EXHIBIT NO. ___(BAL-1T)
DOCKET NO. UE-04____
2004 PSE PCA 2 COMPLIANCE
WITNESS: BARBARA A. LUSCIER

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of **PUGET SOUND ENERGY, INC.** **For Approval of its 2004 Power Cost Adjustment Mechanism Report**	**Docket No. UE-____**

PREFILED DIRECT TESTIMONY OF
BARBARA A. LUSCIER
ON BEHALF OF PUGET SOUND ENERGY, INC.

AUGUST 31, 2004

PUGET SOUND ENERGY, INC.

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PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY OF BARBARA A. LUSCIER

I. INTRODUCTION

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

A. My name is Barbara A. Luscier. My business address is 10885 N.E. Fourth Street, P.O. Box 97034, Bellevue, Washington 98009-9734. I am the Manager of Revenue Requirements for Puget Energy, Inc. ("Puget Energy" or "the Company").

Q. What is your educational and professional experience?

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

Q. What are your duties as Manager of Revenue Requirements for Puget Energy?

A. I am responsible for regulatory accounting activities.

Q. What is the purpose of this filing?

A. In accordance with the Commission's Twelfth Supplemental Order in Docket No. UE-011570, the Company must file an annual report detailing the power costs included in its deferral calculation under the Power Cost Adjustment Mechanism. Through its Petition, the Company is requesting approval of PSE's Power Cost Adjustment Mechanism Annual Report for the Twelve Months Ended June 30, 2004 ("2004 PCA Report"), including the deferral of under-recovered power costs. The amount deferred represents excess power costs over those included in the baseline rate after taking into consideration the application of the PCA Mechanism sharing bands.

II. BACKGROUND REGARDING THE PCA MECHANISM

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

A. As authorized by the Commission, the Company's PCA Mechanism accounts for differences in PSE's modified actual power costs relative to a power cost baseline. This mechanism accounts for a sharing of costs and benefits that are graduated over four levels of power cost variances, with an overall cap of $40 million (+/-) for the four year period July 1, 2002 through June 30, 2006. If the cap is exceeded, costs and benefits in excess of $40 million would be allocated 99% to the customers and 1% to the Company. *See* Attachment A, the Stipulation associate with the Commission's Twelfth Supplemental Order in Docket No. UE-011570, which defines the specific sharing levels and conditions.

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

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

Fixed Costs:

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

Variable Costs:

Actual monthly amounts recorded in FERC Accounts 501 – Steam generation fuel, 547 – Other power generation fuel, 555 – Purchased power, 447 – Sales for resale, 565 – Transmission of electricity by others. In addition, variable costs and credits for sales of non-core gas Transmission Revenue for Colstrip 1-4 lines, Third AC and Northern Intertie in account 45600017 are included. The allowed rate of return on amounts associated with Tenaska, Cabot and the Bonneville Exchange Power Agreement ("BEP") regulatory assets are also included in variable costs.

Adjustments per the 2001 General Rate Case Settlement:

The following are adjustments as determined in Docket UE 011570:

(1) Prudence disallowance from UE-921262, disallowing a portion of

the power costs associated with March Point 2 (3%) and Tenaska (1.2%);

(2) Contract price adjustments to limit the rate or total cost to the most recently approved contract rate;

(3) Colstrip Availability adjustment if the actual availability factor for the four plants at Colstrip falls below a 70% equivalent availability factor;

(4) New long-term resource pricing adjustment to bring the cost of the new resource to the lower of actual unit cost or the average embedded cost.

No adjustment was required during the July 1, 2003 through June 30, 2004 period ("PCA Period 2") for either item 3 or 4 above. Adjustments under items 1 and 2 are shown in the Company’s work papers provided with this filing.

Q. **Are there other adjustments to be considered along with those determined in UE-011570?**

A. Yes, per the Commission orders issued in Docket UE-031725 (the "PCORC" docket), PSE is subject to the possible disallowance of costs associated with the Tenaska Benchmark Disallowance. Particulars concerning the Tenaska Benchmark Disallowance will be discussed later in my testimony.

III. PCA PERIOD 2 ACCOUNTING

Q. Please explain how the Company has tracked the PCA Period 2 activity.

A. The Company has detailed accounting instructions, which are provided in the supporting workpapers to this filing, that track PCA Mechanism activity. Each month the Company calculates the power costs subject to PCA sharing using the same methodology as shown in Exhibit B from the original PCA Mechanism filing. Allowed power costs include the fixed and adjusted variable costs, net of the adjustments discussed above. Total allowable costs are then compared to the baseline power costs from Exhibit A-1 and any difference is allocated to the Company or customers based on the different levels of sharing defined in the PCA Mechanism. Any difference allocated to the customers, is recorded in FERC Account 182.3, Other regulatory assets or Account 254, Other regulatory credits depending on whether the accumulated balance is a debit or credit.

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

Q. What is the resulting deferral balance for PCA Period 2?

A. As of June 30, 2004 the Company has deferred $2,129,177 of under-recovered power costs, as shown in Exhibit No. ___(BAL-3) page 3 of 25 (2004 PCA Report at p. 2). Interest of $16,758 has also been accrued as allowed for under the PCA Mechanism, for a total customer deferral balance under the PCA mechanism at June 30, 2004 of $2,145,935.

This deferral balance includes an estimate for potential disallowance of 50% of the return on the Tenaska regulatory asset for the full PCA 2 Period, consistent with the Company's financial reporting regarding the PCORC orders. If the Commission does not impose any disallowance for the return on the Tenaska regulatory asset prior to the implementation of Order No. 14 in the PCORC docket, as requested in the Company's Petition in this proceeding, the deferral balance would be $7,647,687. Should the Commission grant this request, substitute pages of the Company’s 2004 PCA Report, reflecting the reversal of the PCA Period 2 disallowance through May 23, 2004, have been provided in Exhibit No. ___(BAL-4).

Q. Will there be a rate increase as a result of this filing?

A. No. In either of the scenarios described above, the deferral balance is not at a level where an increase is warranted.

Q. What is the effective baseline rate at the end of PCA Period 2 when changes in the variable power cost components are considered?

A. As shown on Exhibit No. ___(BAL-3) page 4 of 25 (2004 PCA Report at p. 3: Exhibit A-1 Power Cost Rate Updated), when changes in variable components of the PCA Mechanism are considered, the baseline rate for the twelve month period ended June 30, 2004 is $46.296. This reflects actual power cost exceeding the Baseline rate by $24,258,355. *See* Exhibit No. ___(BAL-3) page 23 of 25 (2004 PCA Report at p. 22). Major contributors to the increase are discussed by Ms. Ryan in her testimony.

If the Commission were to approve the Company's Petition and determine that there will be no Benchmark disallowance imposed during the first part of PCA Period 2, the effective rate would be $46.846 with actual power cost exceeding the Baseline rate by $35,134,440. Proposed substitute pages reflecting these revisions are provided in Exhibit No. ___(BAL-4) (substitute pages 3 and 22).

Q. Were there changes to the Baseline rate within PCA 2 Period?

A. Yes, from July 1, 2003 through May 23, 2004, the baseline rate was $43.953 as established in the 2001 general rate case settlement. Attached in Exhibit No. ___(BAL-3) pages 5 – 15 (2004 PCA Report at pp. 4 – 14) is the calculation of this Baseline rate and supporting schedules for this period. For the remainder of PCA Period 2, May 24, 2004 through June 30, 2004, pursuant to the Commission's Order No. 14 issued in the PCORC docket, the Baseline rate was $46.303. Attached in Exhibit No. ___(BAL-3) pages 16 – 25 (2004 PCA Report at pp. 15 – 24) is the calculation of the new Baseline rate and supporting schedules for this period.

Q. How were the PCORC Docket Orders implemented?

The Company adjusted the PCA deferral calculation to reflect the Commission's authorization regarding recovery of undisputed fixed costs as of April 7, 2004 and the Fredrickson 1 Plant fixed costs as of April 30, 2004 (the date the purchase was finalized). The implementation of the new Power Cost Baseline Rate associated with the PCORC Docket was May 24, 2004. Since that date, the Company has applied the new authorized Power Cost Baseline Rate in the calculation of the

PCA monthly true up.

Q. Have the estimated fixed costs related to the Frederickson 1 Plant purchase been trued-up to actual in the PCA Period 2 calculation?

A. Yes, to the extent that the amounts were known, such costs were trued-up to reflect actual costs. PCA Deferral Calculation, Schedule B, has been adjusted accordingly. These fixed costs will remain constant until the next general rate case or power cost rate case order.

IV. ISSUES RELATED TO THE PCORC TENASKA DISALLOWANCES

Q. Please describe the Tenaska disallowances imposed in PCORC Order No. 14?

A. On May 13, 2004, the Commission issued Order No. 14 in the PCORC docket authorizing the Company to file revised tariff sheets that reflect a revenue deficiency of $44,112,960. In the same Order, the Commission determined that PSE did not prudently manage Tenaska gas costs. As a result, the Company was ordered to adjust the PCA deferral account to reflect a one-time disallowance of $16,648,873 net of tax ($25,613,650 before tax impacts) for PCA Period 1.

The Commission also imposed a Tenaska Benchmark Disallowance to be applied to future Tenaska cost recovery.

Q. Has the $25.6 million been credited back to PCA Period 1?

A. Yes, for PCA deferral purposes, it was credited as of June 30, 2003. This eliminated any customer deferrals from PCA Period 1. For PCA deferral accounting purposes, it also lowered the cumulative deferral balance that is tracked for the $40 million cap by the same amount.

Q. How is the amount of the Tenaska Benchmark Disallowance determined?

A. For periods beginning with the effective date of tariffs issued under PCORC Order No. 14, May 24, 2004, PSE is to track the actual costs for Tenaska against the original Tenaska contract “benchmark” cost. The Benchmark is defined as the total cost under the original Tenaska contract, less the 1.2% disallowance per Docket UE-921262. When actual costs that are determined to be prudent are in excess of the Benchmark there will be a disallowance related to the return “on” the Tenaska regulatory asset. If the total Tenaska costs in excess of the benchmark are greater that the return “on” the Tenaska regulatory assets, then one-half of the return “on” Tenaska is excluded from allowed costs. If the total Tenaska costs in excess of the benchmark are less than the return “on” for the Tenaska regulatory asset, then all of the return that falls under the benchmark and half of the return that exceeds the Benchmark would be included in allowed costs.

Q. Where is the Tenaska Benchmark Disallowance reflected in the Company’s 2004 PCA Report?

A. Actual “allowable” costs net of the Benchmark Disallowance are included in

Exhibit A-1, in the determination of the Baseline rate for May 24, 2004, through the end of PCA Period 2. For future PCA period accounting, the estimated Benchmark Disallowance that the Commission ordered for the PCORC rate year will be included in Exhibit A-1. Once a PCA Period commences, each month's adjusted actual "allowable" costs as reflected in Schedule B are compared to the baseline amounts with the difference being considered for deferral, subject to the sharing calculation.

Because the Tenaska Benchmark Disallowance did not exist at the time the original baseline was set in July 2002, this adjustment is not included on the Exhibit A-1 for the period July 1, 2003 through May 23, 2004. Consistent with the Company's financial reporting treatment, to reflect a potential disallowance for this period, a new line has been created on Schedule B, line 30, to reflect the disallowance as a reduction to total "allowable" costs.

Q. Why did the Company recognize a disallowance related to Tenaska for the first ten plus months of PCA Period 2?

A. In PCORC Order No. 15, the Commission clarified that it had not determined what treatment regarding the return on Tenaska was appropriate for PCA Period 2 with respect to the time period prior to issuance of Order No. 14. Order No. 15 at ¶¶ 50, 53. The Commission indicated that the decision would have to await the outcome of the compliance proceeding for PCA Period 2. However, the Company believed it was required to recognize a reduction in earnings in the interim.

As the Company could not determine based on PCORC Orders No. 14 and 15 the likelihood of 100% of the return on the Tenaska regulatory asset being recoverable for the PCA Period 2 through May 23, 2004, it was determined that for financial reporting purposes, $10.8 million or 50% of the return on the Tenaska regulatory asset for PCA Period 2 prior to May 24, 2004 should be recorded as a loss. This $10.8 million represents one-half of the return on the Tenaska regulatory asset for this part of the PCA 2 Period, and is calculated consistent with the benchmark methodology established in Order No. 14 in the PCORC docket. The Company followed this financial reporting in determining the PCA deferral for this period.

This financial treatment is in accordance with Financial Accounting Standard 71, which provides that for the Company to recognize earnings for a regulatory asset it has to be "probable" that the revenues will be recoverable. In order to recognize 100% recovery of this cost, the Company would have had to have been 90% to 95% sure that the Commission's order in this 2004 PCA true-up proceeding would agree that no such disallowance should be imposed for PCA Period 2. The Company did not have that assurance based on the Commission's Orders in the PCORC docket.

As stated in its Petition for approval of the 2004 PCA Report, PSE requests that the Commission not impose any disallowance of the return on the Tenaska regulatory asset for this part of PCA Period 2. In the event the Commission grants PSE's Petition, the Company would recognize the recovery of this cost at the time of the Order, which would reverse the previously recorded cost of

$10.8 million prior to tax.

V. ADJUSTMENT OF COSTS OUTSIDE OF THE PCA PERIOD

Q. Please describe the need for "Adjustments of Costs Outside of the PCA Period".

A. In the Company's PCA Period 1 compliance filing, Docket No. UE-031389, a procedure entitled "Methodology for Adjustments of Costs Outside of the PCA Period" was agreed to by the parties and describes the treatment of such adjustments. *See* Exhibit No. ___(BAL-5).

Q. Were there any such adjustments in PCA Period 2?

A. Yes. In May 2004, the arbitrators in the Colstrip Units 1 & 2 coal supply agreement dispute issued their binding decision, ruling in favor of Western Energy Company (a subsidiary of Westmoreland Coal Company) by establishing a new contract base profit level retroactive to July 31, 2001. The new base price profit per ton is applicable through the remaining term of the 35-year coal supply agreement, which continues through December 3, 2009. The additional fuel cost the Company incurred for the period July 31, 2001 through May 30, 2004, due to this ruling is $8.1 million. The amount for the PCA period portion, July 1, 2002 through May 30, 2004, $5.5 million, is treated as a power cost under the PCA 2 Period. The $2.6 million related to periods prior to the PCA mechanism was treated as a cost outside the PCA Mechanism.

Also, at June 30, 2004, the Company accrued a loss reserve of $1.1 million per FAS-5 in connection with a Colstrip 3 & 4 order issued in May 2004 by the U. S. Department of the Interior. As this claim relates to periods prior to July 1, 2002, no portion of the expense is being considered in the determination of the deferral in PCA Period 2, or other PCA Periods.

Q. Does this conclude your testimony?

A. Yes, it does.