EXHIBIT NO. ___(KJH-1T)
DOCKET NO. ____________
2005 POWER COST ONLY RATE CASE
WITNESS: KIMBERLY J. HARRIS

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-_______**

PREFILED DIRECT TESTIMONY OF
KIMBERLY J. HARRIS (NONCONFIDENTIAL)
ON BEHALF OF PUGET SOUND ENERGY, INC.

JUNE 7, 2005

PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY OF KIMBERLY J. HARRIS

CONTENTS

PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

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

A. My name is Kimberly J. Harris. My business address is 10885 N.E. Fourth Street Bellevue, WA 98004. I am the Vice President of Regulatory and Government Affairs for Puget Sound Energy, Inc. ("PSE" or "the Company").

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

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

Q. What are your duties as Vice President of Regulatory and Government Affairs for PSE?

A. I am responsible for the Company's regulatory strategy at this Commission and at FERC, and for governmental affairs at the federal level. My duties include participation and negotiations in regional discussions related to energy matters, including issues involving the Bonneville Power Administration and regional transmission organizations.

Q. Please summarize your testimony.

A. My testimony provides an overview of the Company's filing in this "power cost only rate case" in which it is asking for an increase in electric rates due to the increased costs of generating or purchasing the power PSE provides to its customers. Among other things, the Company is seeking this relief to obtain approval and recovery in rates of its acquisition of a wind powered electric generation facility to be located in Columbia County, Washington (the "Hopkins Ridge Project").

I generally describe the PCA Mechanism and PCORC proceedings, and their importance to the Company. I also highlight some of the limitations of the current PCA Mechanism with respect to addressing issues that impact the Company's financial health. In this regard, I point out a specific problem the Company has identified in this case related to the fact that the PCA Mechanism's $40 million excess power cost cap will be removed in the middle of the rate year for this case.

With respect to the Hopkins Ridge Project acquisition and other changes to PSE's electric portfolio, I describe the Company's understanding of the standards that the Commission has directed the Company to follow in considering whether to acquire a new power resource, and that the Company believes it has followed with respect to the power cost decisions presented in this case.

Finally, I introduce the other Company witnesses who will provide more detailed support for the Company's requested relief in this case.

II. REQUESTED RELIEF

Q. What level of rate increase is the Company requesting in this case?

A. The total requested rate increase to be allocated to electric customers is $55,571,666, an average 3.65 percent increase over the electric rates set in the Company's 2004 general rate case (Docket Nos. UG-040640 et al.) that became effective on March 4, 2005.

Q. Please explain why the Company needs the proposed rate relief.

A. The Company's current electric rates include costs that it projected would be incurred to generate or purchase the power PSE needs to serve its electric customers during the rate year for its 2004 general rate case: March 2005 through February 2006. These projections were last updated in October 2004, at the time the Company prepared its rebuttal filing in the 2004 general rate case.

Since that time, changes have occurred or are scheduled to occur with respect to the Company's electric portfolio that, in total, are projected to increase the Company's power costs during the proposed rate year for this case: December 1, 2005 through November 30, 2006.

Q. What is driving these power cost increases?

A. Increases in the projected price of natural gas during the rate year are responsible for much of the upward pressure on PSE's power costs. As described in the prefiled direct testimony of Ms. Julia Ryan, rate year gas prices are forecast to increase approximately 17% from the level currently set in rates.

Other factors driving power costs higher include annual cost increases in PSE's existing long-term power purchase agreements ("PPAs"), increased costs related to Mid-Columbia hydropower contracts that PSE is obligated to share, and a full-year's impact of the BPA transmission rate increase discussed in the 2004 general rate case that impacted only the very end of the rate year in that case. These and other changes to the Company's electric resource portfolio are detailed in the prefiled direct testimonies of Ms. Ryan and Mr. Eric Markell.

In addition, the Company has acquired the Hopkins Ridge Project, which it anticipates will be completed and in service by December 1, 2005. While costs related to the Hopkins Ridge acquisition represent only about 10% of the increase the Company is requesting in this case, the structure of the PCA mechanism makes it important to re-set the Company's power cost baseline rate to reflect this new resource, for the reasons described below.

III. THE PCA MECHANISM AND PCORC PROCEEDINGS

A. The PCA Mechanism and Its Importance

Q. Under what authority has the Company filed this proceeding?

A. The Company filed its proposed tariff revisions in this proceeding pursuant to the Power Cost Adjustment (PCA) mechanism that the Commission approved in the Company's 2001-02 general rate case, Docket Nos. UE-011570 and UG-011571. The PCA mechanism authorizes the Company to request a rate increase based on increases to its power costs over and above the "power cost baseline rate" or "power cost rate" ("Power Cost Rate") that is reflected in the Company's current rates (as set in the Company's most recent rate case). The Commission described the PCA mechanism and its power cost only rate review feature in its Order No. 12 in the Company's first power cost only rate case, Docket No. UE-031725 ("2003 PCORC"), dated April 7, 2004. The availability of PCORC proceedings is a critical feature of the PCA mechanism from the Company's perspective.

Q. Why is the availability of PCORC proceedings a "critical feature" of the PCA Mechanism for the Company?

A. At the time the parties to the Company's 2001 general rate case settlement negotiated and agreed to the PCA Mechanism, it was clear that the Company was entering into an extended period in which it would need to acquire a large volume of new power resources to continue to serve its customers. This need for resource acquisitions has been highlighted in the last two rounds of the Company's Least Cost Planning process (in 2003 and 2005) subsequent to that settlement.

Such acquisitions can place a company in a difficult financial position for at least two reasons: (1) the potential delay between the time a new resource is placed into service and the time there is recovery of those costs from customers; and (2) the potential for the company to invest substantial funds in a new resource only to have some portion of that investment disallowed for ratemaking purposes, after the company has already committed to acquire the resource.

With respect to the second reason, the longer the delay between the acquisition decision and the ratemaking proceeding that seeks approval and recovery of the investment for the resource, the greater the danger that conditions will have changed. This can make it difficult for parties to review the acquisition based on the information that was known or reasonably available to the Company at the time of the decision, as opposed to information that became known subsequent to the decision.

Q. How does the PCA Mechanism address these concerns?

A. The availability of a PCORC proceeding within the PCA mechanism addresses both of these concerns by providing for more timely recovery of funds invested in new resources to serve customers and for more immediate review of the Company's "prudence" in making a resource acquisition decision.

Through the explicit authorization to file a rate case limited to power costs and the agreement that such cases be expedited, the Company is able to begin recovering the costs of a new resource in rates immediately as of the time the new resource begins providing power to the Company's customers. As stated in the PCA mechanism itself: "One objective of a new resource proceeding is to have the new Power Cost Rate in effect by the time the new resource would go into service." Docket Nos. UE-011570 and UG-011571, Twelfth Supp. Order, Exhibit A, Settlement Terms for the PCA Mechanism, ¶ 11.

In addition, having regulatory approval of the decision to invest in a resource closer to the time that the decision was made helps all parties better understand how and why those decisions were made.

Q. Do PCORC proceedings serve other important purposes?

A. Yes. As described above, the Company anticipates that its power costs during the rate year for this case will be higher than the costs currently set in rates for a number of reasons unrelated to the Hopkins Ridge Project acquisition. Resetting the Company's Power Cost Rate under the PCA Mechanism will send better price signals to PSE's electric customers regarding the cost of the electricity they consume and will reduce financial pressures on the Company caused by these increasing power costs. In addition, the PCORC allows for rate increases in small steps over time as the Company's power costs increase, which helps reduce the rate shock customers might experience if the Company were limited to filing general rate cases that included such power cost increases as well as cost increases related to its general operations.

B. Some Limitations of the Current PCA Mechanism

Q. Do PCORC proceedings and the PCA Mechanism address all of the Company's current concerns related to resource acquisitions and investments?

A. No, they do not. The Company is facing a number of other challenges in these areas that are not addressed by the PCA Mechanism in its current form. For example, regional transmission constraints are of significant concern to the Company as it evaluates the viability and costs of potential new resource options. To the extent a new resource is a viable, low cost option including the associated costs of transmission upgrades or other transmission solutions, and to the extent the Company therefor commits to acquire the resource, the Company can seek recovery of transmission costs associated with the new resource as part of its PCORC filing. The Company is doing so in this case with respect to the millions of dollars of transmission upgrades required for the Hopkins Ridge Project, as described in the prefiled direct testimonies of Mr. Roger Garratt and Mr. John Story. However, many projects that might otherwise have been viable or low costs will not survive the evaluation process absent more extensive regional transmission investments and solutions.

In addition, the Company is itself making extensive investments in its gas and electric delivery infrastructure, as described by Ms. Sue McLain in the Company's 2004 general rate case. There is currently no mechanism under which the Company can obtain timely recovery of such investments without significant lag between the time such plant is placed into service and the time the investment is reflected in the Company's rates.

Q. Are there other issues related to the current PCA Mechanism?

A. The Company has identified a specific issue that impacts this proceeding related to the fact that the $40 million PCA Mechanism cap expires during the middle of the rate year for this case, as described in Mr. Story's testimony. That coincidence of timing, and the fact that rates are generally set based on the power costs that are projected to be incurred during the entire course of a rate year – rather than on a month by month basis during the rate year – means that the Company is now projecting it will be forced to credit phantom "power cost savings" to customers during the first seven months of the rate year. Then, following expiration of the $40 million cap, the Company will be forced to absorb power costs that are not being recovered in rates during the last five months of the rate year and beyond.

Q. Does expiration of the $40 million cap impact the Company in other ways?

A. Yes. Now that the Company is facing removal of the $40 million cap, it is quite concerned about the total amount of excess power costs to which the Company will be exposed during a financial reporting year, which is a calendar year. As

Mr. Story explains, because the PCA year is currently July through June, the annual sharing bands of the PCA Mechanism do not match the Company's fiscal year. The fact that a fiscal year includes one half of two different PCA years makes financial projections much more difficult and volatile.

Q. Is the Company proposing any solution to these issues?

A. Not at this time. The Company plans to meet with Commission Staff, Public Counsel and other parties to discuss potential agreed solutions to these issues. The Company will propose the relief it believes is appropriate after consulting with the other parties.

C. The Hopkins Ridge Project and the PCA Mechanism

Q. You mentioned above that the Hopkins Ridge Project acquisition accounts for only about 10% of the Company's requested relief in this case, but that the structure of the PCA Mechanism makes it important to re-set the Company's Power Cost Rate to reflect this new resource. Would you please explain?

A. Although the net cost increase during the rate year associated with the Hopkins Ridge Project acquisition is relatively small, the Company will not recover the cost of its investment during the rate year absent a true-up of the Power Cost Rate. This is because the Company's annual PCA filings allow deferral for future recovery of the *variable* portion of power costs in excess of the amounts recovered through the baseline rate (and vice versa with respect to any savings, subject to the PCA sharing bands). The Company is not permitted to recover additional *fixed* costs through the annual PCA compliance filing accounting.

As described in the prefiled direct testimonies of Ms. Ryan and Mr. John Story, the Hopkins Ridge Project acquisition is projected to permit the Company to avoid purchasing power in the wholesale market during the rate year at a projected cost of approximately $20.4 million. However, when netted against incremental production O&M, transmission and capital costs, the net result to the Company's electric portfolio is an increase of approximately $5.7 million during the rate year. Because wholesale market purchases are a variable cost while much of the latter costs are fixed, the Company's annual PCA true-up filings after the Hopkins Ridge Project goes into service would incorrectly calculate that the Company had experienced many millions of dollars in power cost savings, when in fact its overall power costs had increased slightly.

Q. If the Hopkins Ridge Project acquisition increases the Company's power costs, why did it purchase that resource?

A. The above discussion relates only to the rate year in this case, which is the first year of operation for the Hopkins Ridge Project. The Hopkins Ridge Project is a long-term resource that, over the life of the Project, is expected to reduce the Company's power costs compared to what they would be if the Company had not acquired the Project. The Company projected during its evaluation process that acquisition of the Hopkins Ridge Project would result in net present value savings of $30 million over twenty years compared to the generic portfolio modeled in the Company's 2003 Least Cost Plan, as described in the prefiled direct testimony of Mr. W. James Elsea. This represents the highest amount of projected savings of any of the other potential resources evaluated by the Company during the RFP process.

Q. Is it too early to file this proceeding, given that the Hopkins Ridge Project has not yet been constructed?

A. No. As described above, a PCORC is designed to be filed ahead of the time a new resource goes into service. The Company is filing this case just six months before the Hopkins Ridge Project is anticipated to be placed into service. Thus, this filing is just far enough ahead of time to accommodate the expedited PCORC proceeding provided for in the PCA Mechanism such that an order can be issued approving rates to go into effect at the time the Hopkins Ridge Project enters commercial operation. Indeed, as Mr. Roger Garratt describes in his prefiled direct testimony, individual strings of wind turbines at the Project will begin generating power for PSE's customers some two months before the Project as a whole is completed and officially placed into service.

Furthermore, as discussed in the Company's 2004 general rate case, this Commission is accustomed to looking forward into a rate year to project costs that are anticipated to be incurred during the rate year.[1] Costs need not have already been incurred in order for the Commission to recognize that they will be incurred.

Finally, as described in the testimonies of Mr. Markell and Mr. Garratt, the Company is currently obligated to pay most of the approximately $200 million for the Hopkins Ridge Project pursuant to the fixed price agreements for the acquisition. As of April 30, 2005, the Company had already actually incurred $40.6 million in costs for the Project. By the close of this proceeding, the Company will have incurred nearly all of the costs required to complete the Project.

IV. THE COMMISSION'S PRUDENCE STANDARD

Q. What is your understanding of the Commission's prudence standard?

A. In the Company's 2003 PCORC proceeding, Docket No. UE-031725, the Commission reaffirmed the standard it applies in reviewing the prudence of power generation asset acquisitions:

> The test the 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. The company must establish that it adequately

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[1] *See, e.g.* Docket Nos. UG-040640 et al., Order No. 06 (Feb. 18, 2005) at ¶ 108 (Concluding that "power costs determined in general rate proceedings and in PCORC proceedings should be set as closely as possible to costs that are reasonably expected to be actually incurred during short and intermediate periods following the conclusion of such proceedings.").

> studied the question of whether to purchase these resources and made a reasonable decision, using the data and methods that a reasonable management would have used at the time the decisions were made. (Order No. 12, Docket No. UE-031725, at ¶ 19)

In addition to this generic reasonableness standard, the Commission has cited several specific factors that inform the question whether a utility's decision to acquire a new resource was prudent. These factors include the following:

- First, the utility must determine whether new resources are necessary.[2]
- Once a need has been identified, the utility must determine how to fill that need in a cost-effective manner. When a utility is considering the purchase of a resource, it must evaluate that resource against the standards of what other purchases are available, and against the standard of what it would cost to build the resource itself.[3] The utility must analyze the resource alternatives using current information that adjusts for such factors as end effects, capital costs, impact on the utility's credit quality, dispatchability, transmission costs, and whatever other factors need specific analysis at the time of a purchase decision.[4]
- The utility should inform its board of directors about the purchase decision and its costs. The utility should also involve the board in the decision process.[5]
- The utility must keep adequate contemporaneous records that will allow the Commission to evaluate its actions with respect to the decision process. The Commission should be able to follow the utility's decision process; understand the elements that the utility used; and determine the manner in which the utility valued these elements.[6]

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[2] *See, e.g., WUTC v. Puget Sound Power & Light Co.*, Docket No. UE-921262, *et al.*, Nineteenth Supplemental Order (September 27, 1994) ("*Prudence Order*") at 11.

[3] *Id*.

[4] *Id.* at 2, 33-37, 46-47.

[5] *Id.* at 37, 46.

[6] *Id.* at 2, 37, 46.

Q. Did the Company's acquisition of the Hopkins Ridge Project meet this standard?

A. Yes. As described in the testimonies and exhibits in this case, the Company had a clear documented need for power in the near term. The Company's decision to acquire the Hopkins Ridge Project (as well as a smaller resource, a two-year PPA from Arizona Public Service) occurred in the context of formal requests for proposals issued pursuant to the Commission's competitive bidding rules, WAC Chapter 480-107, shortly after completion of the Company's 2003 Least Cost Plan.

The Company also had a deliberate, organized process for evaluating bids. The acquisition was the result of an extensive process through which the Company evaluated the relative costs and risks of many potential alternative resource opportunities. It examined PPA purchases and ownership of new resources. The Company also examined a self-build option. The evaluation process also included significant modeling that can be replicated. Consistent with the Commission's prior orders, the Company kept detailed records in connection with this evaluation process and the management decisions that resulted from that process.

The Company's efforts clearly meet the "adequate study" and "reasonable data and methods" standards applied by the Commission in determining whether an acquisition was prudent. In addition, by acquiring the Hopkins Ridge Project and Arizona Public Service Purchased Power Agreement, the Company obtained new resources at a reasonable cost compared to other potential resource options.

Q. Has the Company followed the prudence standard with respect to other resource decisions presented in this case?

A. Yes. The testimonies and exhibits in this case also demonstrate that the Company has taken care to analyze and document the decisions it is making with respect to other changes to its electric resource portfolio.

V. OVERVIEW OF OTHER WITNESSES

Q. Please summarize the testimony of the other witnesses who appear for PSE.

A. The following additional witnesses present direct testimony on PSE's behalf:

Mr. Eric Markell, the Company's Senior Vice President Energy Resources, presents an executive summary of the process that led to the Company's decision to acquire the Hopkins Ridge Project and how this process meets the Commission's prudence standard. He also describes generally the Hopkins Ridge Project, how the transaction was structured, what it costs, and how it is being financed. Finally, he discusses several other recent changes to the Company's long-term (greater than two years) resource portfolio that are projected to affect its power costs during the rate year.

Mr. Roger Garratt, the Company's Director of Resource Acquisition, describes in greater detail than Mr. Markell's executive summary the manner in which the Company evaluated the proposals submitted in response to its requests for proposals. He also describes the self-build option the Company analyzed as a potential alternative means of meeting some of its resource needs. He then provides additional detail regarding the Company's decision to acquire the Hopkins Ridge Project as well as the costs and construction schedule for the Project.

Mr. W. James Elsea, the Company's Financial Analysis Manager of Energy Resources, describes the modeling tools and analyses the Company utilized to evaluate the various resource alternatives that were proposed in response to its requests for proposals to meet its need for additional power resources. He also describes how the

Company updated its assumptions and inputs to these models during the course of its evaluation so that its ultimate decision to acquire the Hopkins Ridge Project was based on current information.

Ms. Julia Ryan, PSE's Vice President of Risk Mangement and Strategic Planning, describes the Company's projection of normalized power costs presented in this case. She focuses in particular on changes to PSE's power supply portfolio since the Company's 2004 general rate case, as well as power cost issues that were contested in that case. She also compares the Company's power cost projections for this case to those the Commission approved in the 2004 general rate case.

Mr. John Story, PSE's Director of Cost and Regulation, describes: (1) adjustments to PSE's power supply costs that have prompted PSE to seek the proposed increased Power Cost Rate; (2) the rate impact of adding the Hopkins Ridge Project to PSE's power supply portfolio; (3) the calculation of PSE's new Power Cost Rate, which accounts for the addition of the Hopkins Ridge Project, updates expenses to account for current power costs and corrects the allocation of deferred tax expense to production related costs; and (4) the calculation of a new tracker schedule for the Production Tax Credits associated with wind projects. Finally, he describes in greater detail than my summary, above, the problems the Company has identified related to the removal of the PCA Mechanism's $40 million cap on excess power costs during the middle of the rate year for this case.

Finally, **Ms. Sara Cardwell**, PSE's Manager of Pricing and Cost of Service, describes: (1) the temperature adjustment methodology used to develop the pro forma kilowatt-hours for the test year in this case ending March 2005; (2) the allocation of the proposed Power Cost Rate and the Production Tax Credits as described in the testimony of Mr. John H. Story to the various customer classes; (3) the rate design for the Power Cost Rate and the Production Tax Credits; and (4) the revised and new tariff schedules.

VI. CONCLUSION

Q. Do you have any concluding remarks?

A. Yes. The Company appreciates the opportunity to request relief from the Commission through the PCORC process. Our filing is voluminous, not to overwhelm readers, but in an effort to try to ensure that we are fulfilling our obligation to demonstrate the reasonableness of the Company's decisionmaking and requested relief in this case. We are also mindful of the fact that, because this is an expedited proceeding, care should be taken in filing a PCORC case to provide a significant amount of information at the outset without the need for other parties to wait for commencement of the data request process. We hope that our filing meets the expectations of the Commission and the parties to this case.

Q. Does this conclude your testimony?

A. Yes it does.

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