

REDACTED VERSION
(HIGHLY CONFIDENTIAL)
Exhibit ___ (KLE-1T)
Docket No. UE-031725
Witness: Kenneth L. Elgin

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondents.

DOCKET NO. UE-031725

TESTIMONY OF

Kenneth L. Elgin

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

January 30, 2004

1 **Q. Please state your name and business address.**

2 A. Kenneth L. Elgin. My business address is Chandler Plaza Building, 1300 South
3 Evergreen Park Drive SW, Olympia, Washington, 98504-7250.

4
5 **Q. By whom are you employed and in what capacity?**

6 A. I am employed by the Regulatory Services Division of the Washington Utilities
7 and Transportation Commission as the Case Strategist.

8
9 **Q. Have you prepared an exhibit describing your education and relevant
10 employment experience in public utility regulation?**

11 A. Yes. It is Exhibit ____ (KLE-2).

12
13 **Q. What is the purpose of your testimony in this docket?**

14 A. I will summarize Staff's presentation and provide an overview of each witness'
15 testimony. I will also provide recommendations on two issues.

16 The first issue involves the cost of fuel to produce power at Puget Sound
17 Energy's ("PSE" or the "Company") Tenaska and Encogen projects. I
18 recommend an adjustment to reflect a reasonable level of fuel costs for these
19 projects. PSE has not shown that its actions regarding fuel purchases are prudent

1 or result in reasonable costs after it bought out the contracts in 1997 and 1998 and
2 became responsible for managing the fuel supply.

3 My second recommendation concerns a clause in the contract to acquire
4 partial ownership of Fredrickson I that enables the Company to terminate the
5 contract prior to closing if it does not receive "WUTC Approvals." I recommend
6 that the Commission find that this clause is contrary to the public interest and
7 sound regulatory policy.

8
9 **Q. Are you sponsoring any exhibits that support your recommendations in this**
10 **proceeding?**

11 A. Yes. I sponsor Exhibit ____(KLE-3C) through Exhibit ____(KLE-6).

12
13 **SUMMARY OF STAFF'S PRESENTATION**

14
15 **Q. Please summarize Staff's presentation and each supporting witness'**
16 **testimony?**

17 A. Staff recommends that rates be increased by \$7,527,693, or .55%. This
18 recommendation is supported by the testimony of Msrs. Schooley, Mariam,
19 McIntosh, Russell and myself.

1 Mr. Schooley presents an adjustment to the cost of fuel to reduce the
2 overall cost for Tenaska to the level the Commission determined appropriate for
3 rates in Docket No. UE-921262, the "Prudence Review." In the Prudence Review,
4 the Commission found that Puget Sound Power & Light Company ("Puget") was
5 imprudent in acquiring the Tenaska resource. The Commission then calculated
6 the amount of "damages" that resulted from Puget's imprudent actions in order
7 to set a reasonable amount that ratepayers will pay for power from Tenaska over
8 the remaining life of the contract. Mr. Schooley's adjustment is essential to
9 ensure that ratepayers pay no more than the Commission determined is
10 appropriate due to Puget's previous imprudent actions. Mr. Schooley also
11 calculates the adjustment based upon my recommendation to reduce the cost of
12 fuel for Tenaska and Encogen. Ratepayers should receive benefits at least equal
13 to those presented to the Commission by PSE when the Company reformed the
14 fuel supply contracts. The cost of fuel will continue to include the amortization
15 of the regulatory assets on the Company's balance sheet, and the amortization of
16 the asset will be included in future calculations of fuel cost for these two projects.

17 Dr. Mariam analyzed the Company's proposed weather normalization
18 adjustment. He recalculates the normalized test period energy sales, which

1 results in an adjustment to both power supply costs and the resulting unit
2 baseline rate cost.

3 Mr. McIntosh analyzed the Company's normalized *pro forma* power
4 supply cost based upon the new test period and loads. This includes changes in
5 the Company's total resource portfolio, including the acquisition of a share of
6 Fredrickson I. Thus, Mr. McIntosh is responsible for determining whether the
7 Company's acquisition of Frederickson I was prudent and the related costs
8 appropriate for recovery in rates. As he explains in detail, Staff concludes that
9 the acquisition of Frederickson is prudent and appropriate to include in rates.

10 As I stated earlier, I explain why an adjustment to the cost of fuel supply
11 for both Tenaska and Encogen is necessary. These adjustments recognize a
12 reasonable level of benefits for ratepayers as a result of the Company reforming
13 these two contracts in 1997 and 1999.

14 Finally, Mr. Russell combines all elements of Staff's adjustments to a *pro*
15 *forma* level and determines the baseline power cost included in rates. He ensures
16 that all rate base amounts, such as the Company's treatment of its White River
17 investment, are calculated properly, and he reviews all other necessary
18 adjustments to ensure that the calculation of baseline power supply cost is
19 accurate. Mr. Russell's Exhibit ___ (JMR-2) page 2, line 10 separates out Mr.

1 Schooley's Prudence Review adjustment for Tenaska from the recommendation I
2 make for Tenaska and Encogen fuel costs. My adjustment is the sum of both
3 amounts appearing in Mr. Russell's Exhibit___ (JMR-2), page 2, Adjustment Nos.
4 12 and 13. Mr. Schooley's Prudence Review adjustment is presented in that
5 exhibit only by Adjustment No. 12.

6
7 **FUEL SUPPLY FOR TENASKA AND ENCOGEN**

8
9 **Q. Mr. Elgin, you stated that you address the issue of fuel supply for the Tenaska**
10 **and Encogen projects. What is the genesis for this recommendation in this**
11 **Power Cost Only Rate Case ("PCORC")?**

12 A. In Docket Nos. UE-971619 (Tenaska) and UE-991918 (Encogen), the Company
13 filed petitions seeking authority from the Commission to create regulatory assets
14 associated with the cost of reforming the underlying fuel costs of these two
15 power contracts. The cost of fuel and the amortization of the regulatory asset are
16 all fuel expenses now appropriate for Commission review.

17 In addition, the reasonable cost of fuel is directly related to the calculation
18 of annual variances in power supply costs to be deferred in the Power Cost
19 Adjustment ("PCA") mechanism.

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Q. Was the Company aware that the cost of fuel for Tenaska and Encogen would be reviewed in the PCORC?

A. Yes. Docket No. UE-031389 involved the annual PCA review. In that case, Staff and Public Counsel objected to the amount of fuel costs for the Tenaska and Encogen projects. Therefore, they agreed with the Company to carve-out that “impasse issue” and set it for hearing in the PCORC. Partial Settlement Stipulation at ¶¶ 9-10. The Commission accepted and adopted the parties’ agreement in its Order No. 04, issued on January 14, 2004. Paragraph 9 of that Order states:

The participating Parties were unable to agree in this docket upon a methodology for determining the costs of power for the Tenaska and Encogen generating resources, and they anticipate those power cost issues will be resolved in pending Docket No. UE-031725.

Most recently, the Company joined a motion with Staff and Public Counsel asking the Commission to clarify that this impasse issue, specifically with respect to prudence, will be litigated and resolved in this PCORC. On January 29, 2004, the Commission issued its Order No. 05, Order on Clarification, in Docket No. UE-031389 affirming that there is no limitation on the parties’ pursuit of matters involving the prudence of Tenaska and Encogen fuel costs. Thus, there is no

1 question but that PSE understood that its fuel procurement decisions for Tenaska
2 and Encogen would be subject to a prudence review in this proceeding.

3 The Company has actually been on notice of this issue since it reformed
4 the underlying fuel contracts in 1997 and 1998. I will discuss this in more detail
5 later in my testimony.

6
7 **Q. Please explain how the amortization of regulatory assets impacts the cost of**
8 **power?**

9 A. The creation of the regulatory asset and its amortization schedule were necessary
10 to match the costs of reforming the contracts with the future benefits of lower
11 fuel costs. Without the accounting orders, PSE would have been required to
12 expense the buy-outs in the year the payments were made to reform the
13 contracts. Exhibit ___(KLE-3C) and Exhibit ____(KLE-4C) contain the petitions
14 filed by the Company, Staff's open meeting memoranda, and the Commission
15 orders creating the regulatory assets, all in Docket Nos. UE-971619 and UE-
16 991918, respectively. Therefore, the cost of fuel for purposes of determining the
17 baseline cost of power in the PCORC should include the amortization and return
18 on these regulatory assets.

1 Q. Mr. Elgin, please explain why the adjustments you recommend are reasonable
2 to consider at this time?

3 A. In addition to my previous testimony surrounding the partial settlement of the
4 PCA review in Docket No. UE-031389, the orders creating the regulatory assets
5 clearly put PSE on notice that its actions with respect to the power supply
6 contracts are subject to review in future rate proceedings to ensure that the
7 Company is prudent in managing these contracts. The ordering paragraph in
8 both dockets contains the following language:

9 The Company's actions in purchasing the gas sales contract, managing the
10 cost of gas, and restructuring the power purchase agreement is subject to
11 review in future rate proceedings; the Company bears the burden of proof
12 in any such proceeding regarding these matters. Any costs determined to
13 be unreasonable or imprudent in such proceedings are subject to
14 disallowance.

15
16 Therefore, in any rate proceeding, such as the PCORC, PSE's actions with respect
17 to the cost of fuel after it reformed the contracts are subject to Commission
18 review and future adjustment. If PSE fails to carry its burden to prove that it
19 acted prudently or that the resulting costs are reasonable, then the Commission
20 should make an adjustment to ensure that customers pay only reasonable costs
21 for service.

22

1 **Q. Please explain the basis for your adjustment to the cost of fuel for Tenaska and**
2 **Encogen in this case?**

3 A. In its petitions for accounting treatment, PSE asserted that the Company would
4 reduce the cost of these projects to ratepayers through lower gas costs. The
5 Company asserted that the combination of the amortization of the regulatory
6 asset, plus the expected savings in the cost of gas, would reduce the cost of
7 power from these two projects. Instead, the actions of the Company have
8 resulted in the cost of these resources being more today than if the Company had
9 not taken any action at all. The Company did not present sufficient evidence in
10 its direct case or in discovery that these higher fuel costs were prudently
11 incurred or reasonable in amount.

12
13 **Q. Are there any other reasons why an adjustment is necessary now?**

14 A. Yes. Puget Sound Power & Light Company ("Puget") acquired the assets of
15 Washington Energy Company in 1996. The Commission authorized the
16 acquisition in early 1997. The combination of the two companies led to the
17 creation of PSE as a combined energy utility. An element of PSE's long-term
18 strategy following the acquisition was its desire to achieve "power stretch
19 savings." The power stretch savings, in essence, were actions PSE needed to take

1 to reduce the cost of its power supply. One element of PSE's strategy to achieve
2 the power stretch savings was its decision to buy-out the underlying fuel supply
3 contracts for Tenaska and Encogen and be responsible for purchasing the fuel
4 supply for the projects. The contract reformation assumed that, through lower
5 fuel costs, the Company would be able to provide future benefits for customers.
6

7 **Q. What action should the Commission take to ensure that ratepayers receive the**
8 **expected benefits from the contract buy-outs?**

9 A. Given the absence of sufficient evidence that PSE's actions were prudent, the
10 consequences of the Company's decision-making for fuel costs for these projects
11 belong with PSE shareholders. The Company's strategy for fuel purchases relied
12 upon transactions in short-term markets. These resources are long-term firm
13 contracts, and it is reasonable to expect the Company to make an affirmative
14 showing that its decision in this regard was prudent. Since PSE has provided
15 insufficient evidence regarding the prudence and reasonableness of its actions
16 regarding these fuel purchases, an adjustment is necessary to ensure that the cost
17 of power from both Tenaska and Encogen reflect a level of costs that include both
18 the amortization of the regulatory asset and the expected benefits that the
19 Company asserted in its petitions were possible when it reformed these

1 contracts. Management should be held accountable to achieve the lower fuel
2 costs that underlie PSE's accounting petitions.

3
4 **Q. Please explain the calculation of your adjustment for fuel supply, which**
5 **would include the amortization of the regulatory asset?**

6 A. The adjustment is calculated in Mr. Schooley's Exhibit____ (TES-5C) and Exhibit
7 ____ (TES-6C). The calculation is based upon the difference between the test
8 period cost of fuel and the cost of fuel the Company asserted in its prior
9 accounting petitions were possible and reasonably obtainable, plus the return on
10 and of the regulatory asset shaped to match expected benefits.

11 The cost of fuel supply for the Tenaska project should be reduced by some
12 \$38,500,000 for the PCORC rate year, while the cost of fuel for the Encogen
13 project should be reduced by approximately \$7,200,000 for the PCORC rate year.
14 The total adjustment for both projects in the PCORC reduces fuel costs by about
15 \$45,750,000.

16 The adjustment involves only fuel costs. As I previously stated, Staff still
17 includes the amortization of the regulatory asset in the calculation of baseline
18 power costs. These assets would continue to be included in the calculation of

1 power costs according to the schedule set out in the Commission orders
2 authorizing the asset on PSE's balance sheet.

3 Mr. Russell's Exhibit ____ (JMR-2), page 2, Adjustment 13, "Encogen &
4 Tenaska Adjustment" shows the adjustment. In his presentation, Mr. Russell
5 separates in Adjustment 12 Mr. Schooley's Tenaska Prudence Review adjustment
6 from the fuel adjustment that I recommend. The adjustments are presented so
7 that the Commission may consider them individually or in combination. My
8 proposed adjustment for fuel supply is the sum of both Adjustment 12 and 13 in
9 Mr. Russell's Exhibit __ (JMR-2).

10 The only complicating factor in the adjustments is the transfer of the
11 calendar year amounts for fuel supply savings to the PCA periods. Mr.
12 Schooley's exhibits identify these amounts for both the PCA and PCORC
13 periods.

14
15 **Q. Mr. Elgin, please summarize why Staff's adjustment to the fuel cost for**
16 **Tenaska and Encogen is reasonable?**

17 **A.** PSE has been on notice since 1997 and 1998 that its actions with respect to these
18 power supply contracts are subject to future review to ensure that the Company
19 is managing these contracts prudently and reasonably.

1 The Company has not provided sufficient evidence to carry that burden of
2 proof, nor has it demonstrated that it managed the fuel supply for these contracts
3 in a manner consistent with its prior stated objective to reduce the total cost of
4 power from these two contracts. Staff's adjustments provide the level of benefits
5 to ratepayers anticipated and represented by PSE to the Commission when the
6 regulatory assets were first created. As I previously stated, management is
7 responsible for its decisions and ratepayers should not be adversely affected by
8 PSE's prior decisions to remain in a short position for fuel supply for these
9 projects absent a showing that such actions were prudent and reasonable.

10
11 **Q. Is it Staff's position that the Company should not consider any short position**
12 **in its fuel supply contracts?**

13 A. No. The Company is obligated to continually evaluate opportunities for
14 obtaining reasonable costs of fuel for its power plants. As new resources are
15 developed, new issues arise with different sets of facts and circumstances that
16 need evaluation. My adjustment in this case merely captures a level of benefits
17 that PSE asserted were reasonably available to the Company at the time, and, in
18 the absence of sufficient evidence to show that the Company's actions to manage

1 the fuel supply were prudent and reasonable, is an appropriate adjustment for
2 the Commission to adopt at this time.

3 The importance of this issue is further highlighted by the fact that the
4 Tenaska regulatory asset created by the Commission is the single largest item on
5 the Company's balance sheet. At year-end 2002, the amount for this regulatory
6 asset is approximately \$229,000,000.

7
8 **Q. Mr. Elgin, you have explained how the Company has long been on notice of its**
9 **responsibility to demonstrate that its gas procurement practices for Tenaska**
10 **and Encogen are prudent and the resulting costs reasonable for ratemaking**
11 **purposes. You have also explained that the Company failed to sufficiently**
12 **address these issues in its direct case in this proceeding. Should the Company,**
13 **on rebuttal, attempt to provide new evidence on these issues, do you have a**
14 **recommendation for the appropriate process to address the merits of that**
15 **evidence, if the Commission elects to do so?**

16 **A.** Yes, but first let me emphasize that Staff's recommendation is the adjustment for
17 Tenaska and Encogen fuel cost that I discussed earlier. Should the Commission
18 elect to consider new evidence from the Company on this issue, there are two
19 available process options. First, the Company is not precluded from filing

1 another PCORC to demonstrate that the cost of fuel for these projects is
2 prudently incurred and reasonable. Any rebuttal evidence on the gas
3 procurement issue I have identified can be addressed fully in the direct
4 testimony filed by PSE in the next PCORC. The recommended adjustment by
5 Staff in this proceeding would be effective until the Commission orders
6 otherwise in that later case.

7 An alternative process exists. It mirrors the decision by the Commission
8 in the Prudence Review, Docket No. UE-921262. That is, the Commission would
9 "spin off" a prudence review of the Company's gas procurement practices for
10 Tenaska and Encogen, and would place those contested costs in rates subject to
11 refund, based on the final decision in that proceeding. However, if the
12 Commission takes this option, Mr. Schooley's adjustment is still essential to
13 preserve the Commission's decision in the Prudence Review to cap the damages
14 from Puget's prior imprudent actions.

15
16 **Q. What issues and complications result from the consideration of any new
17 evidence from PSE on rebuttal in this PCORC?**

18 **A.** It would not be fair or appropriate to the Commission or the parties to consider
19 any new evidence given the expedited nature of this case. There is only one

1 week between the filing of rebuttal on February 13, 2004 and the commencement
2 of hearings on February 23, 2004. While Staff committed to use "best efforts" to
3 complete a PCORC in a shorter time period than the normal statutory 10 months
4 of a general rate filing, we assumed that the Company would provide sufficient
5 evidence on all relevant issues in its direct case. That was not done here and the
6 parties should not suffer the consequences of the Company's omission.

7
8 **Q. Has the Commission previously considered the failure of a company to carry**
9 **its burden of proof in direct testimony?**

10 A. Yes. The Commission recently did so with regard to PSE. In Docket Nos. UE-
11 011163 and UE-011170, a case involving a request for interim rate relief filed by
12 PSE, the Commission stated:

13 In Commission proceedings, pre-filed evidence *is* a party's evidence
14 supporting its case. Pre-filed evidence serves an essential regulatory
15 function. The Commission resolves complex, high-stakes, multiparty
16 litigation within time frames from start to completion that are often
17 shorter than the civil courts can schedule and hold a trial. Pre-filed
18 evidence is one of the means by which efficiency is accomplished. Other
19 Parties rely on the pre-filed evidence as the basis for preparing their cross
20 examination of witnesses and in formulating their responsive evidence.
21 (6th Suppl. Order at ¶ 15.)
22

23 This standard is compelling in this limited issue case designed only to establish a
24 new baseline power cost for PSE on an expedited basis.

1 If the Commission believes it is necessary to provide PSE another chance
2 to demonstrate that its actions on fuel supply were prudent and reasonable in
3 this docket, then it is necessary to provide the parties an opportunity for
4 discovery and filing of responsive evidence.

5
6 **Q. Did you consider the implications of Staff's fuel cost adjustment for the**
7 **Company's financial performance?**

8 A. Yes. As with any proposed adjustment, there is always the risk of what may
9 happen to the Company in light of the financial community's reaction. First, I
10 must acknowledge that risk, however measured, is determined by the degree of
11 uncertainty surrounding any potential issue. The Company's response can
12 significantly impact perceived uncertainty in the financial community.

13 There are also pluses and minuses for PSE in Staff's presentation. Staff's
14 recommendation in this case includes the purchase of Frederickson I in rate base
15 and a rate increase, although clearly not to the level requested by the Company.
16 Staff also continues to recommend that the regulatory asset representing the
17 Tenaska and Encogen buy-out costs remain on PSE's books.

18 Staff, however, cannot recommend that the Company's proposal for
19 Tenaska and Encogen fuel costs be included in rates. The Company accepted the

1 risk of staying short on fuel supply for these projects, and it failed to demonstrate
2 the prudence and reasonableness of that decision. PSE chose to reform the
3 contracts and accept responsibility for managing the fuel costs. Since PSE failed
4 to carry this burden and adequately demonstrate that its decisions result in
5 reasonable costs, Staff is compelled to recommend that the Commission
6 determine baseline power costs in this case based upon the reduced costs for fuel
7 essentially promised to ratepayers by PSE. Reactions from the financial
8 community on this issue was a risk PSE's management accepted for shareholders
9 and must be considered and evaluated in that context.

10
11 **REGULATORY APPROVAL OF NEW RESOURCES**

12
13 **Q. You recommend that the Commission find contrary to the public interest a**
14 **clause of the Frederickson contract that allows PSE to terminate the contract**
15 **prior to closing if it does not receive timely "WUTC Approvals". Where in the**
16 **contract is this provision located?**

17 **A.** The provision can be found in Exhibit __ (EMM-37C/HC), page 80 of 262, Article
18 14.1(a)(ix). The term "WUTC Approvals" is defined in the same exhibit at pages
19 22 and 92 of 262.

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Q. Please explain why this issue is important for the Commission to address?

A. This issue involves clearly defining the responsibility of management to acquire least cost resources as opposed to regulatory oversight of utility management decision-making with respect to costs and rates. The Company is entitled to fair, just, reasonable and sufficient rates if it has carried out its obligations as a public service company. One of those obligations is to acquire least cost resources. The Commission then determines rates based upon reasonable costs. The contract provision I have identified improperly changes that policy.

Q. Do you have any evidence that supports your recommendation on this issue?

A. Yes. In response to Staff Data Request No. 68, the Company's position during contract negotiations was clearly spelled out. The Company stated:

[XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
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XXXXXXXXXXXXXXXXXXXX. This negotiation position is not in the public

1 interest with respect to any prospective project developer or seller of an existing
2 resource.

3

4 **Q. Are there any Commission approvals required for the acquisition?**

5 A. No.

6

7 **Q. Is this first time this issue of Commission approval has arisen for PSE?**

8 A. No. This issue has been a source of controversy since at least 1985.

9

10 **Q. What has been the Commission's policy with respect to resource acquisitions
11 and "pre-approval"?**

12 A. The Commission's 7th Supplemental order in Cause No. U-85-87 explains its
13 policy with respect to "regulatory approval" of new resources and its obligation
14 under Title 80 RCW to determine rates. Exhibit____(KLE-5) is a copy of that
15 order.

16

17 **Q. What was the outcome of that order and subsequent Commission practice with
18 respect to regulatory "approval" of new resources acquired by PSE?**

1 A. The standard practice became for the Commission to “acknowledge” or “accept”
2 the contracts the Company executed when acquiring resources pursuant to
3 PURPA. This policy would also apply to any opportunity presented PSE, such
4 as Frederickson, to purchase an existing resource. The Commission’s objective is
5 not to interfere with management decision-making. The Commission assumes
6 that PSE will acquire new resources consistent with its statutory obligations.
7 The Commission, in turn, determines rates consistent with its statutory
8 obligations after it reviews whether the Company has carried its burden to prove
9 that an acquisition is prudent and reasonable.

10 The Commission’s practice is nothing more than to receive
11 contemporaneous information regarding the Company’s decisions to acquire
12 new resources.

13
14 **Q. Have there been any other proceedings where this pre-approval issue has**
15 **arisen?**

16 A. Yes. The Commission was directly confronted with this issue in the Prudence
17 Review. The Commission’s 19th Supplemental Order at page 40 quotes the
18 testimony of Mr. Lauckhart, Puget’s Vice President of Power Supply at the time:

19 The appropriate forum for Commission review of long-term purchases is
20 in rate cases. In each rate case, the costs of purchases are reviewed for

1 inclusion in rates based on whether they are prudent. Advance approval
2 requirements would impose additional transaction, negotiation difficulties
3 and burdens on the company as it pursues individual opportunities and
4 would inappropriately shift managerial responsibility to the Commission.
5

6 The Commission itself stated at page 41 that, “[I]t did not approve these
7 contracts for ratemaking purposes by ‘accepting’ those contracts following
8 submittal and a favorable Commission Staff recommendation as previously
9 acknowledged by Puget itself.”
10

11 **Q. Do you know whether there has been any change in Commission policy with**
12 **respect to defining utility responsibility to acquire new resources and pre-**
13 **approval?**

14 **A.** There has been no change in Commission policy. Even the PCORC embraces
15 traditional Commission ratemaking policy under current statutes. PCORC is a
16 streamlined single-issue general rate proceeding for purposes of changing rates
17 by updating baseline power costs. PSE must execute all sorts of contracts to meet
18 its public service obligations. Managers make these decisions, then seek rate
19 treatment if existing rates do not provide adequate compensation for a utility’s
20 costs. PSE’s decision to include a regulatory approval clause in the contract for
21 Frederickson I is contrary to Commission policy and is not in the public interest.

1 There is a further concern regarding this issue and the Company's
2 communication with the financial community.

3
4 **Q. Please explain what the Company communicated to the financial community**
5 **with respect to the Frederickson I acquisition?**

6 A. In its October 22, 2003, Form 8-K filing with the Securities and Exchange
7 Commission, the Company stated, "The acquisition (Fredrickson I), subject to the
8 approval by the Washington Utilities and Transportation Commission (WUTC),
9 could be completed by March 2004." Exhibit___ (KLE-6) is a copy of the
10 Company's Form 8-K filing with the SEC. This statement suggests, incorrectly,
11 that the Commission must take action and approve PSE's decision prior to PSE
12 acquiring the project.

13
14 **Q. Is there evidence that the WUTC Approval clause impacted the cost for PSE to**
15 **acquire Frederickson?**

16 A. Yes. In response to Staff Data Request No. 68, PSE indicated that the regulatory
17 approval clause increased the cost of the project.

1 **Q. Is Staff recommending a disallowance based upon this information?**

2 A. No.

3

4 **Q. Why is Staff not recommending a disallowance?**

5 A. Any specific calculation of the compensation for this contract clause is difficult
6 and perhaps impossible to isolate in this case or any future case. Moreover, there
7 are too many other qualitative variables affecting consideration for accepting
8 “WUTC Approval.” Finally, recommending an adjustment would place the
9 Commission in the position of determining the compensation necessary for
10 ratepayers to accept the risk of something more properly aligned with
11 management and shareholder incentives.

12

13 **Q. What is Staff’s recommendation on this issue?**

14 A. The Commission should affirm in its order that contract clauses requiring
15 “WUTC Approvals” are not in the public interest. Such a clause affects the
16 timing, cost and certainty of new projects, particularly for project developers.
17 PSE needs to take decisive action when opportunities arise in order to satisfy its
18 public service obligation to acquire the least cost resources for ratepayers.

19

1 Q. Does this complete your direct testimony?

2 A. Yes.

3

4