BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondent.	DOCKET NO. UE-031725 STAFF RESPONSE IN OPPOSITION TO PETITION OF PUGET SOUND ENERGY, INC. FOR RECONSIDERATION AND IN PARTIAL SUPPORT OF PETITION FOR CLARIFICATION

1 Puget Sound Energy, Inc. ("PSE" or "Company") asks the Commission to reconsider its Order No. 14, entered May 13, 2004 in this proceeding. The Company claims that reconsideration is necessary because the Commission adopted a "new regulatory test" to evaluate the prudence of Tenaska fuel acquisition that violates: (1) Washington law;[1] (2) fundamental notions of fairness, due process and ratemaking;[2] and (3) public policy.[3]

[1] PSE Petition at 3-7.
[2] PSE Petition at 7-10.
[3] PSE Petition at 10-17.

2 In the alternative, the Company asks for clarification on how the disallowances ordered by the Commission should be implemented in the Power Cost Adjustment ("PCA") mechanism.

3 Commission Staff opposes reconsideration. The Commission did not apply a new test to evaluate the prudence of PSE's acquisition of fuel supply for Tenaska. It applied its traditional prudence test to find that the Company had mismanaged gas purchases for Tenaska. Thus, *all* of the Company's arguments on reconsideration rest on a fundamental mischaracterization of Order No. 14 and should be rejected on that basis alone. (Section I.A.)

4 The Petition for Reconsideration should be rejected also because it misconstrues Order No. 14 even with respect to the standards for cost recovery established by the Commission. The Commission applied "used and useful" and "matching" theories, but only by analogy to guide its determination of those standards. The standards are also a fair and reasonable application of the Commission's broad discretion to fix rates and determine ratemaking methodology based on the particular facts and circumstances of this case. (Section I.B.)

5 While Staff opposes reconsideration, Staff does support certain aspects of the Company's request for clarification of Order No. 14. (Section II.)

I. ARGUMENT IN OPPOSITION TO RECONSIDERATION

A. The Company's Petition for Reconsideration Should Be Denied Because It Is Based Entirely on the False Premise That the Commission Adopted and Applied a New and Unknown Test to Evaluate Prudence

6 At the outset, it is worth noting what the Company does not address in its Petition. The Commission's Order No. 14 found expressly that PSE's management of the fuel supply for Tenaska was imprudent *and* resulted in unreasonable costs:

> PSE failed to carry its burden of proof to demonstrate its management of fuel gas acquisition for Tenaska was prudent through the PCA and PCORC periods under consideration in this proceeding. Puget's mismanagement of gas purchases for Tenaska was imprudent resulting in the incurrence of costs that are not reasonable considering the total costs of gas, return of, and return on the Tenaska regulatory asset.[4]

The Company does not contest any aspect of this finding. PSE does state that it "continues to believe that these decisions were reasonable when made, given the information that PSE possessed and reasonably could have known at the time of its decisions."[5] However, the Company's belief is unsupported completely and absolutely. The Petition is simply silent on those matters.

7 Beyond this important omission, there is one overriding reason for the Commission to deny reconsideration: every single one of the Company's legal, equitable, ratemaking and public policy arguments rest on the fundamental, but grossly incorrect, premise that the Commission adopted, without prior notice to the

[4] Order No. 14 at ¶ 109 (Finding of Fact No 5).
[5] PSE Petition at 1: 24-26.

Company, a novel "used and useful" test to evaluate the prudence of PSE's fuel management decisions for Tenaska. This assumption is made clear throughout the Company's Petition:

> The Commission has adopted and applied a new regulatory test in the Tenaska Order. Described as a "used and useful" theory, the new test instead evaluates a resource by narrowly assessing its economic value at indeterminate review points rather than according to the resource's physical use and availability for service . . . The new test elipses the long-standing prudence standard upon which PSE and other utilities have always relied and assumed that they would be judged.[6]
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> At no time has PSE ever understood that its management of the Tenaska asset could or would be judged by the new economic test set forth in the Tenaska Order.[7]
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> The Commission's use of, and reliance upon, the prudence test – and only that test – to evaluate the Tenaska resource did not change when it approved the creation of the regulatory asset in 1997. The Order in Docket No. UE-971619 stated unequivocally that the approval of PSE's accounting petition '[did] not in any way modify or affect the Commission's prior orders regarding standards or burdens of proof in determining whether costs of a utility were imprudent or unreasonable.' PSE was thus put on notice that the Commission would evaluate its management of the Tenaska asset according to the prudence standard – not a 'hybrid' standard that includes an economic component.[8]
>
> Under these earlier Orders, the Commission consistently applied a single test – the prudence standard – that guided PSE in its efforts to manage the Tenaska resource. In the Tenaska Order, however, the Commission adds yet another test – an economic test 'used and useful' component.[9]

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[6] PSE Petition at 2: 2-5 and 12-14.
[7] PSE Petition at 7: 25-26.
[8] PSE Petition at 8: 12-19.
[9] PSE Petition at 9: 1-4.

> The new economic test indisputably departs from the Commission's historical use of, and reliance upon, a prudence standard to evaluate utility resource decisions. As such, it effectively supersedes a proven and workable review standard.[10]

8 Thus, the Company ignores the considerable attention the Commission devoted to explaining that it was adopting its traditional, well-known test to evaluate prudence:

> Historically, the Commission has followed the widely adopted standard for evaluating prudence whereby:
>
> > It is generally conceded that one cannot use the advantage of hindsight. The test this Commission applies to measure prudence is what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision. This test applies both to the question of need and the appropriateness of the expenditures.
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> The Commission applied this standard in its original consideration of PSE's Tenaska and Encogen contracts, has consistently applied it in other proceedings, and will apply it here. The Company must establish that it adequately studied the questions relevant to management of the costs of gas and made prudent decisions in light of the contract restructuring approved by the Commission in 1997 and 1999, using the data and methods that a reasonable management would have used at the time the decisions were made. This requires evaluation of the Company's decisions not just from the perspective of management for the benefit of shareholders, but also for the benefit of customers. 'The fundamental question for decision is whether management acted reasonably in the public interest, not merely in the interest of the company.'

* * *

[10] PSE Petition at 10: 18-20.

> PSE expresses appropriate concern that we must evaluate the prudence of past decisions on the basis of what the Company "knew or should have known at the time" the decisions were made. The Commission fully understands its own standard, including the point that the prudence of decisions must not be evaluated on the basis of hindsight. We find the record adequate to our evaluation of the prudence of PSE's management decisions on the basis of what the Company knew or should have known at the time the decisions were made.[11]

9 Having carefully reviewed its long-standing prudence test, the Commission then expressly applied[12] that same test in light of the evidence and arguments presented by the parties.[13]

10 The Commission did apply regulatory concepts based in "used and useful" theories and principles of "matching" costs and benefits. However, the Commission was equally clear to explain that these principles were *not* applied to evaluate prudence. Rather, they were applied only to determine a fair and reasonable cost disallowance *after* the Commission had first concluded, using its traditional prudence test, that the Company had mismanaged the acquisition of fuel supply for Tenaska.[14] For example, the Commission stated:

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[11] Order No. 14 at ¶¶ 65 and 67 (citations omitted.) As a point of clarification, we note that the Commission's statement that it approved the Tenaska contract restructuring in 1997 is not technically correct. The Commission did not approve the restructurings themselves. Rather, it approved the accounting treatment related to restructurings.

[12] Order No. 14 at ¶¶ 87-92.

[13] Order No. 14 at ¶¶ 44-49 (Staff); ¶¶ 51-54 (ICNU); ¶¶ 56-64 (PSE).

[14] It is difficult to understand how the Company failed to understand this distinction since the Commission previously applied the same two-step approach – prudence evaluation, then, cost disallowance – to find that PSE's original acquisition of Tenaska was imprudent and required a disallowance based upon an original method developed specifically for the facts and circumstances of that proceeding. *WUTC v. Puget Sound Power & Light Company*, 19th Supplemental Order, Docket

> Thus, we will use the hybrid analysis to *determine recovery in rates* that are fair, just, reasonable and sufficient . . . We consider first the prudence of PSE's management of gas supply acquisition since the contract buyout.[15]

11 Elsewhere, the Commission echoed this distinction between first evaluating prudence, where the traditional approach was applied, and then determining an appropriate cost recovery remedy, where the hybrid approach was applied:

> *In addition to prudence*, the parties' respective theories also touch on, or at least are analogous to, principles of regulatory ratemaking generally characterized as the "used and useful" theory, and the principle of "matching" costs and benefits. All of PSE's opponents propose *remedies* grounded in the concept that to the extent costs incurred do not match expected benefits in the periods at issue, those costs should be disallowed.[16]

Similarly, the Commission stated:

> Although they do not expressly argue for the direct application of the used and useful theory of rate regulation, the various caps urged by the opposing parties are based on principles that relate to that *theory of cost disallowance* . . . This type of standard -- that costs allowed should be roughly commensurate with benefits conferred -- as a standard for recovery of the Tenaska contract buyout costs, was not expressly articulated when the regulatory asset was created, yet it does have some merit.[17]

12 In fact, the rules for cost recovery established by the Commission vary depending on whether or not the Company prudently manages Tenaska fuel

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Nos. UE-921262, *et al.* (1994). The Commission has done nothing different in this proceeding. *See also WUTC v. Puget Sound Power & Light Co.*, 4th Supplemental Order, Cause No. U-83-54 (1984) for the proposition that prudence is the proper test to determine *whether* an expense should be recovered in rates, but not *how much* of the expense should be recovered.

[15] Order No. 14 at ¶¶ 85 and 87. (Emphasis added.)

[16] Order No. 14 at ¶ 68. (Emphasis added.) *See also* Order No. 14 at ¶¶ 50 and 55, where the Staff and ICNU cost disallowances are discussed as "remedies" for the Company's imprudent management of Tenaska fuel supply.

[17] Order No. 14 at ¶ 78. (Emphasis added.)

supply.[18] Thus, the rules are not even triggered until the Company's fuel management decisions are first evaluated under the traditional prudence test.

13 In sum, the Company's core premise that the Commission adopted and applied a new test of prudence is nothing more than a straw-man argument with no support or logic in Order No. 14. All of the Company's legal, equitable, ratemaking, and policy arguments, thus, fall by the wayside.[19]

B. The Company's Petition for Reconsideration Should Be Denied Also Because It Misconstrues the Standards the Commission Established for Cost Recovery

14 Not only has the Company mischaracterized Order No. 14 as adopting a new regulatory test to evaluate prudence, the Company has also misconstrued the Order

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[18] Order No. 14 at ¶ 95.

[19] This would include the Company's claim that the Commission violated RCW 80.04.210 regarding amendments to prior orders and should remedy that violation through additional proceedings. PSE Petition at 9: 23 through 10: 6, 17: 16-18 and 19: 12-16, citing, *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

It would also include PSE's allegation that Order No. 14 is an arbitrary *ex post* change in regulatory policy that PSE did not anticipate and could not have anticipated. PSE Petition at 9: 10-22. Indeed, the Company has known since 1997 that it would be held to the Commission's traditional test for prudence in future rate proceedings and subject to cost disallowance for unreasonable costs, *whether or not those costs were prudent*. The Commission's prior order approving the Tenaska accounting petition stated clearly that:

> The Company's actions in purchasing the gas sales contract, managing the cost of gas, and restructuring the power purchase agreement is [sic] subject to review in future rate proceedings; the Company bears the burden of proof in any such proceeding regarding these matters. Any costs determined to be *unreasonable or imprudent* in such proceedings are subject to disallowance.
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> The Commission's approval of the instant petition does not in any manner modify or affect the Commission's prior orders regarding standards or burden of proof in determining whether costs of a utility were imprudent or unreasonable.

In the Matter of the Petition of Puget Sound Energy, Inc., for an Order Regarding the Accounting Treatment for the Purchase of a Gas Sales Contract, Order, Docket No. UE-971619 (December 15, 1997). (Emphasis added; citations omitted.)

with respect to the rules of cost recovery. Relying heavily upon, *POWER v. Util. & Transp. Comm'n*, 104 Wn.2d 798, 711 P.2d 319 (1985) ("*POWER*"), the Company argues that the Commission unlawfully applied the "used and useful" standard in RCW 80.28.250 to operating expenses, when that statute is limited to rate base valuation.[20]

15 The Commission, however, was clear that it was only utilizing "used and useful" and "matching" *concepts* that it also warned would not be applied rigidly. The concepts were applied only by analogy because they provided "useful guidance (but not a straitjacket) for considering the evidence."[21]

16 Indeed, had the Commission applied these principles strictly, it could have derived a much larger cost disallowance.[22] The Commission could have adopted

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[20] PSE Petition at 4-7.

[21] Order No. 14 at ¶¶ 68 and 70. *See also* Order No. 14 at ¶ 85, where the Commission stated:

> We think that the regulatory concepts grounded in both 'used and useful' and 'prudence' theories have merit, but that neither should dominate exclusively in this particular case, where the regulatory asset gave rise to on-going purchasing obligations, and where the environment has changed substantially from the time the asset was created.

[22] Thus, beyond being irrelevant, it is disingenuous for the Company to argue that the Commission's cost recovery approach imposes asymmetric risks on PSE. PSE Petition at 17-19. If anything, the approach adopted by the Commission is skewed in PSE's favor. For example, the Commission's order approving the Tenaska accounting petition approved a compounding of interest on the regulatory asset by allowing the Company to capitalize one-half of the interest. Order No. 14 at ¶ 34. Thus, by the end of the rate plan period (2001), the regulatory asset balance was greater ($231.5 million) than the original balance ($215 million), which allows PSE to recover more than the cost of the contract buyout. Ex. 5 at 47: 17 and 20.

Moreover, the gas cost savings that are available in later years are a fraction of the savings projected originally by the Company. Compare Ex. 283C at 14, line 8 versus Ex. 310 at 7, line. It hardly provides "too great a benefit to customers at PSE's expense" (PSE Petition at 18: 15) to allow ratepayers to realize these savings via the PCA.

Finally, the Company provides Attachment A in support of its argument regarding risk symmetry. Attachment A relies upon new evidence and should not be considered by the

Staff's proposal, which provided ratepayers all savings the Company had the opportunity to achieve, as shown in the economic analysis presented to the Commission in 1997 to justify the significant cost of the regulatory asset.[23] The Commission could also have adopted ICNU's proposal, which advocated removal of the Tenaska regulatory asset from PSE's books and a complete write-off of the asset.[24] Instead, the Commission adopted its hybrid approach to cost recovery in order to weigh all "interests, theories, historical facts, and scenarios of the future, such that the end result is fair, just, reasonable and sufficient rates."[25]

17 Moreover, contrary to PSE's assertion, *POWER* actually supports Order No. 14 with respect to cost recovery.[26] The Court recognized that the statutory mandate

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Commission. Even if considered, Attachment A is misleading because: (1) it begins with PCA Period 1 and, thus, excludes savings in earlier years that accrued only to shareholders; and (2) it depicts "Variable Contract" costs that vary only slightly despite the Commission's unchallenged finding that the Company was imprudent because it had no strategy for fuel purchases other than its continued reliance on an undefined and potentially volatile short-term market.

[23] Order No. 14 at ¶ 69. Staff's proposal resulted in a disallowance of $38.5 million for the PCORC period, compared to the Commission's disallowance of $9.9 million. Ex. 306. For the PCA period, Staff's disallowance was $34.7 million, compared to the Commission's disallowance of $25.6 million. Ex. 305C.

[24] Order No. 14 at ¶ 68.

[25] Order No. 14 at ¶ 96.

[26] Similar support for Order No. 14 can also be found in *Jersey Central Power & Light Co. v. Federal Energy Regulatory Comm'n*, 810 F.2d 1168 (D.C. Cir. 1987), despite the Company's own reliance on that case. PSE Petition at 2: 5-6 and 25: 9-10. Indeed, the Court stated that a commission "is not precluded from employing 'used and useful,' or any other specific rate-setting formula" as long as the resulting rate is just and reasonable under the "end results" test. *Id*. at 1187, citing of *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). The Court remanded the case to FERC because, unlike the Commission in the instant case, FERC had *not* balanced consumer and investor interests based on the particular facts of the case. *Id*. at 1181-82 and 1187.

Moreover, in language incompletely cited by the Company (PSE Petition at 2: 5-6), the concurring opinion of Judge Starr stated:

For me, the prudent investment rule is, taken alone, too weighted for constitutional

to the Commission to fix rates that are "just, fair, reasonable and sufficient" is a broad standard that allows the Commission wide discretion not only in setting rates, but also in selecting the appropriate ratemaking methodology.[27] The Company does not allege that the Commission's hybrid approach to cost recovery violates that statutory mandate or abuses the Commission's broad discretion.

18 *POWER* also involved the Commission's consideration of costs incurred by Puget Sound Power & Light Company to plan and design a subsequently canceled nuclear power generating facility (Pebble Springs). The Commission found to be prudent both Puget's decision to invest in Pebble Springs and its decision to abandon Pebble Springs. No party on appeal challenged those findings.

19 The parties, however, did challenge the Commission's decision to allow the Company to amortize over 10 years all expenditures associated with the project, even though the Commission had rejected the Company's request to include the un-

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> analysis in favor of the utility. It lacks balance. But so too, the 'used and useful' rule, taken alone, is skewed heavily in favor of ratepayers. It also lacks balance. In the modern setting neither regime, mechanically applied with full rigor, will likely achieve justice among the competing interests of investor and ratepayers so as to avoid confiscation of the utility's property or a taking of the property of ratepayers through unjustifiably exorbitant rates. Each approach, however, provides important insights about the ultimate objective of the regulatory process, which is to achieve a just result in rate regulation.

Id. at 1191. The Commission was entirely consistent with the majority and concurring opinions in *Jersey Central* with its "flexible" application of "used and useful" and "matching" principles. Order No. 14 at ¶ 81.

[27] *POWER*, *supra*, 104 Wn.2d at 808 and 812, citing RCW 80.28.010(1) and RCW 80.28.020. *POWER*, *supra*, at 807, also affirms that the function of ratemaking is legislative in character. Thus, while the Commission is bound by its statutory mandate in setting rates, it is not bound by the specific proposals made by the parties in a particular rate case. It may fashion its own remedies for a specific case, as long as the result is rates that just, fair, reasonable and sufficient.

amortized balance in rate base. The Court upheld the Commission's decision to allow full return *of* a *prudent* investment, but no return *on* that investment, as an appropriate application of the Commission's statutory discretion.

20 Thus, with respect to Tenaska in PCA Period 1, Order No. 14 is aligned with *POWER*, despite the Commission's unchallenged finding that PSE imprudently managed the facility's fuel supply. The disallowance is an amount equal only to the return *on* the asset and associated taxes.[28]

21 With respect to the PCORC Period, Order No. 14 assumes that PSE was prudent, but only because the Commission could not pinpoint the precise consequences to gas costs or the regulatory asset that resulted from PSE's failure to manage prudently.[29] Order No. 14 also allows PSE to recover *all* of its actual costs of gas and return *of* the regulatory asset, *plus* 50% of any portion of return *on* the asset above the established benchmark.[30] Thus, Order No. 14 is more favorable to the Company than was allowed under the facts and circumstances presented in *POWER*.

22 The same favorable treatment will apply to Tenaska costs in future rate proceedings. Assuming that the Company's gas purchases and purchasing plan for Tenaska are prudent and the benchmark is exceeded in any PCA period, there will

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[28] Order No. 14 at ¶¶ 93-94.
[29] *Id*.
[30] Order No. 14 at ¶¶ 95 and 97.

be an annual calculation that considers the total cost of Tenaska, including a return *of and on* the asset and associated taxes.[31]

C. Conclusion

23 In sum, PSE has mischaracterized the Commission's Order No. 14 as a new approach to prudence reviews. In fact, Order No. 14 maintains the *status quo* regarding the Commission's prudence evaluation of energy resource decisions.[32]

24 Beyond that pivotal error, the Company also fails to demonstrate that Order No. 14 violates the broad discretion afforded the Commission by statute and case law to set rates and ratemaking methodology as required by the facts and circumstances of a particular case.[33] The Commission, in fact, adopted a cost recovery approach with less impact on PSE than would result under other justified approaches, despite the Company's imprudent management of Tenaska fuel costs.

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[31] *Id.*

[32] Thus, the Commission should reject PSE's arguments that Order No. 14 compromises the Commission's least cost planning approach and increases uncertainty in the electric industry. PSE Petition at 13-17. If anything, all utilities will acknowledge Order No. 14, and Order No. 12 approving the inclusion in rates of Frederickson, as a clear signal from the Commission that prospective resource decisions will be both evaluated under the traditional prudence test and scrutinized for possible cost disallowance as required by the facts and circumstances of a particular case. Any uncertainty already inherent in that approach is actually *reduced* for PSE through the PCA and PCORC, which provide for a more contemporaneous prudence review of the Company's resource decisions, and through the cost recovery rules established in Order No. 14, which tell PSE *now* exactly how it will be held responsible for its Tenaska fuel management decisions in the future.

[33] Of course, one of the critical facts that the Commission considered in establishing a benchmark for cost recovery based on the original costs of the Tenaska contract is that the original contract itself was found to be an imprudent acquisition by the Company. None of the commission cases cited by PSE in its Petition have that same important feature. PSE Petition at 11: 19 through 12: 8.

Moreover, the commentator upon which PSE relies rejected a used and useful standard where there is no competitive market. PSE Petition at 12: 9-13. PSE, however, originally justified the Tenaska restructuring as a means for the Company to acquire fuel in markets the Company claimed were competitive. Ex. 52 at 5; Ex. 283C at 17.

25 For these reasons, the Company's Petition for Reconsideration should be denied.

II. ARGUMENT IN PARTIAL OPPOSITION TO CLARIFICATION

26 In the alternative, the Company asks for clarification of several aspects of Order No. 14. Staff's response to these requests follows, based on its interpretation of Order No. 14.

A. Uncontested Accounting Matters

27 The Company asks the Commission to confirm the accounting treatment of four matters that were addressed at the post-order conference on May 17, 2004.[34] Staff agrees with the Company's proposals on these matters.

28 Staff has also conferred with the Company regarding item III.A.2,[35] and understands that, for PCA deferral purposes effective April 7, 2004, PSE intends to use the fixed costs shown in the "Rate Year" column of PCA Schedule A-1 and the contract rates shown in Schedule E, as included in the PCORC compliance filing. Staff is amenable to that proposal.

B. Effect of Order No. 14 On the First 10.5 Months of PCA Period 2 (July 1, 2003 through May 13, 2004)

29 The Company asks the Commission to clarify that Order No. 14 does not impose the 50% return limitation during the first 10.5 months of PCA Period 2 in

[34] PSE Petition at 20.
[35] PSE Petition at 20: 16-21.

addition to the one-time disallowance of $25.6 million. If the Commission does intend to impose the 50% return limitation, the Company requests permission to defer those returns for possible later recovery when offsetting net benefits that may occur in the Tenaska contract's later years.[36]

30 If neither request is met, the Company states that it will be subject to a $42.9 million disallowance through 2004, rather than the $25.6 million "one-time" disallowance stated in Order No. 14 for PCA Period 1.[37] PSE questions whether the Commission intended such a "severe impact."[38]

31 Staff does not dispute the Company's representation of its cost responsibility through 2004. However, the impact of the $25.6 million adjustment on PCA Period 2 and later periods is the logical consequence of reducing the balance in the PCA account, as ordered clearly by the Commission,[39] under the existing PCA mechanism that the Commission also stated clearly it was not altering.[40] Whether that impact is severe and unintended is for the Commission to say.

32 Staff, however, does oppose the Company's request to either not impose the 50% return limitation until mid-May 2004 or allow PSE to defer un-recovered

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[36] PSE Petition at 21: 18 through 23: 9.
[37] PSE Petition at Attachment B.
[38] PSE Petition at 22: 12-13.
[39] The Commission stated clearly that the $25.6 million disallowance is "a single adjustment to the deferral account . . ." Order No. 14 at ¶ 93. The Commission echoes this intent by ordering PSE to "adjust the balance of the PCA deferral account . . . to reflect a disallowance of costs unreasonably incurred during the PCA period . . ." Order No. 14 at ¶ 128 (Ordering Section 3).
[40] Order No. 14 at ¶¶ 94, 96 and 102.

returns on the regulatory asset for later recovery. The former request is contrary to the Commission's clear intent to examine fully PSE's fuel management decisions for the entire PCA Period 2.[41] The latter request is contrary to the Commission's clear intent to calculate future disallowances according to the Tenaska rules of cost recovery.[42]

C. Impact of the One-Time Disallowance on PCA Period 2 and Future Periods

33 PSE asks the Commission to clarify that the Company's fuel management decisions before July 2003 have been fully addressed in Order No. 14 and are no longer relevant to cost reviews in PCA Period 2 and future review periods.[43]

34 Staff understands the $25.6 million reduction for PCA Period 1 as the Commission's determination of a fair and reasonable remedy for the Company's imprudent management of Tenaska fuel costs prior to the creation of the PCA. Thus, Staff has no intent to further examine the prudence or cost impact of decisions made by PSE before June 2002.

35 However, Staff agrees with the Commission that, because the $25.6 million adjustment "may have consequences in later PCA periods, we will take it into account when reviewing those periods."[44] The Company can raise at those later

[41] Order No. 14 at n.104.
[42] Order No. 14 at ¶ 97.
[43] PSE Petition at 23: 10 through 24: 5.
[44] Order No. 14 at ¶ 94.

times any concerns it may have regarding any adjustments it believes are duplicative.

D. Future PCA Compliance Filings

36 Finally, PSE asks the Commission to clarify that the Company need not provide evidence of its fuel management decisions and actions in its PCA Period 2 filing to be made in August 2004, since the evidence in the instant docket concerned those matters through February 2004.[45]

37 Staff disagrees. Regardless of evidence that was introduced in this docket, it is necessary for the Commission and parties to review the Company's fuel management decisions that are contemporaneous with the time period under examination. This will be the case for the PCA Period 2 filing and all later filings under the PCA mechanism.

DATED This 1st day of June, 2004.

CHRISTINE O. GREGOIRE
Attorney General

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ROBERT D. CEDARBAUM
Senior Counsel
Washington Utilities and
Transportation Commission
(360) 664-1188

[45] PSE Petition at 24: 8 through 25: 6.