. What "cost of an equivalent plant" did PSE use to determine the equity**
29 **return component for the Coal Transition PPA?**

30 A. First, PSE calculated an equivalent plant size of 346 MW, based on the average
31 volume of power to be delivered during the term of the Coal Transition PPA.
32 PSE then calculated a projected cost of an equivalent plant of approximately
33 \$215 million, based on capital costs of bids received in response to PSE's

1 2011 RFP. Of course, the Coal Transition PPA is a firm, 24x7 product, and the
2 capacity factors of the projects bid into the 2011 RFP are less than 100%.

3 Therefore, a projected cost of an equivalent plant of approximately \$215 million
4 likely understates the true capital cost of an equivalent plant.

5 **Q. How did PSE calculate a projected capital cost of approximately \$215 million**
6 **as the cost of the equivalent plant?**

7 A. PSE multiplied the equivalent plant size of 346 MW by [REDACTED]
8 [REDACTED]. This proposal yielded the least cost
9 purchased or self-built electric generation plant (expressed in dollars per kilowatt)
10 of the proposals offered in response to the 2011 RFP.

11 **Q. Is this the the same “cost of an equivalent plant” that PSE used to perform**
12 **its quantitative analysis for the Coal Transition PPA for the 2011 RFP?**

13 A. No. PSE used a \$ [REDACTED]/kW “cost of an equivalent plant” for purposes of analyzing
14 the Coal Transition PPA for the 2011 RFP. This \$ [REDACTED]/kW represented PSE’s
15 projected capital cost to build a self-build peaking plant. PSE subsequently
16 reduced the “cost of an equivalent plant” to the [REDACTED]
17 [REDACTED] for purposes of determining the equity
18 return component for the Coal Transition PPA.

1 **Q. Why did PSE reduce the “cost of an equivalent plant” from \$ [REDACTED]/kW to**
2 **\$ [REDACTED]/kW?**

3 A. As discussed above, the \$ [REDACTED]/kW “cost of an equivalent plant” represents PSE’s
4 projected cost to self-build a peaking plant. PSE used this value for purposes of
5 analyzing the Coal Transition PPA for the 2011 RFP because such value was
6 unlikely to change materially throughout the 2011 RFP process. For purposes of
7 determining the equity component for the Coal Transition PPA, however, PSE
8 used the [REDACTED]
9 [REDACTED]
10 [REDACTED].

11 **Q. How would the “cost of an equivalent plant” of \$ [REDACTED]/kW affect the**
12 **quantitative analyses performed by PSE for the 2011 RFP?**

13 A. The \$ [REDACTED]/kW represents a 33% reduction in the “cost of an equivalent plant” of
14 \$ [REDACTED]/kW used by PSE in the quantitative analyses for the 2011 RFP. Therefore,
15 the quantitative analyses performed by PSE understate the quantitative benefits
16 provided by the Coal Transition PPA.

17 **Q. What “equity component of its authorized rate of return” did PSE use to**
18 **determine the equity return component for the Coal Transition PPA?**

19 A. PSE used a pre-tax weighted average cost of equity of 7.24% as the “equity
20 component of its authorized rate of return” for purposes of determining the equity

1 return component for the Coal Transition PPA. This pre-tax weighted average
2 cost of equity of 7.24% reflects the return on equity and equity ratio authorized by
3 the Commission in PSE’s last general rate proceeding:

4	Equity Ratio		48.00%
5	Return on Equity	x	9.80%
6	<u>Grossup for Tax (1-FIT Rate)</u>	÷	65%
7	Pre-Tax Weighted Average Cost of Equity		7.24%

8 For ease of calculation, this pre-tax weighted average cost of equity remains fixed
9 throughout the term of the Coal Transition PPA. In other words, the pre-tax
10 weighted average cost of equity of 7.24% will be the “equity component of its
11 authorized rate of return” for purposes of determining the equity return
12 component for the Coal Transition PPA, regardless of whether the Commission
13 increases or decreases PSE’s authorized equity ratio or return on equity during the
14 contract term.

15 **Q. Has PSE amortized the “equivalent plant cost” over the life of the Coal**
16 **Transition PPA?**

17 A. Yes. PSE has amortized the “equivalent plant cost” over the life of the Coal
18 Transition PPA. The Coal Transition PPA has a term of 133 months
19 (commencing on December 1, 2014, and expiring on December 31, 2025).
20 Therefore, PSE amortizes the “equivalent plant cost” over the contract term of
21 133 months.

1 **Q. Has PSE prepared a calculation of the equity component for the Coal**
2 **Transition PPA?**

3 A. Yes. PSE has prepared a calculation of the equity component for the Coal
4 Transition PPA. Please see Exhibit No ___(RG-9) for PSE's calculation of the
5 proposed equity component for the Coal Transition PPA.

6 **Q. Please describe the calculation.**

7 A. Exhibit No ___(RG-9) contains a table that includes eight columns (Columns A-
8 G):

- 9 • Column A (Month) and Column B (Year) provide the
10 month and year of each month, respectively, during the
11 term of the Coal Transition PPA
- 12 • Column C (PPA) identifies the volumes to be delivered for
13 each month under the Coal Transition PPA.
- 14 • Column D (Net Plant \$MM) provides the net book value of
15 an equivalent plant of approximately 346 MW. (As
16 discussed above, the projected cost to build or acquire an
17 equivalent plant of 346 MW as of December 1, 2014 is
18 about \$215 million.
- 19 • Column E (Depreciation \$MM) presents a full value of
20 \$215 million for an equivalent plant of 346 MW as of
21 December 1, 2014, and depreciates such value on a
22 straight-line basis over the 133-month term of the Coal
23 Transition PPA.
- 24 • Column F (Avg. Net Plant \$MM) provides the average net
25 book value (in millions of dollars) of an equivalent plant of
26 346 MW over the course of one year.

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- Column G (Pre-tax Equity Return) provides the monthly pre-tax equity return of an equivalent plant of 346 MW by multiplying the pre-tax weighted average cost of equity of 7.24% by the average net book value of the equivalent plant for that month.

The total nominal pre-tax equity return for an equivalent plant of 346 MW is \$86.22 million. *See* Exhibit No ___(RG-9) at Row A. This total nominal pre-tax equity return yields a net present value of \$66.75 million, using PSE’s currently authorized rate of return of 7.8%. *See* Exhibit No ___(RG-9) at Row B.

PSE then calculated a levelized monthly amount of \$0.75 million and a levelized annual amount of \$9.01 million for an equivalent plant of 346 MW. *See* Exhibit No ___(RG-9) at Rows C and D, respectively. PSE then converted the levelized monthly and annual results to generic unitized rates to be applied to varying volumes throughout the life of the contract. The unitized results on a unit basis is \$2.13/kW monthly and \$25.61/kW annually. *See id.* at Rows F and G, respectively. This is then converted to a levelized \$2.92/MWh. *See id.* at Row H.

VII. DEFERRAL OF COSTS

Q. Is PSE proposing a recovery methodology for costs associated with the Coal Transition PPA in this proceeding.

A. Yes. Please see the Prefiled Direct Testimony of Ms. Katherine J. Barnard, Exhibit No ___(KJB-1T), for a discussion of PSE’s proposed recovery methodology for costs associated with the Coal Transition PPA.

1 **VIII. CONCLUSION**

2 **Q. Please summarize why the Commission should approve the petition filed by**
3 **PSE.**

4 A. The Coal Transition PPA that PSE presents to the Commission for approval in
5 this petition is a resource that is tailored to meet PSE’s resource needs and one
6 that meets the lowest reasonable cost resource standard. Before deciding to
7 pursue this resource, PSE undertook a thorough and detailed analysis of the Coal
8 Transition PPA through its RFP process, including re-evaluations to reflect
9 changing power and gas prices, as well as changes in PSE’s forecasted load. PSE
10 acted deliberately in negotiating the Coal Transition PPA. PSE engaged in
11 discussions and negotiations with TransAlta Centralia periodically over the past
12 two years, and the Coal Transition PPA that PSE presents to the Commission in
13 this case has evolved to reflect changing load, prices, and resource needs. As the
14 testimony and supporting exhibits filed by PSE in this proceeding demonstrate,
15 the Coal Transition PPA provides positive benefits for PSE and its customers.

16 Moreover, the Commission should approve PSE’s acquisition of the Coal
17 Transition PPA because it is consistent with energy policy in the State of
18 Washington. In 2011, the legislature passed, and Governor Gregoire signed into
19 law, the Coal Transition Energy Bill that allows utilities—such as PSE—to enter
20 into long-term coal transition PPAs—such as the Coal Transition PPA—to
21 facilitate the smooth transition from coal-fired electricity generation located in

1 Washington to other forms of electricity generation that produce less greenhouse
2 gas emissions. The Coal Transition Energy Bill provides for a phased transition
3 that ensures the stability of the electric grid and maintains affordable electricity
4 resources.

5 **Q. Does that conclude your prefiled direct testimony?**

6 A. Yes, it does.