BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of PUGET SOUND ENERGY, INC. For Approval of its 2004 Power Cost Adjustment Mechanism Report	DOCKET NO. ____________ PETITION

1. This Petition is brought by Puget Sound Energy, Inc. ("PSE" or the "Company"). PSE's representative for purposes of this proceeding is:

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2. This Petition brings into issue: WAC 480-07-370(1)(b).

I. BACKGROUND

A. The Company's PCA Mechanism Requires Annual True-Up Filings

3. In the Commission's Twelfth Supplemental Order in Docket Nos. UE-011570 and UG-011571 ("Twelfth Supplemental Order"), the Commission approved the parties' Settlement Stipulation for Electric and Common Issues for PSE's 2001 general rate case ("Stipulation"). Among other things, the Twelfth Supplemental Order authorized a Power Cost Adjustment Mechanism (PCA). Exhibit A to the Stipulation, which is attached to the Twelfth Supplemental Order, sets forth details regarding the PCA, and is hereinafter referred to and cited as the "PCA Settlement."

4. Following verification of certain numbers set forth in the exhibits to the PCA Settlement, the Commission ordered that revised pages of Exhibits A, B, D and F be substituted for the corollary pages of Exhibits A, B, D and F of the PCA Settlement. The Commission further ordered that the resulting adjusted calculations be used for purposes of the PCA accounting required by the PCA Settlement beginning July 1, 2002. *See* Fifteenth Supplemental Order in Docket Nos. UE-011570 and UG-011571 (May 13, 2003). A copy of the PCA Settlement, as revised, is attached to this Petition as Exhibit A.

5. The PCA Settlement describes the PCA as:

> a mechanism that would account for differences in PSE's modified actual power costs relative to a power cost baseline. This mechanism would account for a sharing of costs and benefits that are graduated over four levels of power cost variances, with an overall cap of $40 million (+/-) over the four year period July 1, 2002 through June 30,

> 2006. If the cap is exceeded, costs and benefits in excess of $40 million would be shared at a different level of sharing.

PCA Settlement, ¶ 2. The PCA Settlement sets forth the various levels of costs and benefits sharing between the Company and its customers, and provides that "[t]he customer's share of the power cost variability will be deferred as described below…." *Id.* at ¶ 3.

6. In order to implement its sharing provisions and overall cap, the PCA Settlement requires an annual true-up of actual power costs (versus the normalized level set in rates) and an accounting of sharing amounts. To accomplish this, the PCA Settlement provides that "[i]n August of 2003 and each year thereafter, the Company shall file an annual report detailing the power costs included in the deferral calculation, in a form satisfactory to the Commission, for Commission review and approval." PCA Settlement, ¶ 4.

B. PSE's 2003 PCA Report and the PCORC Orders

7. In compliance with the PCA Settlement and Twelfth Supplemental Order, the Company filed with the Commission in August 2003 PSE's 2003 Power Cost Adjustment Mechanism Report for the Twelve Months Ended June 30, 2003 ("2003 PCA Report") in Docket No. UE-031389.

8. On January 14, 2004, the Commission approved a multiparty settlement regarding most of the disputed issues in Docket No. UE-031389. Order No. 04, Docket No. UE-031389 (Jan. 14, 2004). The settlement did not resolve an impasse issue regarding costs of power for the Tenaska and Encogen generating resources. That issue was subsequently

set for resolution in Docket No. UE-031725, PSE's then-pending power cost only rate case ("PCORC").

9. The Commission's Orders No. 14 and 15 in the PCORC docket, UE-031725, subsequently determined that there would be no disallowance of PSE's costs related to Encogen, but imposed certain disallowances related to the return on the Tenaska regulatory asset.

10. Through its orders in the PCORC docket, the Commission also approved inclusion in PSE's rates of PSE's newly acquired interest in the Frederickson 1 generating facility as well as an increase in the Power Cost Baseline Rate under the PCA due to increased power costs since the original PCA Settlement.

11. As described below and in the testimony of Ms. Barbara Luscier, filed with this Petition as Exhibit No. ___(BAL-1T), the Company has implemented the Commission's PCORC orders in its PCA accounting, as well as the agreed methodologies that were approved in Docket No. UE-031389.

II. PSE's 2004 PCA REPORT

12. In compliance with the PCA Settlement and Twelfth Supplemental Order, this Petition presents to the Commission PSE's Power Cost Adjustment Mechanism Annual Report for the Twelve Months Ended June 30, 2004—PCA Period Two ("2004 PCA Report") for the Commission's review and approval. The 2004 PCA Report is filed with this Petition as an exhibit to the testimony of Ms. Barbara Luscier, PSE's Manager of Revenue

Requirements, at Exhibit No. ___(BAL-3). As described below, PSE requests that the Commission approve Exhibit No. ___(BAL-3) as revised by the substitute sheets provided in Exhibit No. ___(BAL-4).

13. Ms. Luscier's direct testimony explains details associated with the PCA annual true up for the one-year period that began on July 1, 2003 and ended on June 30, 2004 ("PCA Period 2"). *See* Exhibit No. ___(BAL-1T). Accompanying workpapers are being provided to the Commission Staff and Public Counsel with this filing and will be provided to parties intervening in this docket.

14. The 2004 PCA Report submitted in Exhibit No. ___(BAL-3) shows calculations consistent with the Company's current financial accounting relating to the PCA. These financial records include recognition of a reduction in earnings of $10.8 million pretax for the first 10 plus months of PCA Period 2 based on application of the 50% Tenaska benchmark disallowance established in PCORC Order No. 14. However, PSE requests that the Commission determine in this proceeding that no disallowance related to Tenaska will be applied to PCA Period 2 prior to May 24, 2004 (the date rates approved in Order No. 14 on May 13, 2004 went into effect). If the Commission grants PSE's request, the Company would reverse the earnings reduction recognized for this period. The substitute pages provided in Exhibit No. ___(BAL-4) flow that reversal through to the 2004 PCA Report.

15. In PCORC Order No. 15, the Commission clarified that it would address in the PCA Period 2 true-up proceeding the issue whether any further Tenaska disallowance

should be applied to the portion of PCA Period 2 that had elapsed prior to issuance of Order No. 14. Order No. 15, Docket No. UE-031725, at ¶ 53. Although the issue was left open, PSE felt it had to recognize a reduction in earnings in the interim.

16. As described in the testimony of Ms. Luscier and Ms. Durga Waite, Puget Energy's Director of Investor Relations, cost information that the Company had available to it at the time of the Tenaska PCORC Orders indicated that if the Commission were to apply the benchmark methodology adopted in Order No. 14 to the entire PCA Period 2, 50% of the return on the Tenaska regulatory asset would be disallowed for that period. Recognition of this potential disallowance was appropriate under applicable accounting standards since the Company could not state with a high level of confidence, in advance of the PCA Period 2 true-up Order, that the Commission would *not* apply the benchmark methodology established for future PCA periods to PCA Period 2. If the Commission orders in this proceeding that the Company can recover its full return on Tenaska for the first 10 plus months of PCA Period 2, then the Company would reverse the earnings reduction already recognized for this period.

17. PSE requests in this Petition that the Commission determine it will *not* impose any further disallowance associated with Tenaska with respect to periods prior to May 24, 2004 – the date the new rates approved in PCORC Order No. 14 went into effect.

18. In Order No. 14, the Commission determined that PSE had failed to manage prudently fuel purchasing for Tenaska "over many years, up to and including recent periods."

Order No. 14 at ¶ 93. Because it was not possible to identify the precise cost consequences of this failure, the Commission determined it would "make a single adjustment to the [PCA] deferral account, approximating an appropriate disallowance of return on the [Tenaska regulatory] asset." *Id.* The Commission emphasized that this was not a change to the PCA mechanism, but rather "a one-time disallowance of costs on which the mechanism operates." *Id.* at ¶ 94. The Commission stated:

> Because this adjustment may have consequences in later PCA periods, we will take it into account when reviewing those periods. We also observe that this disallowance is a consequence of practices and policies undertaken by a prior management. We have confidence in the new management, and expect that it will be able to demonstrate in future proceedings that it has developed prudent gas purchasing practices.

Id. PCORC Order No. 15 reaffirmed that the Commission "would take the effects of the disallowances [imposed in Order No. 14] into account in future proceedings." Order No. 15 at ¶ 52.

19. PCORC Order No. 15 also stated that PSE will bear the burden to show the prudence of its fuel acquisition for Tenaska during PCA Period 2 if the prudence of such acquisition is challenged in the PCA Period 2 compliance proceeding. Order No. 15 at ¶ 52. This is consistent with the PCA Settlement, which provides that "the Commission shall have an opportunity to review the prudence of the power costs included in the deferred calculation" in annual PCA true-up proceedings. PCA Settlement, at ¶ 4.

20. Thus, in support of its requested relief, PSE is submitting evidence to show the prudence of its management of power costs during PCA Period 2. In particular, PSE submits with this Petition the testimony of Ms. Julia Ryan, PSE's Vice President Risk Management and Strategic Planning. Ms. Ryan describes the efforts undertaken by PSE to attempt to control and moderate its power costs incurred during PCA Period 2, including PSE's management of Tenaska costs.

21. PSE also submits for the Commission's consideration the testimony of Mr. Eric Markell, PSE's Senior Vice President Energy Resources. Mr. Markell addresses the Company's efforts during PCA Period 2 with respect to planning for, and analysis of, the Company's long-term gas-for-power requirements and decisions with respect to fuel supply acquisition for its generation portfolio. He addresses this topic in response to the concern raised in PCORC Order No. 14 that "Instead of developing a comprehensive strategy and a balanced approach considering opportunities in short-term, intermediate-term, and long-term gas markets, PSE simply continued its practice of buying in the short-term market." Order No. 14 at ¶ 91.

22. PSE respectfully submits that the Tenaska disallowances already imposed in PCORC Order No. 14 have sufficiently addressed the Commission's concerns regarding the Company's management of fuel supply for Tenaska. At the time Order No. 14 was issued, just six weeks remained in PCA Period 2. As described in Ms. Luscier's testimony, the "one-time" $25.6 million disallowance for PCA Period 1 has been credited to customers'

benefit in the PCA deferral account. And the 50% Tenaska Benchmark disallowance will apply to future PCA periods beginning with PCA Period 3, which is already underway. PSE requests that no further disallowances be imposed in this PCA Period 2 proceeding.

III. REQUESTED ACTION

23. For the reasons set forth above and in the testimonies filed with this Petition, PSE respectfully requests that the Commission issue an order:

- Determining that no further disallowances will be imposed related to PCA Period 2 costs prior to May 24, 2004, and specifically that the Tenaska 50% benchmark methodology will not be applied to PCA Period 2 from July 1, 2004 through May 23, 2004; and
- Approving PSE's 2004 PCA Report, Exhibit No. ___(BAL-3), as revised with the substitute pages provided in Exhibit No. ___(BAL-4).

DATED: August 31, 2004.

PERKINS COIE LLP

By ______________________________
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Attorneys for Puget Sound Energy, Inc.