Exhibit T___ (TES-1TC/HC)
Docket No. UE-031725
Witness: Thomas E. Schooley

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondents.	DOCKET NO. UE-031725

DIRECT TESTIMONY OF

Thomas E. Schooley

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

REDACTED VERSION

January 30, 2004

DIRECT TESTIMONY OF

THOMAS E. SCHOOLEY
DOCKET No. UE-031725

Q. Please state your name and address.

A. My name is Thomas E. Schooley. My business address is 1300 S. Evergreen Park Drive S.W., PO Box 47250, Olympia WA 98504-7250.

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

A. I am employed by the Washington Utilities and Transportation Commission as a Regulatory Analyst in the Regulatory Services Division.

Q. How long have you been employed by the Commission?

A. Since September 1991.

I. QUALIFICATIONS AND PURPOSE OF TESTIMONY

Q. Please briefly describe your educational background and experience at the Commission.

A. I received a Bachelor of Science degree from Central Washington University in 1986. I met the requirements for a double major in Accounting and Business

Administration-Finance. Additionally, I have a Bachelor of Science degree in geology from the University of Michigan. I passed the Certified Public Accountant exam in May 1989. Since joining the Commission I have attended several regulatory accounting courses, including the summer session of the Institute of Public Utilities.

I testified in Docket No. UE-960195 involving the merger between Washington Natural Gas and Puget Sound Power & Light. I was the lead Staff analyst in several applications for accounting treatment, including Puget Sound Energy, Inc. ("PSE" or the "Company") Docket Nos. UE-971619 and UE-991918. I testified in the Avista general rate case, Docket No. UE-991606, and Avista's energy recovery mechanism, Docket Nos. UE-000972, UE-010395, UE-011595, and UE-030751. I also assisted in the development of Staff testimony in PRAM 2, Docket No. UE-920630, concerning Puget, and I presented the Staff recommendation on environmental remediation in Docket No. UE-911476 concerning Puget. I analyzed PacifiCorp's proposed accounting treatment of Clean Air Act allowances in Docket No.UE-940947, and participated in meetings of PacifiCorp's inter-jurisdictional task force on allocations.

I have prepared detailed statistical studies for use by Commissioners and other Commission employees, and have interpreted utility company reports to determine compliance with Commission regulations.

Q. What is the purpose of your direct testimony?

A. The Company purchases power from the Tenaska gas-fired cogeneration facility located in Whatcom County. The cost of power from Tenaska includes the cost of gas purchased to run the project. I recommend a disallowance of $13,232,315 for the cost of gas in the Tenaska contract for the twelve-month period ended June 30, 2003. This is the period of time of the Company's Power Cost Adjustment ("PCA") Annual Report in Docket No. UE-031389. I will refer to this time period as "PCA #1."

I also recommend a disallowance of $11,947,000 in the Power Cost Only Rate Case ("PCORC") in Docket No. UE-031725 relating to gas costs in the Tenaska contract. Finally, I present the calculation of adjustments supported by Mr. Elgin in his testimony. Mr. Elgin presents the rationale for adjustments to the fuel procurements at Tenaska and Encogen, another gas-fired cogeneration facility in Whatcom County.

Q. In both your sponsored adjustment, and in Mr. Elgin's adjustment, do you assume the regulatory assets behind the gas contract buy-outs are recovered?

A. Yes. Both my sponsored adjustment, and Mr. Elgin's adjustment assume full recovery of, and a return on, the regulatory assets.

Q. Do you sponsor any exhibits in support of your testimony?

A. Yes. I sponsor Exhibit ___(TES-2C) through Exhibit __(TES-6C).

II. TENASKA "PRUDENCE REVIEW" ADJUSTMENT

Q. Generally speaking, what is the basis for the disallowances you recommend with respect to gas costs in the Company's Tenaska power contract ?

A. My adjustments rely upon prior orders of the Commission regarding the "Prudence Review" of Puget Sound Power & Light Company ("Puget") in Docket No. UE-921262.

Q. Please explain your recommendation that the Commission adjust the cost of fuel for the Tenaska project based on those Commission decisions.

A. Puget filed a general rate case in 1992 in Docket No. UE-921262 that, in part, sought to recover the increased cost of new power supply resources. In its 11th

Supplemental Order, the Commission determined that Puget had failed to carry its burden to prove that it was prudent in the acquisition of certain new resources totaling $86,000,000 in increased power supply costs. Rather than disallowing those costs, the Commission placed the $86,000,000 into rates subject to refund, and it ordered Puget to file further evidence demonstrating its prudence in the acquisition of the new resources. In its 18th Supplemental Order, the Commission placed the contract for power purchased from the Tenaska project within the scope of the Commission's "Prudence Review."

Q. What was the result of the Prudence Review?

A. Puget filed supplemental evidence, including evidence related to the Tenaska contract. Other parties responded and additional hearings followed. The Commission issued its 19th and 20th Supplemental Orders finding that Puget was imprudent in its acquisition of three contracts: the Tenaska contract, the Sumas contract, and the March Point 2 contract.

The Commission's 19th Supplemental Order contains the following Finding of Fact No. 5:

> Puget has not carried the burden to demonstrate that its new resource acquisitions were prudent. Puget mismanaged its contract selection and evaluation. Puget was imprudent in its failure to move from the flexible planning process to a rigorous, specific evaluation of the merits of resources at

> the time their acquisition was being considered. The company's decision-making process was not adequate and was not adequately documented.

Q. Did the Commission take any other action concerning the Tenaska contract, given this finding of imprudence?

A. Yes. The Commission determined that it was not reasonable to disallow all costs of the Tenaska contract, but it did establish the appropriate rate making treatment for the excessive costs associated with Tenaska. As stated in Findings of Fact 6 and 7 of the 19th Supplemental Order:

> Puget was imprudent because it failed to analyze the value of dispatchability of a company built resource and factor that value into its evaluation of the purchase price it agreed to pay for its power purchase contracts.
>
> As the result of Puget's actions, it has not obtained some resources at a reasonable cost. Because this is Puget's responsibility, ratepayers should not bear the extra costs. For the Tenaska and the March Point II, Puget's failure to factor in the value of dispatchability caused Puget to pay too much for the contracts. Future ratemaking treatment for these contracts should include the percentage disallowances to reflect these excess amounts, as follows: Tenaska 1.2% and March Point II 3%. (emphasis added)

No disallowance was imposed for the Sumas contract.

Q. What is the result of this finding?

A. By disallowing the extra costs, the Commission created a cap on the amount that PSE may recover in rates for the Tenaska contract. In the Prudence Review, the

Commission determined the amount of disallowance by comparing a reasonable level of costs to the actual levelized prices over the life of the contract, following Public Counsel witness Mr. Blackmon's model. Therefore, if the total costs of the Tenaska contract, as requested by PSE in today's filings, were present in the Prudence Review, the amount of the disallowance would have been even greater. Exhibit_____(TES-2C) provides the stream of contract costs authorized by the Commission for rate-making purposes in the Prudence Review.

Q. Please identify any events subsequent to the Prudence Review that are relevant to your testimony.

A. In 1997, Washington Natural Gas Company and its parent company Washington Energy Company merged into Puget Sound Power & Light Company. The surviving company was renamed Puget Sound Energy, Inc. One element of this combination was Puget's acquisition of the expertise of the gas company to manage future natural gas fuel costs. Later in 1997, PSE filed an accounting petition in Docket No. UE-971619 seeking authority from the Commission to create a regulatory asset and an amortization schedule for the costs to buy-out the fuel supply for the Tenaska contract. As indicated in the Company's petition[1], the Commission's approval of an accounting order was necessary for PSE to complete the transaction allowing it to cost-effectively reform the fuel supply for Tenaska. The objective was to reduce overall costs from the Tenaska project, thereby, benefiting the Company and its customers.

Q. Please explain the effect of the accounting petition in Docket No. UE-971619.

A. The original contract for power from the Tenaska project was based on escalating gas prices for Tenaska Partners, the owner, over the term of the contract. PSE negotiated a buy-out of that contract with the gas supplier and the Commission allowed the cost of the buy-out to be booked as a regulatory asset. PSE's filing for the accounting order showed substantial savings immediately and over time by comparing the original contract rates to offers for long-term gas contracts. PSE was, therefore, allowed to purchase gas for Tenaska on the premise that savings would accrue to both the Company and its customers. An amortization schedule was established to spread the savings equitably over the life of the contract.

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[1] The petition is contained in Mr. Elgin's Exhibit __ (KLE-3C). My reference is to page 5, paragraph 12 of the petition.

Q. Have these projected savings materialized?

A. No. While the cost of gas is somewhat lower than the gas cost in the original contract, when the return of and the return on the regulatory asset are added, the total cost of the Tenaska resource is greater than the original contract costs, which had already been found excessive by the Commission in the Prudence Review.

Q. Please generally describe the calculation of your adjustments for the Tenaska contract.

A. My adjustments bring the cost of Tenaska power to the maximum cost allowed in the Prudence Review. Exhibits _____ (TES-3HC) and ____ (TES-4HC) present the calculations.

Q. Please explain the PCA #1 adjustment for Tenaska on Exhibit _____ (TES-3HC).

A. For the PCA #1 period, July 2002 through June 2003, I use the actual megawatt-hours (MWh) delivered plus the actual MWh displaced (lines 11 and 12). The contract price per MWh from the original contract is multiplied times the MWh in each six-month period (line 24 equals line 4 times line 13). The sum of the two six-month periods is the expense PSE would have incurred assuming no revision to the contract.

Q. Please state the original cost for Tenaska in the PCA #1 period.

A. The total cost based on the original contract is about **[XXXX C XXXXX]** (line 24).

Q. To what did you compare this original amount for PCA #1?

A. I compared this to the actual cost of the Tenaska project. The actual cost includes four items: 1) the cost of power delivered; 2) the amount paid to Tenaska for displaced power; 3) the cost of power purchased to replace the power that was displaced; and 4) the recovery of the regulatory asset.

Q. Please describe items 2 and 3, the displacement costs and the consequent cost of replacement power.

A. PSE may ask the Tenaska plant owners to turn off the plant when economic conditions allow PSE to purchase power more cheaply than the production cost of the plant. Tenaska receives a payment from PSE for this "displacement." During times of displacement, which can last from hours to months, PSE nearly always replaces the power with market purchases.

Q. Please describe in more detail the payment to Tenaska for displacement.

A. The displacement fee includes Tenaska's contractual fixed costs, Tenaska's direct cost for turning off the machine, and a portion of the savings from the market purchases. To calculate the "savings," the market price of replacement power is compared to the plant's incremental generation rate and one-half the difference is included in Tenaska's fee.

Q. In your adjustment, you use replacement power costs. Please explain why and how you calculate those costs?

A. As explained to me by PSE personnel,[2] when the Tenaska plant is displaced, power is usually bought on the open market. As described above, the calculation of the displacement payment uses a replacement power cost. I applied this same price to the displaced MWh to determine the replacement power expense.

[2] My discussions on this topic occurred on December 30, 2003 with John Spellman, Manager Power Supply Operations, Energy Trading & Power; Jeff Shillcutt, Supervisor, Energy Accounting Energy Risk Control; Barbara Luscier, Manager, Revenue Requirements, Federal & State Regulation; and Kacee Chandler, Manager Energy Analysis, Energy Risk Control.

Q. Returning to your calculation of the total cost of power for the Tenaska project, could you please give us the specifics of that calculation?

A. The cost of power delivered to PSE in the PCA #1 period is **[XXX HC XXXXXX]** (line 15). The payments to Tenaska for displacement are **[XXXX HC XXXXXX]** (line 16). The replacement power is about **[XXX HC XXXXXX]**(line 17), and the recovery of the regulatory asset is $27.4 million (line 21). In total, the cost to customers for the Tenaska project in the PCA #1 period is $153.4 million (line 22).

Q. How does this compare to the original cost from the Prudence Review?

A. The total from the PCA #1 period exceeds the implied original contract by $13.7 million ($153.4 million minus $139.7 million). The $13.7 million is reduced by the PCA #1 Schedule E adjustment **[X HC X]**, and by 1.2% to avoid duplicating the disallowance adjustment for Tenaska already included in the PCA #1 filing. My adjustment is, therefore, $13,232,315 (line 29).

Q. What does this disallowed amount represent?

A. The disallowed amount reduces the total cost for the Tenaska contract down to the level determined appropriate by the Commission in Docket No. UE-921262.

Q. What affect does your adjustment have on the PCA #1 deferral?

A. If my adjustment is accepted, the settled level of the PCA #1 power costs, $25,268,220, from Docket No. UE-031389 must be reduced by $13,232,315. Following this adjustment, power costs in the PCA #1 period would be $12,031,042 above the baseline, but within the $20 million band of the PCA mechanism approved by the Commission in the Company's last general rate case, Docket No. UE-011570. [3].

Q. Please describe your adjustment for Tenaska in Docket No. UE-031725, the Power Cost Only Rate Case.

A. Calculation of the PCORC adjustment is shown in Exhibit __(TES-4C). The methodology is similar to the PCA #1 adjustment. Customers should be responsible for no more than the total expenses allowed by the Commission in the Prudence Review. The rate year in the PCORC is the period April 2004 through March 2005. For this rate year, I base Tenaska's power cost on a near capacity load times the fixed costs, plus projected gas costs, less a value for projected displacement. I compare this to the contract rates for 2004 and 2005 times the same production level.

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[3] Wholesale customers are assigned 0.0404% of the total.

Q. What does your calculation show?

A. I show that the net production cost of Tenaska, including recovery of the regulatory asset, is **[XXXXXXXX C XXXXXXX]** (line 22). Per the original contract prices, the projected cost for Tenaska would be **[XXX C XXX]** (line 24). Therefore, the production cost plus regulatory asset recovery exceeds the maximum allowed cost by about $12.2 million (line 25). Again, this difference must be discounted by 1.2% resulting in a rate year disallowance of $12.1 million. The adjustment to the PCORC is $11,947,000 after applying the production factor.

III. FUEL PROCUREMENT ADJUSTMENT FOR TENASKA AND ENCOGEN

Q. You indicated earlier in your testimony that you present the adjustments, which quantify Mr. Elgin's recommendation concerning gas procurements for Tenaska.

A. That's correct. These calculations are shown in Exhibit ____(TES-5C) for the PCA #1 period and Exhibit ____(TES-6C) for the PCORC rate year.

Q. Please explain Exhibit ____(TES-5C).

A. In Exhibit ____(TES-5C), I compared the savings PSE projected in the regulatory asset filings, Docket Nos. UE-971619 and UE-991918, to the values shown in PSE's Response to Staff Data Request No. 3 in PCA #1, Docket No. UE-031389.

Q. What did PSE present as reductions in fuel costs in the regulatory asset filings?

A. Exhibit B of PSE's petition shows projected savings in 2002 of over **[XXX C XX]** at Tenaska and **[XXX C XXX]** at Encogen. PSE projected 2003 savings of **[XX C XX]** and **[XX C XX]** for Tenaska and Encogen, respectively. These amounts are on line 12 of my Exhibit __(TES-5C).

Q. What was the projected level of reduction in fuel costs for the PCA #1 period?

A. During the PCA #1 period, the projected reductions in fuel cost were about **[XX C XXX]** at Tenaska and **[XXX C XXX]** at Encogen (line 20).

Q. What does PSE show as its actual results for the same time period?

A. In PSE's Response to Staff Data Request No. 3 from Docket No. UE-031389, PSE shows that fuel costs were **[XXXXXX C XXXXX]** than those in the original

Tenaska contract. But at Encogen, the fuel costs **[XXXXXXXXX C XXXXXXXXX].** These amounts appear on line 21 of my exhibit.

Q. What is the resulting adjustment?

A. The differences between these amounts are $35.1 million and $4.5 million for the two plants in the PCA #1 period (line 22). The sum of these differences is $39.2 million after reducing the Tenaska figure for the Prudence Review disallowance of 1.2% (line 24).

Q. How does this adjustment relate to your adjustment in Exhibit ____ (TES-3HC)?

A. The disallowance of $13.2 million in Exhibit __(TES-3HC) overlaps with Mr. Elgin's disallowance shown in Exhibit __(TES-5C). The disallowance of $39.2 million less the disallowance of $13.2 million gives an incremental reduction of $25.972 million. This is shown on line 26 of Exhibit ____ (TES-5C).

Q. What is the impact on the PCA #1 deferral of Mr. Elgin's recommendation?

A. If Mr. Elgin's testimony is accepted, the settled level of the PCA #1 power costs, $25,268,220, must be reduced by $39.205 million. The effect would show power costs in the PCA #1 period at $13,931,150 below the baseline.

Q. Turning to the Power Cost Only Rate Case, what were the projected reductions in fuel costs for the Tenaska and Encogen projects at the time of the regulatory asset filings?

A. Exhibit ____ (TES-6C) presents the 2004-2005 data from the regulatory asset filings on line 12. The potential fuel savings at Tenaska were from **[XXXXXXXX C XXXXXXXX]**. At Encogen, the potential savings ranged from **[XXXXXXXX C XXXXXXX]**. For the PCORC rate year the potential gas savings would have been **[XXXX C XXX]** Tenaska and **[XXXX C XXXX]** at Encogen (line 20).

Q. What does PSE now show for the PCORC rate year?

A. PSE's data in the workpapers supporting the response to Staff Data Request No. 3 shows a fuel cost **[XXXXX C XXXXXX]** for the period, April 2004 – March 2005, at Tenaska, and a **[XXXXXXXXXXXXX C XXXXXXXXXXXXXX]** (line 21).

Q. What is the resulting adjustment?

A. The difference between these amounts is $39.0 million in the PCORC rate year at Tenaska and $7.2 million at Encogen (line 22). The sum of the two, after reducing the Tenaska figure for the Prudence Review disallowance and after applying the production factor, is $45.3 million (line 26).

Q. How does this adjustment relate to your adjustment in Exhibit ____ (TES-4C)?

A. The disallowance of $11.9 million in Exhibit __(TES-4C) overlaps with Mr. Elgin's disallowance shown in Exhibit __(TES-6C). The disallowance of $45.2 million less the disallowance of $11.9 million gives an incremental reduction of $33.341 million. This is shown on line 28 of Exhibit ____ (TES-6C). Mr. Russell shows the two adjustments in Exhibit ____ (JMR-2C) as new Adjustment 12 for the "Prudence Review" disallowance sponsored by myself, and new Adjustment 13 as the incremental disallowance sponsored by Mr. Elgin.

Q. Does this conclude your testimony?

A. Yes.