EXHIBIT NO. ___(WFD-1CT)
2013 PSE PCORC
WITNESS: WILLIAM F. DONAHUE

BEFORE THE
WASHINGTON UTILITIES AND 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 No. UE-130583**
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondent.	**Docket No. UE-130617**
In the Matter of the Petition of PUGET SOUND ENERGY, Inc. For an Accounting Order Authorizing the Sale of the Water Rights and Associated Assets for the Electron Hydroelectric Project in Accordance with WAC 480-143 and RCW 80.12.	**Docket No. UE-131099**
In the Matter of the Petition of PUGET SOUND ENERGY, Inc. For an Accounting 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 No. UE-131230**

PREFILED REBUTTAL TESTIMONY
(CONFIDENTIAL) OF WILLIAM F. DONAHUE
ON BEHALF OF PUGET SOUND ENERGY, INC.

AUGUST 28, 2013

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PUGET SOUND ENERGY, INC.

PREFILED REBUTTAL TESTIMONY
(CONFIDENTIAL) OF WILLIAM F. DONAHUE

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PUGET SOUND ENERGY, INC.

PREFILED REBUTTAL TESTIMONY (CONFIDENTIAL) OF WILLIAM F. DONAHUE

I. INTRODUCTION

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

A. My name is William (Bill) F. Donahue. My business address is 10885 N.E. Fourth Street Bellevue, WA 98004. I am the Manager, Natural Gas Resources for Puget Sound Energy, Inc. ("PSE").

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

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

Q. What are your duties as Manager, Natural Gas Resources for PSE?

A. As Manager, Natural Gas Resources for PSE, my responsibilities include: (i) contract management of long-term natural gas supply (including the Cedar Hills biogas), pipeline and storage capacity for both the gas and electric portfolios; (ii) analytical support for integrated resource planning and long-term gas resource acquisitions; (iii) maintenance of PSE's relationship with natural gas pipeline and storage owners and operators; (iv) negotiation of pipeline and storage capacity and long-term gas supply acquisitions; (v) management of tariff and contract matters of the Jackson Prairie Storage Project; and (vi) representation of PSE before the Federal Energy Regulatory Commission ("FERC") and Canadian regulatory bodies involving gas pipeline and storage rates and tariffs.

Q. What is the nature of your testimony in this proceeding?

A. This prefiled rebuttal testimony responds to issues raised and assertions made by Staff of the Washington Utilities and Transportation Commission ("Commission Staff") with regard to PSE's contract with Bio Energy (Washington), LLC ("Bio Energy") for the purchase of the pipeline quality biogas produced by the Cedar Hills Regional Landfill facility ("Cedar Hills biogas"). This testimony explains why PSE acquired this gas supply, the environmental attributes related to this gas, and the benefits of such acquisitions to PSE's customers. Finally, this testimony explains the importance of consistent treatment of costs in this case and the proposed Accounting Petition filed by PSE in Docket UE-131276.

II. BACKGROUND REGARDING CEDAR HILLS BIOGAS

Q. Please describe PSE's acquisition of the Cedar Hills biogas.

A. In October 2008, PSE signed a twenty-year contract with Bio Energy to purchase all of the pipeline quality gas produced by the Cedar Hills Regional Landfill facility ("Cedar Hills"), which became effective with the facility's commercial operation date in May 2009. The arrangement was the result of a collaborative effort among PSE, Bio Energy and King County to develop a project that captures the waste gas produced at the Cedar Hills Landfill, processes it to achieve pipeline quality supply, and delivers the gas into Northwest Pipeline GP's ("NWP") interstate system.

The supply arrangement was negotiated for the benefit of PSE's electric customers ("Power Book") for delivery to various PSE power generation facilities via the NWP system. PSE believed that power generated from landfill gas would have potential green benefits, which is why the contract was negotiated as a Power Book resource. However, at the time of the purchase, it was not clear PSE could obtain clear title to the renewable attributes; therefore, no value was ascribed to the environmental attributes in the acquisition phase.

The arrangement was structured to give the Power Book a measure of price diversity, with pricing based on an AECO-related index, a supply basin that the Power Book had been unable to directly access. Furthermore, the transaction was negotiated at a time (mid-2008) of very high gas prices, and although the pricing was based on the AECO index, it included a market-based floor to give Bio Energy price certainty for project financing; and a market-based ceiling to protect PSE from higher gas prices. Although the volume (expected to be between 3,000 and 6,500 MMBtu per day) is modest in terms of the Power Book's total daily demand, the Cedar Hills biogas was purchased to serve generation demand at a market sensitive price. In sum, PSE entered into the Cedar Hills purchase to meet generation needs with the added benefit of potential value of the renewable attributes of the gas.

Q. Please describe the pricing of the Cedar Hills biogas.

A. The market price of natural gas at the time that PSE signed the contract to purchase the Cedar Hills biogas was approximately $8.00 per dekatherm ($/Dth), and the common market expectation at that time was that natural gas prices would go even higher. The parties to the agreement priced the gas at [redacted], which they calculated as a sharing of approximately one-half of the avoided transportation costs to deliver gas from Alberta. The parties further agreed to a floor price of $[redacted]/Dth and a ceiling price of $[redacted]/Dth for the first five years (through May 21, 2014) to hedge or mitigate the price risk in an uncertain market. The use of a floor and ceiling price is a simple financial hedge, and PSE paid no premium for the Cedar Hills biogas because it received no environmental attributes from the seller. PSE acquired the environmental attributes associated with Cedar Hills biogas separately from King County under an arrangement whereby PSE shares a percentage of any net margin on the resale of the Cedar Hills biogas with its environmental attributes.

Q. Please describe the actions PSE has taken with regard to the renewable attributes of the Cedar Hills biogas.

A. In February, 2011, PSE entered into an agreement with King County to purchase all of the Cedar Hills gas emission credits, providing PSE the right to all of the

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environmental attributes associated with the Cedar Hills biogas. As PSE analyzed the various markets, it became apparent that the renewable value of the Cedar Hills biogas may be greater in certain markets as a natural gas product rather than burning the gas to generate electricity and the associated value of renewable energy credits ("REC").

Q. Prior to PSE's agreement with King County in February 2011, did PSE generate any RECs with the Cedar Hills biogas?

A. No. Prior to PSE's agreement with King County in February 2011, PSE did not have the right to the environmental attributes associated with the Cedar Hills biogas. The Cedar Hills biogas was no different than other purchased physical gas, and PSE pooled the biogas with PSE's other physical gas purchases, which PSE then sold or consumed in power generation in the normal course of business.

Q. After PSE's agreement with King County in February 2011, did PSE generate any RECs with the Cedar Hills biogas?

A. No. In analyzing the benefits of obtaining the environmental attributes, PSE had planned to generate RECs by using the biogas to generate power at its Mint Farm Generating Station, which had been certified for this application. By the time PSE secured the rights to the attributes in February 2011, however, the market had evolved such that the Cedar Hills biogas had greater value as a biogas than could be derived through the generation of RECs. Accordingly, PSE changed its strategy from the burning of biogas to create RECs to instead monetizing the renewable attributes of the biogas and establishing accounting procedures to separately track the Cedar Hills biogas.

Q. Please describe PSE's activities to market the biogas.

A. In February 2011, PSE began separately accounting for and storing the production of Cedar Hills biogas while negotiating with third parties to sell the biogas. In March 2011, however, the Cedar Hills Regional Landfill facility interrupted production due to the failure of a major processing plant component and did not resume biogas production until July 2012. Due to the production delay, PSE began delivering biogas under its negotiated sale contract obligations in the fall of 2012.

In July 2012, PSE recognized that Cedar Hills biogas may qualify for the Environmental Protection Agency's ("EPA") Renewable Fuels program. The EPA program, which is independent of Washington's Renewable Portfolio Standard program, allows the biogas to be used to produce Renewable Identification Numbers ("RIN"), which allows for a significantly higher value to be received through this program. Accordingly, in July 2012, PSE continued storing Cedar Hills biogas produced in excess of that needed to fulfill existing contract obligations until the biogas was certified for the EPA program. The Cedar Hills biogas received EPA certification in May 2013 for all inventoried biogas and all future biogas production. PSE negotiated additional sales contracts to sell the Cedar Hills biogas under the EPA renewable fuel standard program in June 2013.

Since July 2012 and throughout the RIN certification process, PSE has continued to enter into transactions with third parties for biogas sales contracts to extract the best value for the Cedar Hills biogas.

III. THE COMMISSION SHOULD INCLUDE THE ACTUAL COST OF THE CEDAR HILLS BIOGAS IN THE CALCULATION OF THE NET PROCEEDS PAYABLE TO CUSTOMERS FOR THE BENEFITS OF THE CEDAR HILLS BIOGAS IN THE ACCOUNTING PETITION FILED BY PSE IN DOCKET UE-131276

Q. Please summarize Commission Staff's adjustment for the Cedar Hills biogas contract.

A. Commission Staff proposes to remove $1.984 million from power costs for what it terms as the "premium" associated with PSE's acquisition of Cedar Hills biogas. *See generally* Exhibit No. ___(EJK-1T). In essence, Commission Staff erroneously asserts that customers "should not be required to pay any MTM or premiums associated with a speculative activity which has not provided any ratepayer benefits to date." Exhibit No. ___(EJK-1T), at page 3, lines 14-15.

Q. Does the mark-to-market adjustment associated with Cedar Hills biogas reflect a "premium" cost of such biogas compared to AURORA-modeled market prices of natural gas?

A. No. Commission Staff incorrectly asserts that

> [t]he Cedar Hills biogas MTM adjustment is not the same as a MTM adjustment associated with financial hedges of natural gas. This MTM adjustment is essentially the "premium" cost of the biogas compared to Aurora modeled market prices of natural gas.

Exhibit No. ___(EJK-1T), at page 2, lines 14-17. The mark-to-market associated with the Cedar Hills biogas represents the difference between its contract price described above and the forward gas market prices underlying the rate year power costs. This adjustment does *not* reflect a "premium" cost of Cedar Hills biogas compared to AURORA-modeled market prices of natural gas.

Q. Is PSE's acquisition of the Cedar Hills biogas a "speculative activity which has not provided any ratepayer benefits to date" and "was not acquired under any least gas cost acquisition strategy"?

A. No. As discussed above, PSE entered into the contract with Bio Energy to purchase the physical gas as a fuel for PSE's gas-fired generation units to generate power to serve electric generation load. In doing so, PSE acquired a long-term local supply of market-priced physical gas for use in meeting its generation requirements and avoided a substantial portion of the transportation costs associated with that supply because it would not have to traverse multiple pipelines to get to PSE's market. PSE needed the physical gas to serve power customers as part of PSE's electric gas supply and was to be used for economic generation or sold if not needed for generation. Although PSE uses the Integrated Resource Plan process to select appropriate generation resources and the appropriate pipeline capacity to fuel gas-fired units because of the long-term fixed costs associated with such resources, the Integrated Resource Plan process is not the appropriate methodology to select and acquire *market-priced* gas supply that utilizes the pipeline capacity to fuel the generation units.

Subsequently, PSE acquired the environmental attributes because such attributes would likely provide greater value to customers and to the seller, who could not obtain further value without control of the physical gas. Enhancing the physical gas by combining it with the ownership of its environmental attributes created a much more valuable commodity – biogas. There was no financial speculation on the value of the Cedar Hills biogas because PSE negotiated an arrangement whereby [redacted].

PSE has monetized the renewable attributes of the Cedar Hills biogas, set aside the net benefits, and requested to return the net benefits associated with the Cedar Hills biogas to customers in the Accounting Petition filed by PSE in Docket UE-131276.

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Q. Please explain how PSE planned to maximize the value of the Cedar Hills biogas.

A. PSE could have simply continued using the Cedar Hills biogas for normal power generation needs at its Mint Farm Generating Station but now, because it controlled the environmental attributes, the biogas would have generated RECs, which could be used to meet RPS requirements or sold as unbundled RECs in the open market. However, PSE determined that *more* value could be created if the gas was instead sold into the California biogas market where the proceeds attributable to the environmental attributes were three to four times greater than as an unbundled REC. PSE forecasts that this level of revenue would more than offset the contracted cost of the Cedar Hills biogas and create a net benefit to its customers. In short, PSE's goal was, and is, to maximize the value of Cedar Hills biogas for its customers.

PSE concluded that it had sufficient RECs to meet its own compliance obligations. Furthermore, PSE determined that (i) the market value of unbundled RECs had declined dramatically due to changing rules in California and (ii) additional rule changes in California had substantially shut-down out-of-state sourced biogas transactions. Therefore, PSE worked with a third-party consultant to learn about the EPA Renewable Fuels program (RIN market) to determine if this was a viable way to maximize the value of the Cedar Hills biogas for customers.

Q. Why did PSE choose to store the Cedar Hills biogas instead of generating RECs?

A. PSE could have generated RECs from daily Cedar Hills biogas production at the Mint Farm Generating Station, however, it is likely that Cedar Hills biogas would be produced even on days when it was not economic to dispatch the Mint Farm Generating Station. Therefore, some amount of Cedar Hills biogas would have needed to be stored from time to time. PSE considered that unbundled RECs produced at Mint Farm Generating Station would have derived approximately $1 above the market price of natural gas. Instead, PSE sold small quantities of biogas into the grand-fathered California compliance market, deriving [redacted] above the market price of gas. However, due to restrictions by California regulation, that market could not absorb all of the gas available, so PSE stored the biogas which PSE concluded was eligible to earn RINs in the EPA Renewable Fuels program. Based on its consultations and discussions with potential RIN purchasers at that time, PSE concluded that participation of the Cedar Hills biogas in the EPA Renewable Fuel program could return a value well above $[redacted], but certainly more than $1, per dekatherm over the market price of gas. PSE engaged the third-party consultant and took the necessary steps to enroll the Cedar Hills biogas into the EPA Renewable Fuels program.

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Q. Has PSE ever generated RECs from the Cedar Hills biogas?

A. No. PSE has never generated RECs from the Cedar Hills biogas because, by February 2011 when PSE had obtained the rights to the biogas environmental attributes, there was far greater value in selling the physical biogas with the attributes in other markets.

Q. What is the status of monetizing the environmental attributes of the Cedar Hills biogas?

A. PSE received EPA certification of the Cedar Hills biogas on May 30, 2013 and began selling both the Cedar Hills biogas held in inventory, as well as any Cedar Hills biogas produced from that point forward, into the RIN eligible market beginning June 5, 2013. At the maximum, on June 4, 2013, PSE had approximately 1,090,000 Dth of Cedar Hills biogas in inventory. Through July 31, 2013, PSE has sold 347,000 Dth from the biogas held in inventory and all of the biogas produced since June 5, 2013 for a net benefit of approximately $4.2 million. PSE expects that all of the current production along with the remaining Cedar Hills biogas that was held in inventory at July 31, 2013, will be sold by October 31, 2013, for a net benefit of $10 million. In total, PSE expects to provide customers a net benefit of over $15 million for the Cedar Hills biogas produced from when PSE obtained the environmental attributes in February 2011 through October 31, 2013.

Q. How has PSE accounted for the sales of the Cedar Hills biogas environmental attributes?

A. PSE has been expensing both the cost of the Cedar Hills biogas and the incremental costs associated with (a) storing and then delivering the biogas to market (only costs incremental to those already recovered in electric rates), (b) payment of royalty on the environmental attributes of the biogas and (c) meeting reporting and compliance obligations related to the biogas.

In accordance with the Commission Order 08 in Dockets UE-111048 and UG-111049,[1] at July 31, 2013, PSE has deferred $5.0 million of net revenues from the sale of the environmental attributes of the Cedar Hills biogas in FERC order 25301141, as a liability to customers. PSE expects to defer an additional $10 million of net revenues for the period of August 1, 2013 through October 31, 2013 (the proposed effective date of changes pursuant to the Accounting Petition).

PSE filed the Accounting Petition for biogas to ensure PSE followed the appropriate regulatory treatment envisioned by the Commission and Commission Staff in the 2011 GRC Final Order. If the WUTC approves PSE's recommendations related to Cedar Hills biogas in this case and approves the pending Accounting Petition, PSE would expect to pass nearly $15 million in net benefits back to electric customers for activity through October 31, 2013.

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[1] *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 & UG-111049, Order 08 (2012) (the "2012 GRC Final Order").

Q. What does PSE recommend regarding the regulatory treatment of the Cedar Hills biogas?

A. The Cedar Hills biogas transactions undertaken by PSE will likely provide significant economic benefits to PSE's electric customers if the WUTC approves PSE's recommendations regarding the Cedar Hills biogas in this case and in the Accounting Petition. As discussed in the rebuttal testimony of Mr. David E. Mills, Exhibit No. ___(DEM-8CT), PSE supports Commission Staff's recommendation to remove the costs of the Cedar Hills biogas from the rate year and has reduced rate year power costs accordingly.

PSE requests that the actual cost of the Cedar Hills biogas be appropriately included in the calculation of the net proceeds payable to customers for the benefits of the Cedar Hills biogas in the Accounting Petition filed by PSE in Docket UE-131276. PSE proposes that the Commission consider and approve the Accounting Petition prior to issuance of the Final Order in this case

IV. CONCLUSION

Q. Does that conclude your testimony?

A. Yes, it does.