

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

3 Karl R. Karzmar
4 Director of Regulatory Relations
5 Puget Sound Energy, Inc.
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7 Bellevue, WA 98004

8 and its legal counsel for purposes of this proceeding is:

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

1 **I. BACKGROUND**

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

3 3. In the Commission's Twelfth Supplemental Order in Docket Nos. UE-
4 011570 and UG-011571 ("Twelfth Supplemental Order"), the Commission approved the
5 parties' Settlement Stipulation for Electric and Common Issues for PSE's 2001 general rate
6 case ("Stipulation"). Among other things, the Twelfth Supplemental Order authorized a
7 Power Cost Adjustment Mechanism (PCA). Exhibit A to the Stipulation, which is attached
8 to the Twelfth Supplemental Order, sets forth details regarding the PCA, and is hereinafter
9 referred to and cited as the "PCA Settlement."

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

17 5. The PCA Settlement describes the PCA as:

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

1 2006. If the cap is exceeded, costs and benefits in excess of \$40
2 million would be shared at a different level of sharing.

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

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

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

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

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

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

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

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

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

15 **II. PSE's 2004 PCA REPORT**

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

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

4 13. Ms. Luscier's direct testimony explains details associated with the PCA
5 annual true up for the one-year period that began on July 1, 2003 and ended on June 30,
6 2004 ("PCA Period 2"). *See* Exhibit No. ____ (BAL-1T). Accompanying workpapers are
7 being provided to the Commission Staff and Public Counsel with this filing and will be
8 provided to parties intervening in this docket.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

4 III. REQUESTED ACTION

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

- 7 • Determining that no further disallowances will be imposed related to PCA
8 Period 2 costs prior to May 24, 2004, and specifically that the Tenaska 50%
9 benchmark methodology will not be applied to PCA Period 2 from July 1,
10 2003 through May 23, 2004; and
- 11 • Approving PSE's 2004 PCA Report, Exhibit No. ____ (BAL-3), as revised
12 with the substitute pages provided in Exhibit No. ____ (BAL-4).

13 DATED: August 31, 2004.

PERKINS COIE LLP

By _____
Kirstin S. Dodge
Attorneys for Puget Sound Energy, Inc.

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