BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

In the Matter of the Petition of PUGET SOUND ENERGY, INC., for an Accounting Order Authorizing Accounting Treatment Related to Payments for Major Maintenance Activities

DOCKET UE-130583;

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION
v.
PUGET SOUND ENERGY, INC.

DOCKET UE-130617;

In the Matter of the Application of PUGET SOUND ENERGY, INC., for an Order Authorizing the Sale of the Water Rights and Associated Assets of the Electron Hydroelectric Project in Accordance with WAC 480-143 and RCW 80.12,

DOCKET UE-131099; and

In the Matter of the Application of PUGET SOUND ENERGY, INC., For an Order Authorizing the Sale of Interests in the Development Assets Required for the Construction and Operation of Phase II of the Lower Snake River Wind Facility,

DOCKET UE-131230 (Consolidated)

DIRECT TESTIMONY OF SEBASTIAN COPPOLA (SC-1T)

ON BEHALF OF PUBLIC COUNSEL

AUGUST 14, 2013

DIRECT TESTIMONY OF SEBASTIAN COPPOLA (SC-1T)
DOCKETS UE-130583, UE-130617, UE-131099, & UE-131230

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I. INTRODUCTION

Q: Please state your name and business address.

A: My name is Sebastian Coppola. My business address is 5928 Southgate, Rochester, Michigan 48306.

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

A: I am President of Corporate Analytics, Inc., a consulting firm that provides expert witness services on regulated energy issues and other services.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of the Public Counsel Division of the Washington Attorney General's Office (Public Counsel).

Q: Please describe your educational background and professional experience.

A: For more information regarding my professional experience and educational background please see Exhibit No. SC-2. In summary, I am a business consultant specializing in financial and strategic business issues in the fields of energy and utility regulation. I have more than thirty years of experience in public utility and related energy work, both as a consultant and utility company executive. I have testified in several regulatory proceedings before State Public Service Commissions. I have prepared and/or filed testimony in electric and gas rate cases, power supply and gas cost recovery proceedings, revenue and cost tracking mechanisms/riders and other regulatory proceedings. As accounting manager and later financial executive for two regulated gas utilities with operations in Michigan and Alaska, I have been intricately involved in gas cost recovery and reconciliation cases, gas purchase strategies and rate case filings.

Q: What experience do you have with electric utilities?

A: I have performed rate case analyses and filed testimony in several electric general rate cases addressing issues on revenue requirement, sales level determination, operation and maintenance expenses, cost allocations, cost of capital, cost of service and rate design, and various cost tracking mechanisms. In addition, I have performed analysis of power costs and filed testimony in power supply cost recovery mechanisms, including reconciliation of annual power supply costs.

In my position as Senior Vice President of Finance at MCN Energy Group (MCN), I had also responsibility for project financing of independent power generation plants in which MCN was an owner. In this regard, I was intricately involved and became knowledgeable of PURPA qualified cogeneration plants in Michigan and other states. In addition, I was involved in negotiating the development and financing of power generation and electricity distribution plants in other countries, such as India.

Q: Have you previously filed testimony before the Washington Utilities & Transportation Commission?

A: Yes. In June 2013, I filed testimony on a variety of topics in PacifiCorp's General Rate Case, Docket UE-130043. In March 2013, I prepared reports on behalf of Public Counsel analyzing the natural gas price hedging programs and gas procurements practices of gas utilities in the State of Washington. The reports were filed in Dockets UG-121501, UG-121592, UG-121434 and UG-121569. In September 2012, I filed testimony on behalf of Public Counsel in Avista's General Rate Case, Dockets UE-120436 and UG-120437.

I have also submitted written testimony before the Michigan Public Service Commission, the Public Utilities Commission of Ohio, and the Regulatory Commission of Alaska. Exhibit No. SC-2 lists these testimonies and my credentials in the regulated energy field.

Q: What is the purpose of your testimony?

A: I have been retained by Public Counsel to perform a review of Puget Sound Energy's (PSE or the Company) Power Cost Adjustment (PCA) mechanism, and to make a recommendation as to whether it is functioning as intended, is no longer needed, or should be modified to better accomplish the intended results.

I have focused my review solely on this issue. The absence of a discussion of other matters in my testimony should not be taken as an indication that I agree with those aspects of the Company's filing.

Q: What exhibits are you sponsoring in this proceeding?

A: I am sponsoring the following exhibits:

1. Exhibit No. SC-2 Sebastian Coppola Summary of Qualifications
2. Exhibit No. SC-3 Power Cost Comparison 2002 - 2012
3. Exhibit No. SC-4 Power Sources 2002 - 2012
4. Exhibit No. SC-5 Power Capacity by Source 2002 - 2012
5. Exhibit No. SC-6 PSE 2012 PCA Report

II. SUMMARY OF TESTIMONY

Q: Please summarize your major findings and recommendations.

A: PSE'S PCA was established in 2002, at a time when the Company experienced high volatility in the power markets and significant financial turmoil. The PCA was designed to provide PSE with the means to recover significant variance in power costs.

Since the PCA was implemented, PSE has filed numerous PCORCs and general rate cases (GRCs) in succession. These frequent rate increases coupled with the return of normalcy in the west coast power markets have allowed the Company to successfully manage its power costs and return to good financial health. Moreover, because of these circumstances, large variability in power costs never materialized. Variability remains to this day generally less than 3% of baseline costs.

The PCA has not triggered any surcharges or refunds to customers during the 11 years of its existence. However, the deferral of cost variances over the deadband since inception of the PCA has accumulated to a $3.8 million liability for customers, including interest. This means that if the PCA had ended at the end of 2012, the Company would have recovered this amount from customers through a surcharge. On the other hand, the company's share of actual costs over the baseline amount has netted to an over-recovery of approximately $376,000.

Based on my review, I believe that the PCA is not working as intended. I recommend that the Commission undertake a comprehensive review to decide whether to terminate or modify the PCA significantly. Serious consideration

should be given to key modifications to reset the dead band, simplify the mechanism, and set a lower threshold to occasionally trigger any cumulative surcharges or refunds to customers. If the PCA mechanism is retained, it should be modified to establish a more equitable mechanism to better balance the interests of the Company and its customers.

Q: Does this docket involve a full comprehensive review of the PCA?

A: It is my understanding that, as filed by PSE, this docket does not undertake a full review of the PCA.

Q: If this docket does not include a comprehensive review of the PCA, why is Public Counsel interested in this analysis?

A: In PSE's most recent general rate case, Docket No. UE-111048, concerns about the PCA mechanism were raised. Staff Witness Thomas Schooley testified,

> PSE's Power Cost Adjustment ("PCA") is a burdensome mechanism giving PSE a full return of and on certain regulatory assets; recovery of the cost of lines-of-credit, taxes, insurance, payroll; and a guaranteed rate of return on $2 billion of rate base. One-half of PSE's total rate base now receives a guaranteed return. PSE recovers all PCA costs by updating the base line through frequent rate filings. The purpose of the PCA -- to share the risk of power cost variation between ratepayers and the Company -- is thwarted by this situation.[1]

In its Final Order in that docket, the Commission stated that further in-depth review of the PCA could be considered if there was "showing that these mechanisms are not functioning as intended, are no longer needed, or should be modified to better accomplish their intended results."[2] This PCORC is the first filing that has provided such an opportunity for parties to engage in such analysis and/or make these recommendations.

[1] Docket UE-111048, Direct Testimony of Thomas E. Schooley, Exhibit No. TES-1T, p. 9.
[2] Docket No. UE-111048, Order 8 ¶ 511.

Q: Did you conduct a full review of the PCA mechanism?

A: No. I conducted preliminary analysis on the operation of the PCA within the limitations of the current proceeding to determine whether the mechanism should be further examined, and possibly modified.

III. PCA ANALYSIS

A. OVERVIEW

Q: Please briefly describe the purpose and key features of the PCA mechanism.

A: In PSE's 2001 GRC, Dockets UE-011570 and UG-011571, the Commission approved a stipulation defining a PCA mechanism and other related items. The PCA mechanism allows PSE the ability to recover increases in power costs over a baseline level or refund savings to customers if power costs are below the baseline level. The baseline level is the amount set in rates through either a general rate case or other rate case proceeding. The recovery of cost increases and the refunding of savings are subject to the following limitations:

1. **First Band (Dead Band)** – The Company is responsible to absorb the first $20 million of cost increases above the baseline amount and is allowed to retain the first $20 million of savings below the baseline level.
2. **Second Sharing Band** – Between $20 to $40 million above or below the baseline, the Company shares 50% of cost increases or decreases with customers.
3. **Third Sharing Band** – Between $40 to $120 million above or below the baseline, the Company retains 10% and passes 90% of cost increases or decreases to customers.

4. **Fourth Sharing Band** – Above or below $120 million from the baseline level, the Company retains 5% and passes 95% of cost increases or decreases to customers.
5. **$40 million Cap –** If the Company's share of cost or benefits exceed $40 million between July 1, 2002 and June 30, 2006, customers would absorb 99% of the excess and PSE would only be responsible for 1%.
6. **Deferral and Interest** – The Company defers any surcharges or refunds to customers until they reach $30 million. Interest is accrued on the deferred amount.
7. Additionally, the PCA contained the following:
    - **Recoverable Power Costs** – The Stipulation identified certain broad categories of power costs that were recoverable through the PCA, including power costs from new sources with a term of less or equal to two years.
    - **PCORC** – The Stipulation also allowed the Company to file a Power Cost Only Rate Case to recover the cost of new long term power resources and reset the baseline power costs with updated cost information, subject to certain requirements.
    - **Effective Date** – The PCA mechanism's first annual period began July 1, 2002. In 2006, the annual period was changed to a calendar year with that year having a six month stub period.

Although various modifications have been proposed by the Company and other parties since 2002, the PCA has remained generally unchanged since its inception.[3]

Q: Please provide a brief summary of the PCORC.

A: The PCORC, or power cost only rate case, is an accelerated rate case proceeding limited to power costs. This special, single issue rate proceeding was approved by the Commission in conjunction with the PCA mechanism. The purpose of the PCORC is to allow the Company to periodically true up rates for all power costs incurred and expected to be incurred during a future period, including the addition of new power resources. For example, in the currently pending PCORC (Docket UE-130617), the Company has chosen a future rate year ending October 2014 and has included a number of facilities expected to be on line within that date along with projected power purchases and fuel prices.

Since 2002 the Company has used the PCORC proceeding five times to update power costs. Table 1 below shows the dockets and timing of these cases along with general rate cases filed since that time.

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[3] A number of minor changes have been made to the PCORC over this same period. Company witness Katherine Barnard lists them in her testimony, Exhibit No. KJB-1T, p. 3 and 4.

Table 1
PSE GRCs and PCORCs: 2001-2013[4]

DOCKET	RATE CASE TYPE	EFFECTIVE DATE
UE-011570	GRC	7/1/2002
UE-031725	PCORC	5/24/2004
UE-040640	GRC	3/4/2005
UE-050870	PCORC	11/1/2005
UE-060783	PCORC	7/1/2006
UE-060266	GRC	1/13/2007
UE-070565	PCORC	9/1/2007
UE-072300	GRC	11/1/2008
UE-090704	GRC	4/8/2010
UE-111048	GRC	5/7/2012
UE-130617	PCORC	PENDING

Source: PSE Response to Public Counsel Data Request No. 5.

The Company used the PCORC to achieve more timely recovery of power costs. From 2003 to 2012, PSE's baseline power costs have increased more than 56%.[5]

Q: What is your assessment of the PCORC?

A: PSE is the only electric utility in the State of Washington that has this special rate setting mechanism. In combination with periodic general rate cases, the PCORC has allowed PSE to recover power costs more quickly than traditional regulation would allow. In fact, as stated earlier in my testimony, the Company has fully recovered the baseline power costs set in rates from July 2002 to December 2012. Exhibit No. SC-6 shows that over the 11 year period of the PCA, the Company has slightly over-recovered its share of power costs by $375,636, once deferred power costs are surcharged to customers.

[4] This list does not include PSE's Expedited Rate Filing and Decoupling dockets which modified base rates, and established a multi-year rate plan, Docket Nos. UE-130137 and UE-121697.
[5] Exhibit No. SC-3.

B. FINDINGS AND OBSERVATIONS

Q. Please share the findings and observations from your review of the PCA mechanism.

A. Based on my review and analysis of information provided by the Company through discovery, filed by the Company and other parties in this docket as well as previous dockets, and contained in prior Commission orders, I have outlined below certain key findings regarding the operation and performance of the PCA mechanism over the past 11 years.

1. In five of the 11 years, actual power costs have exceeded the baseline levels, while in the other six years actual costs have been below the baseline.[6]
2. The highest dollar amount of cost increase over the baseline amount was $36.2 million which occurred in 2010. The cost increase was 2.7% above the baseline level.[7]
3. The highest percent of cost increase above the baseline was 3.4%, which occurred in the July 2003 – June 2004 period. The amount of this under-recovery was $29.6 million.[8]
4. The largest amount of cost reduction below the baseline amount was $34.8 million, which occurred in 2011 and represents a variance of 2.5% from the baseline level.[9]

[6] Exhibit No. SC-3. This exhibit shows the actual, baseline and difference in power costs for each PCA year from inception to 2012.
[7] *Id.*
[8] *Id.*
[9] *Id.*

5. In total, the power cost over and under-recoveries from customers during the 11 year period net out to an under-recovery of $2.3 million, excluding interest, which is less than two tenths of one percent (.02%) of the total power costs allowed for recovery during this period. However, as stated earlier, the Company slightly over-recovered its share of the costs.[10]
6. Since the time the PCA first went into effect, PSE has filed 11 general rate cases and PCORC proceedings to reset power cost rates. This translates to an average of one proceeding per year.[11]
7. In addition, the Company has opened 11 dockets to file its annual PCA report and present the deferred account reconciliation.[12]
8. No refund or surcharges to customers have been triggered during the 11 year period. The highest cumulative deferred balance was reached in 2010 at $14 million. The deferred balance has been well below the $30 million surcharge/refund threshold.
9. As of the end of 2012, the deferred amount payable by customers, including interest, is approximately $3.8 million.[13]
10. During this 11 year period the Company's share of power cost increases and decreases, including the amount retained within the dead band, nets out to a benefit of $375,636. In contrast, as noted above, customers would be surcharged $3.8 million if the PCA were to end in 2012.[14]

[10] *Id.*
[11] PSE Response to Public Counsel Data Request No. 5. This tally includes the current PCORC docket.
[12] *Id.*
[13] Exhibit No. SC-6.
[14] *Id.*

Q. What variability in power costs have you observed?

A. In various testimonies filed by PSE since the inception of the PCA mechanism, Company witnesses have repeatedly stated that the Company is subject to significant variability in power costs from year to year and over time. As recently as this proceeding, Company witness David Mills stated the following major drivers to power cost variability[15]:

1. Stream flow variations affecting the supply of hydroelectric generation
2. Weather uncertainty affecting power usage
3. Variations in market conditions such as wholesale gas and electric prices
4. Risk of forced outages
5. Variability of wind generation, and
6. Transmission and transportation constraints

Although to some degree these factors impact power cost variability from year to year, the magnitude has not been as severe as PSE implies. As discussed above and shown in Exhibit No. SC-3, the highest percentage of variability from baseline cost levels has been in the 3% range, or approximately $30 million in cost. This is a very manageable amount for a company with $1.3 billion in annual baseline power costs.

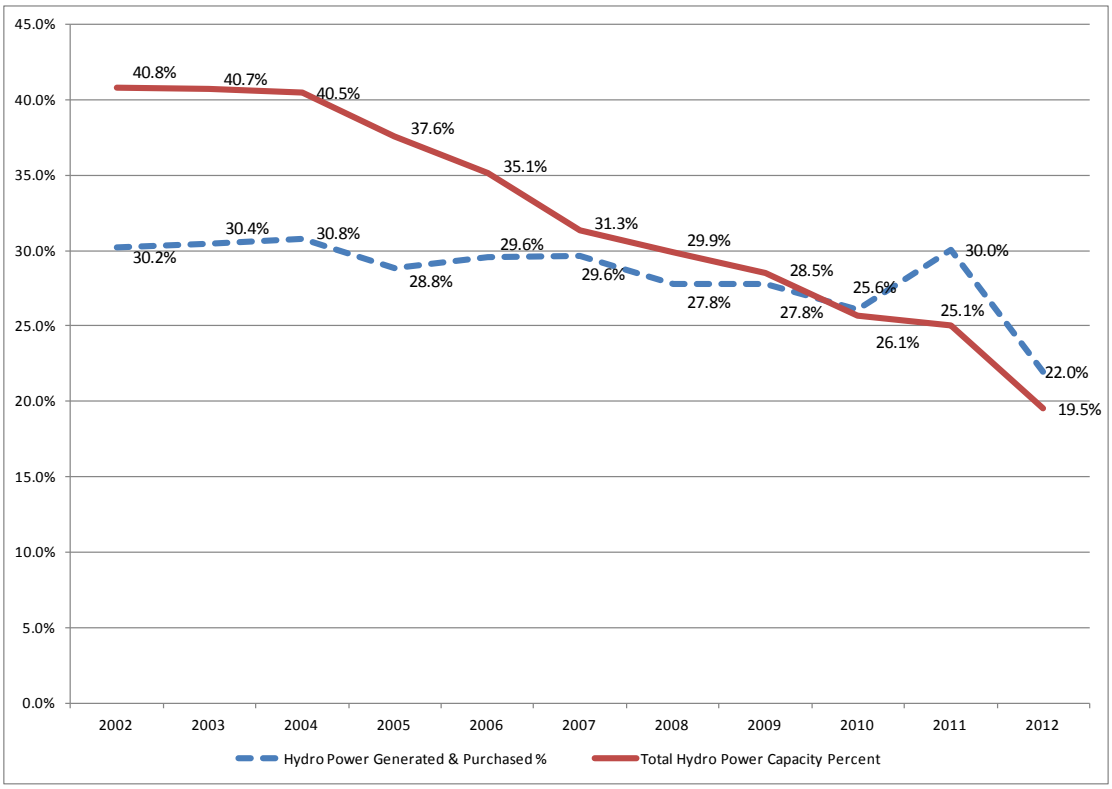
Q. PSE Witness Mills points to variability caused by changes in hydro generation from limited stream water flows during "dry" years.[16] What did you find in your analysis?

A. Through discovery I requested the Company to provide the amount of power generated and purchased by major source (hydro, coal, natural gas, etc.) from

[15] Exhibit No. DEM-1CT, p. 3.
[16] Exhibit No. DEM-1CT, p. 8

2002 to 2012 and forecasted for 2014. Exhibit No. SC-4 shows this information for each year along with the relative percentage. My analysis shows that the percent of hydro power has remained relatively stable in the range of 28 to 30% over the 2002 to 2011 period as a percent of the total power portfolio. The dashed blue line in Table 2 below depicts this fact.

Table 2
PSE Hydro Power
2002 - 2012



Source: PSE Response to PC Data Request No. 9, Attachment A.

The only significant exception occurred in 2012 when hydro generation fell to 22% of the total power portfolio. However, PSE did not experience an increase in power costs, which according to the Company typically follows a drop in regional

hydro generation.[17] In fact, in 2012, power costs decreased $25.7 million from the baseline level, as shown in Exhibit No. SC-3.

Q: Has the Company reduced its reliance on hydro power over the past 11 years?

A: Yes. As shown in Table 2 above and in Exhibit No. SC-5, in 2002 available hydro capacity, including capacity from purchased sources, was slightly above 40%. By 2012, hydro power capacity had fallen to less than 20%. In 2002 PSE had owned and contracted hydro capacity of 1,866 MW. In 2012, hydro capacity was down to 971 MW. Therefore, PSE has cut its reliance on hydro power by about half. This has diminished significantly the impact that hydro has had on the variability of power costs. The Company expects to bring some hydro plants back on line in 2014.[18] However, the 22% of hydro capacity expected to be on line in 2014 is not much different than in 2012.

Q: Has PSE itself testified that hydro generation is not currently a major cause of power cost variability?

A: Yes. The analysis performed by Company witness Salman Aladin and presented in his testimony in the 2011 general rate case filing shows that hydro is not a major contributor to power cost variability.[19]

Q: Does your analysis of the Company's power portfolio show other changes during the 11 year period?

A: Yes. First of all, the Company relied more on purchased power in the early part of 2000 with approximately 70% of its power being purchased from third parties

[17] *Id.*
[18] PSE Response to Public Counsel Data Request No. 010.
[19] Docket UE-111048, Exhibit No. SA-1CT, pp. 12 and 13.

and 30% generated from its owned facilities. By 2010, purchased power dropped to 50% and it currently stands at around 60%.[20] The flurry of PCORC and general rate cases filed by the Company during the past decade is an indication of the Company's strategy to build or buy power plants instead of buying power.

Second, the Company has shifted its power portfolio to natural gas fueled generation and wind power generation. In 2002, natural gas fueled power generation represented 3.8% of the total power portfolio. By 2012, this power source had increased to 11.5% of the portfolio and in 2009 reached as high as 18.6%. Wind power generation, which was non-existent in PSE's portfolio in 2002, has grown to 8.5% in 2012.

Exhibit No. SC-4 shows the trends for each of these sources during the past 11 years.

Q: What implications on power cost variability do these sources have?

A: Natural gas prices have been very volatile during the past decade ranging from less than $2 per million BTU to $13 in the spot market. Although the Company has increased its reliance on natural gas-fueled generation, the impact on PSE's power costs has not been that significant when compared to the cost of the entire power portfolio. If one were to attribute the entire variance in power costs in 2010 to higher gas prices, the variance from the baseline level was only 2.7%.[21].

Natural gas prices have moderated significantly since 2010 and expectations are that they will remain in a moderate range for the foreseeable future given the abundance of gas supplies, particularly from shale gas. The

[20] Exhibit No. SC-4,
[21] This is shown on line 9 of Exhibit No. SC-3

Company's natural gas price hedging program also should help in moderating any significant price volatility.

With regard to wind power generation, PSE, like most other utilities, has gone through a learning curve to understand how to best integrate and rely on wind power. Certainly, planning wind generation has been a challenge. But with the wind industry maturing, the variability of power forecasts and the related cost has diminished and most likely will continue to do so.

Q: What are your observations about other variables listed by Mr. Mills in his testimony, such as weather, facility outages and transmission constraints?

A: The Company has not quantified the impact of these factors on annual power cost variances. Therefore, it is difficult to accurately assess how significant they are. Based on my review, I have not observed that PSE has been subject to other factors that have resulted in significant variability since the inception of the PCA.

Q: What are your conclusions on power cost variability during the past 11 years and going forward?

A: The data provided by the Company and the analysis I have performed clearly shows that power cost variability during the past 11 years has been minimal. The evidence shows that annual variability of less than 3.5% has not created a financial burden on the Company. As such, the PCA mechanism has not triggered any refunds or surcharges and has not been a factor on which the Company has relied for financial support.

Reliance on hydro power has diminished significantly over the past 11 years and does not seem to have resulted in much variability in power costs. The trend shows that the Company will likely rely even less on hydro in the future.

Natural gas fueled generation and wind generation will probably be a larger part of the power portfolio going forward. However, expected moderate gas prices and hedging tools employed by the Company will provide some degree of price stability and minimal power cost volatility.

In summary, with the circumstances described above and the ability that the Company has to reset power costs periodically through general rate cases and PCORC proceedings, my conclusion is that power cost variability in future years may be even less than what the Company has experienced in the past 11 years.

C. RECOMMENDATIONS

Q: What is your recommendation with regard to the PCA?

A: The PCA mechanism is an extraordinary cost recovery mechanism put in place during an extraordinary period of time. It should not have an indefinite life span in its current form.

As discussed earlier in my testimony, power cost variances have been so low that no refunds or surcharges to customers have been triggered during the 11 years that the PCA mechanism has been in place. The highest cumulative amount of deferral was reached in 2010 at $14 million (including interest), which is less than half of the $30 million threshold to trigger a surcharge. Furthermore, debit and credit deferrals have offset each over time. Basically, during this 11 year period, this aspect of the PCA mechanism has been inoperative.

In its order in PSE's 2011 general rate case, the Commission stated:

> **Commission Determination:** Staff, and others who may take an interest, have had ample opportunity in this case and prior cases to address directly any issues concerning the PCA and PCORC mechanisms. Absent some showing that these mechanisms are not functioning as intended, are no longer needed, or should be modified to better accomplish their intended results, we will not order a special proceeding to review them at this time.[22]

The evidence I have presented is sufficiently compelling to justify possible termination of the PCA mechanism, or, at a minimum, a significant overhaul of the mechanism. In order to gather more information, the Commission should order a special proceeding to take place before the Company files its next PCORC to review the need to eliminate or modify the PCA mechanism.

Q: Has the PCA mechanism fulfilled its originally intended objective of protecting the Company's financial integrity?

A: Yes. At the time the PCA was agreed to and approved by the Commission, the Company was suffering significant financial difficulties, the power markets on the west coast were in disarray, the Company was more dependent on wholesale power purchases in a volatile market, and the Company was more dependent on hydro generation.

Q: Do these conditions still exist today?

A: No. PSE has recovered financially. Additionally, the Company is no longer publicly traded, so the underlying financial circumstances have been significantly altered. Moreover, the significant variability in power costs that was anticipated to continue did not materialize. The power markets are not as volatile as they were at the time the PCA was implemented, and the Company received rate relief

[22] Docket No. UE-111048, Order 8 ¶ 511.

in numerous general rate cases and PCORC proceedings in rapid succession. Therefore the anticipated problem with under-recovery of power costs never arose.

Today, the Company is financially healthy, variability of power costs is minimal and the Company has the required regulatory tools through general rate cases and the PCORC to quickly recover anticipated increases in power costs.[23] Because of the amount of time that has elapsed since it was implemented, the changes in circumstances over that time, and the substantial complexity of the mechanism,[24] it is reasonable for the Commission to review the PCA mechanism in a special adjudicated proceeding, prior to the next PCORC.

Q: If the PCA mechanism is terminated, what happens to any deferred surcharge or refund balance?

A: Paragraph B of Exhibit A to the Settlement Stipulation states that:

> If for any reason the PCA shall cease to exist any balance in the deferred accounts not previously reviewed will be reviewed and set for refunds or surcharge to customers at that time.[25]

Q: If the Commission does not terminate the PCA, what modifications do you believe the Commission should consider?

A: I recommend further analysis of ways to simplify the PCA and adjustments to the sharing bands and the dead band.

For example, the current dead band of $20 million represented about 2.5% of the baseline power costs of $843 million in the first PCA year (July 2002 – June 2003). This was a reasonable percent of power cost variability within which

[23] My analysis assumes continuation of the PCORC mechanism separate from the PCA.
[24] Docket No. UE-111048, Exhibit No. TES-1T, p. 9.

the Company has been able to manage. If we apply the same 2.5% to the 2012 baseline power costs of $1.3 billion, the deadband should be increased to about $30 million. In other words, with a larger cost base, the Company has more room to maneuver and manage power costs and their variability.

Q: Should the dead band be symmetrical?

A: No. I am concerned with the cost assumptions embedded in power cost baseline forecasts set in PCORC and general rate cases.[26] These assumptions include price forecasts for power purchases and fuel purchases, the timing of when new power resources come on line and the forecasted mix of generation from various power resources. These assumptions can vary significantly from actual events.

The information provided by the Company in response to discovery shows that for the first six months of 2013, actual power costs are running $29.5 million lower than the baseline amount set in rates. Although some or all of this over-recovery may reverse by the end of 2013, if the year ends with another large over-recovery it will the third year in a row that baseline costs have been materially higher than actual costs.

This scenario then raises the specter that baseline power costs may be inflated and if the dead band is symmetrical, the Company will benefit significantly from higher cost projections imbedded in estimated power costs. A symmetrical dead band implies that there is an even chance of events occurring either on the upside or down side of the baseline level.

[26] Although there has been frequent discussion about the significant asymmetric impact of hydro generation on power costs, as mentioned above, the Company itself has conflicting testimony regarding whether the variance in hydro generation has a significant impact on power cost variability.

However, the Company can exert more control on its costs than customers can. For example, the Company can control to some degree the timing of when new facilities go on line. The Company can control the mix of what power is purchased, generated and dispatched as well as when and how these actions occur. Customers have no control over such events. Furthermore, NYMEX gas futures have an upward price bias, as do prices for electricity futures. These forecasted prices are used to determine baseline power costs.

To the degree that actual prices fall below forecast, an over-recovery of power costs occurs. If there is no PCA mechanism in place, then the Company has the full risk on both sides of the ledger and such variances are not as much of a concern. However, when customers must share cost increases and decreases above the dead band in a PCA mechanism, such variances matter. Therefore, the deadband must be skewed to trigger a sharing of the surcharge or refund at different levels.

Q: What is your recommendation on sharing bands?

A: The current PCA design has three sharing bands on top of the dead band. These sharing bands shift considerable risk to customers and were designed to protect the Company's financial integrity during a period of financial distress. Those circumstances do not exist now.

Q: Do you have an example of how the PCA could be simplified and more equitable for both the Company and customers?

A: Yes. The deadband could be set at $30 million above and $15 million below the baseline cost level and the design of the PCA could be simplified by establishing only one sharing band where customers and Company share equally at 50% for

any increases or decreases in power costs above or below the dead band.

In this situation, if power cost exceed the baseline amount by $35 million, the Company would be responsible for the first $30 million (upper dead band) plus $2.5 million of the $5 million excess. Similarly, if actual power costs were $25 million below the baseline amount the Company would retain the first $15 million (lower dead band) and split the remaining $10 million equally with customers.

Q: In this hypothetical scenario, would you change the threshold amount at which a surcharge or refund to customers would be triggered?

A: Yes. Currently the threshold amount is set at $30 million. Given the low variability in power costs experienced during the past 11 years, no refund or surcharge has ever been triggered.

This threshold amount needs to be set at a level that minimizes frequent surcharges or refunds but yet allows some periodic pass through of accumulated cost deferrals or refunds. Based on the deadband and sharing bands in my example, I recommend that the threshold would be set at $10 million.

If the threshold had been set at this level, it would have triggered only one surcharge and only one refund during the past 11 years.

Q: Should the Commission adjust PSE's Return on Equity if the PCA is retained?

A: Yes. The combination of the PCA and PCORC has reduced the Company's financial risk considerably. As shown by the evidence above, the Company has more than recovered its base line costs over the past 11 years. This is the largest expense for the Company. The PCORC is a rate setting tool that is only available

to PSE and not to other electric utilities in the State of Washington. This regulatory advantage needs to be considered in setting an appropriate allowed ROE for the Company.

Although it is difficult to quantify a specific adjustment to the ROE rate for the lower risk profile, the Commission can use its discretion to select the lower range of recommended ROE rates when setting the allowed ROE. This is a reasonable approach frequently used by regulatory commissions to reflect the lower risk profile among utilities.

IV. CONCLUSION

Q: Please summarize your conclusions and testimony.

A: In summary, the evidence over the past 11 years shows that power cost variability has been minimal, and the PCA may be unnecessary. Thus, the Commission should carefully review whether the current PCA should be terminated or significantly modified. The Commission could take these actions in this case or order a special proceeding to review the need to eliminate or modify the PCA mechanism before the Company files the next PCORC.

Q: Does this conclude your filed testimony?

A: Yes.