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January 17, 2005

Via Email and Federal Express

Carole J. Washburn
Secretary
Washington Utilities and Transportation Commission
PO Box 47250
1300 S Evergreen Park Drive, SW
Olympia WA 98504-7250

Re: In the matter of Washington Utilities and Transportation Commission v. Puget
Sound Energy, Inc.
Docket Nos. UG-040640 et al.

Dear Ms. Washburn:

Enclosed please find the original and twenty (20) copies of the Confidential Initial Brief as well as the original and one copy of the Redacted Initial Brief on behalf of the Industrial Customers of Northwest Utilities in the above-referenced Docket.

The electronic copies will be sent to the Records Center and parties on January 18, 2005, via electronic mail.

Please return a file-stamped copy of the document in the postage-prepaid envelope provided. Thank you for your assistance.

Sincerely yours,



Ally L. Smith

Enclosures

cc: Service List

**BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,)	
)	
Complainant,)	DOCKET NO. UG-040640
)	DOCKET NO. UE-040641
vs.)	<i>(consolidated)</i>
)	
PUGET SOUND ENERGY, INC.,)	
)	
Respondent.)	
)	
<hr/>		
In the Matter of the Petition of)	
)	
PUGET SOUND ENERGY, INC.,)	DOCKET NO. UE-031471
)	<i>(consolidated)</i>
For an Order Regarding the Accounting Treatment for Certain Costs of the Company's Power Cost Only Rate Filing.)	
)	
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In the Matter of the Petition of)	
)	
PUGET SOUND ENERGY, INC.,)	DOCKET NO. UE-032043
)	<i>(consolidated)</i>
For an Accounting Order Authorizing Deferral and Recovery of the Investment and Costs Related to the White River Hydroelectric Project.)	
)	
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**INITIAL BRIEF OF
THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES**

REDACTED VERSION

January 18, 2005

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I. SUMMARY OF ARGUMENT

1

The Industrial Customers of Northwest Utilities (“ICNU”) requests that the Washington Utilities and Transportation Commission (“WUTC” or the “Commission”) make the following adjustments to the revenue requirement proposed by Puget Sound Energy (“PSE” or the “Company”) in this case:

- The Commission should adopt the \$4.25 per MMBtu gas price proposed by Mr. Schoenbeck because Mr. Schoenbeck’s proposal more accurately reflects a normalized gas cost, and it satisfies the intent of PSE’s Power Cost Adjustment (“PCA”) Mechanism. In the alternative, the Commission should require PSE to update the gas cost effective at the termination of the cumulative four-year cap in the PCA on June 30, 2006.
- The Commission should disallow PSE’s proposed combustion turbine (“CT”) oil expense of \$12.75 million because the Aurora model already assumes gas purchases to serve the same load. Allowing PSE to recover this amount along with the power costs forecast by Aurora for the rate period would result in double counting of the cost to serve extreme weather events. In the alternative, the Commission should exclude from revenue requirement an amount equal to the energy assumed to be served by oil (135,200 MWhs) multiplied by the gas price adopted by the Commission for setting the power cost baseline.
- The Commission should retain the current 40-year rolling average methodology for calculating hydro availability. In the alternative, the Commission should require PSE to use all 120 years of available stream flow data to normalize assumed hydro generation.
- The Commission should authorize a reasonable normalized amount for rate case expense to encourage PSE to control its costs for outside experts and lawyers. In addition, the Commission should order \$250,000 to be included in rates for Power Cost Only Rate Case (“PCORC”) expenses, which reflects the sharing of a reasonable normalized amount by the Company and customers.

II. INTRODUCTION/GENERAL ARGUMENT

2 ICNU is addressing the following discrete issues in this proceeding: gas costs, CT oil expense, hydro normalization, and rate case/PCORC expense. ICNU's failure to address other issues in this case is a result of resource constraints, rather than agreement with the Company's positions. A central issue raised by this case is the ability of Staff, Public Counsel, and intervenors to effectively participate in Commission proceedings in light of the increasing amount of resources that PSE is devoting to proceedings such as this one.

3 During 2004, the Commission processed both the PCORC (Docket No. UE-03175) and the general rate case being litigated in this Docket. The Company's expenditures on outside counsel and expert witnesses have been excessive in both cases. For the PCORC, PSE deferred and proposed recovery of approximately \$1.3 million. For the rate case, as of December 10, 2004 (prior to the start of the hearing), PSE had deferred and seeks recovery of \$2.3 million.^{1/} In its rebuttal testimony, PSE agreed to normalize the PCORC expenses at the level proposed by Staff. However, PSE maintains that all general rate case expenses should be deferred and treated as a regulatory asset. As a result, the rate case expense that PSE seeks to recover will likely be much higher than \$2.3 million.

4 No other party can compete with PSE in devoting resources to proceedings. Furthermore, under the deferred accounting/regulatory asset mechanism proposed by PSE, the Company has no incentive to control its costs for regulatory

^{1/} Exh. No. 249 at 1.

proceedings, and these costs receive little or no scrutiny before being put into rates. ICNU urges the Commission to put a stop to PSE's rampant spending on rate cases by adopting a reasonable normalized amount for rate case expense, which will give the Company an incentive to control its costs. Any amount that PSE spends in excess of a reasonable normalized amount should be the responsibility of shareholders, not ratepayers.

5 The other issues raised by ICNU in this case relate to power costs. The gas cost and hydro availability issues both require a determination of the appropriate method for normalizing these costs. The Commission should adopt a normalized gas cost in order to maintain the balance of risks inherent in the PCA and to reflect the fact that the power cost baseline could be in effect significantly longer than the rate year. In the alternative, the Commission should require that the gas cost be updated effective at the expiration of the PCA cap on June 30, 2006.

6 With respect to hydro normalization, the Commission adopted in 1993 a 40-year rolling average methodology for normalizing expected hydro generation. In adopting this standard, the Commission considered testimony from all three Washington investor-owned utilities, each of which advocated changing the 40-year standard.^{2/} In addition, the Commission rejected many of the same arguments that have been presented in this case. Absent demonstration of a clearly superior alternative or other compelling reason, the Commission should not abandon the 40-year standard in this case. If the

^{2/} WUTC v. Puget Sound Power & Light Co. ("PSP&L"), WUTC Docket Nos. UE-920433, UE-930499, & UE-921262, Eleventh Supp. Order at 41-42 (Sept. 21, 1993) ("Eleventh Supp. Order").

Commission does abandon the 40-year rolling average methodology, then it should adopt a new methodology that considers all available data.

7 PSE also seeks to include \$12.75 million in rates for oil expense related to extreme weather events. The proposed oil expense is an adjustment that was made outside PSE's Aurora power cost model. This expense should be rejected because it is not a known and measurable expense. In addition, Aurora already projects the cost of serving all of PSE's normalized loads. By adding this expense to the normalized power costs forecast by Aurora, PSE has double counted and is asking customers to pay for both gas and oil to supply the same energy. The Commission should disallow the oil expense or remove the cost of gas for energy assumed to be supplied by oil.

IV. REVENUE REQUIREMENT

A. Contested Adjustments—Electric

1. Adjustment 2.03—Power Costs

8 To determine the Company's revenue requirement, the Company's test year power costs must be adjusted to normalize variable power supply expenses.^{3/} The Commission should normalize test year costs when test year data cannot be shown to represent costs that will occur during the rate period.^{4/} Hence, the normalization process involves adjusting test year results to remove the impact of unusual events that occurred during the test period and to reflect "known and measurable" events that will occur during the rate period.^{5/} The purpose of the adjustments is to make the test year "a better

^{3/} Eleventh Supp. Order at 35.

^{4/} Leonard Saul Goodman, *The Process of Ratemaking* 318-19 (1998).

^{5/} Eleventh Supp. Order at 32.

predictor of what the Company can expect its operations to cost in the rate year.”^{6/} The utility bears the burden of justifying each adjustment it proposes to test year results.^{7/}

9 Contingent liabilities are an example of an expense that should be excluded from normalized costs.^{8/} Contingent liabilities are expenses that are “speculative, or have no effective date and no reasonable basis for estimating their amount in dollars, or are otherwise neither known nor measurable with reasonable accuracy.”^{9/} Because of their uncertain nature, including contingent liabilities in normalized rates would be unfair:

The inclusion of contingent liabilities in rates is unfair, because such a practice would shift the risk associated with the contingent event wholly to the ratepayer. If the expense is realized, the regulated company is wholly covered; if it is not realized, the company receives a windfall.^{10/}

10 With respect to power costs, the goal of normalization is to adjust those costs so that they represent “typical conditions.”^{11/} As a result, normalized power costs assume “weather-normalized retail loads, normal streamflow conditions, normal thermal operating conditions, and normal wholesale market price conditions.”^{12/} While these adjustments establish the utility’s “normal” expenses, the Commission acknowledges and expects the level of expenses will vary, perhaps even significantly, “from year to year

^{6/} WUTC v. Avista Corp., WUTC Docket Nos. UE-991606 & UG-991607, Third Supp. Order at ¶ 26 (Sept. 29, 2000).

^{7/} Id. at ¶ 29.

^{8/} Leonard Saul Goodman, *The Process of Ratemaking* 318 (1998).

^{9/} Id. at 318-19.

^{10/} Id. at 319.

^{11/} WUTC Docket Nos. UE-991606 & UG-991607, Third Supp. Order at ¶ 34.

^{12/} Re Avista Corp., WUTC Docket No. UE-010395, Sixth Supp. Order at ¶ 35 (Sept. 24, 2001).

based on the actual levels of hydro-conditions, resource operations, loads, and off-system revenues.”^{13/}

11 These normalization principles apply directly to PSE’s power costs in this case. PSE’s proposals regarding the appropriate gas cost, the inclusion of \$12.75 million in oil burn expense, and the use of 60 years of hydro data depart from the Commission’s normalization standards. The Commission should adopt the adjustments to power costs discussed herein to ensure consistency with the Commission’s standards and to exclude speculative and contingent costs from rates.^{14/}

a. Gas Costs

12 The gas cost issue in this case really comes down to one question: Should the goal in setting the PCA baseline be, as Mr. Story contends, to predict the actual costs that will prevail during the rate year or should the goal be, as Mr. Schoenbeck contends, to set a normalized baseline power cost that can apply for a period longer than the rate year? It is important for the Commission to set a normalized gas cost because of the uncertainty of the term for which the power cost baseline set in this case will be in effect.^{15/} Once the power cost baseline is set in a rate case or PCORC, PSE is under no obligation to update its power costs within any defined time period. Under these circumstances, the gas price assumed in rates should reflect a normalized amount over a period of years. Adopting the gas prices proposed by Staff and PSE, both of which are based on a projection of prices during the rate year (March 2005-February 2006), is

^{13/} WUTC Docket Nos. UE-991606 & UG-991607, Third Supp. Order at ¶¶ 34, 205.

^{14/} See Leonard Saul Goodman, *The Process of Ratemaking* 284-85 (1998).

^{15/} TR. 967: 19-20 (Schoenbeck).

inappropriate given that the baseline could be in effect past February 2006. ICNU urges that the Commission adopt the normalized gas cost proposed by Mr. Schoenbeck.

However, if the Commission disagrees with ICNU and adopts the gas price proposed by Staff or PSE, ICNU recommends that the Commission require the Company to update the gas price at the end of the rate year or in no event later than the expiration of the cumulative PCA cap on June 30, 2006.^{16/}

i. Background Regarding PSE's PCA

13 Adopting a normalized gas cost is particularly important because it will apply within the context of PSE's PCA, which the Commission approved as part of the settlement in PSE's last general rate case.^{17/} The PCA sets forth the manner in which PSE and customers share annual deviations in actual power costs from baseline power costs. The purpose of the PCA was to create an equitable sharing of risk around normalized cost levels.^{18/}

14 The PCA sharing mechanism consists of four bands of power cost deviations with a corresponding sharing percentage. For the first \$20 million deviation (either plus or minus), the Company absorbs 100% of the cost or benefit. The second band is for deviations of \$20 to \$40 million. These amounts are shared equally between the Company and its customers (50%-50%). The third band is for deviations from \$40 to \$120 million, and the Company is responsible for 10% of the costs and customers for the remaining 90%. Finally, the fourth band is for deviations in excess of \$120 million. In

^{16/} TR. 972:25 - 973:4 (Schoenbeck).

^{17/} Exh. No. 235 (Exh. A to Settlement Stipulation in Docket Nos. UE-011570 and UG-011571).

^{18/} TR. 975:17-22 (Schoenbeck).

these cases, the Company is responsible for 5% of the costs and customers are responsible for the remaining 95%. The third and fourth bands are somewhat illusory because the PCA also contains a cumulative sharing mechanism for the initial period from July 1, 2002, through June 30, 2006. During this period, customers are responsible for 99% of any deviation should the Company's share of the power costs exceed \$40 million.

15 As of February 13, 2004, PSE reported that the PCA balance was approximately \$43.6 million, exceeding the \$40 million four-year cumulative value.^{19/} However, the Commission's PCORC order disallowing certain costs related to PSE's imprudent management of the Tenaska gas supply resulted in a reduction in the deferral balance to below the cumulative cap.^{20/} PSE has stated that it expects the deferral balance to surpass the cumulative cap once again sometime in 2005.^{21/} Once the cap is exceeded, 99% of excess power costs will be passed through to customers under the PCA until July 1, 2006.^{22/}

ii. Normalized Gas Costs

16 ICNU first raised the issue of how to determine the appropriate gas cost for PSE last year in the PCORC. ICNU argued that a normalized gas cost based on a fundamentals analysis should be used instead of a strip of NYMEX future prices for three reasons. First, a fundamentals analysis more accurately reflects expected market

^{19/} WUTC v. PSE, WUTC Docket No. UE-011570, Quarterly Report of the Power Cost Deferral Calculation (Feb. 13, 2004).

^{20/} TR. 752:20-24 (Story).

^{21/} Id.

^{22/} TR. 754:5-10 (Story).

conditions over time.^{23/} Second, PSE uses a fundamentals analysis in making its own business decisions.^{24/} Finally, the out months of the NYMEX strip have very low volumes and do not represent a liquid market.^{25/} ICNU also has pointed out that PSE uses Aurora, a fundamentals model, to project electric prices, rather than NYMEX prices.^{26/}

17 The Commission approved the gas price proposed by PSE in the PCORC; however, the Commission acknowledged that the issue deserved further scrutiny in future proceedings:

ICNU has raised important questions concerning how a baseline fuel gas price should be established for ratemaking in the context of a PCORC proceeding, and otherwise We agree with Staff that this is an issue that will grow in importance and one that requires additional scrutiny These questions should be revisited in a future proceeding.^{27/}

18 In the current proceeding, PSE initially used an average NYMEX future price based on the strip of prices from the period December 22, 2003, to January 8, 2004, and recommended that the Commission adopt a gas price of \$4.39 per MMBtu.^{28/} This was the same methodology used by PSE in the PCORC. Staff disagreed with PSE's methodology, stating that "using the average of the most recent ten-day forward prices to estimate future spot price has no empirical or theoretical justification."^{29/} Staff proposes that the Commission adopt an alternative methodology that uses, subject to certain

^{23/} See WUTC v. PSE, WUTC Docket No. UE-031725, Order No. 12 at ¶ 48 (Apr. 7, 2004).

^{24/} See id.

^{25/} See id. at ¶ 50.

^{26/} TR. 751:10-13 (Story).

^{27/} WUTC Docket No. UE-031725, Order No. 12 at ¶¶ 55-56.

^{28/} Exh. No. 371HC at 10:20 - 11:4 (Schoenbeck Direct).

^{29/} Exh. No. 451 at 28:11-13 (Mariam Response).

adjustments, a three-month average of NYMEX strips to estimate forward gas prices.^{30/} Staff proposes a gas price of \$4.69 per MMBtu, which increased the power costs initially filed by PSE by \$29.1 million.^{31/} In rebuttal testimony, PSE agreed in principle with Staff's approach; however, PSE proposed to use an average of three months of forward prices ending September 30, 2004.^{32/} PSE's update to its filing using this methodology produces a gas cost for the rate year of \$5.60 per MMBtu, which increases rate-year power costs by \$43.2 million compared to the Company's initial filing.^{33/}

19 ICNU disagrees with the methodology proposed by Staff and PSE and urges the Commission to adopt the \$4.25 per MMBtu gas cost proposed by Mr. Schoenbeck, which reflects a normalized gas cost that extends beyond the test period. If the Commission does not adopt Mr. Schoenbeck's proposal, it should order that the gas cost that is adopted be reset effective July 1, 2006.

20 The record includes considerable testimony regarding the appropriate gas cost to adopt, including extensive discussion of the efficiency of the NYMEX future's market as a tool for forecasting gas prices. The NYMEX prices generally do not reflect a robust market for the later months of the rate period.^{34/} Furthermore, because the NYMEX prices take into account near term circumstances, they are inappropriate for establishing a normalized baseline gas price.^{35/} This second drawback of the NYMEX prices highlights the central issue surrounding the gas price in this proceeding, which is

^{30/} Exh. No. 451 at 6:4-7 (Mariam Response).

^{31/} Exh. No. 451 at 6:8-10, 6:18-19 (Mariam Response).

^{32/} Exh. No. 82C at 21:6-12 (Ryan Rebuttal).

^{33/} Exh. No. 82C at 11:13-15 (Ryan Rebuttal).

^{34/} Exh. No. 371HC at 11:14 - 12:4 (Schoenbeck Direct).

^{35/} Id.

whether the Commission should adopt a price that is intended to reflect prices during the test year or a price that represents a reasonable normalized value for the purposes of applying the sharing bands of the PCA.

21

Mr. Schoenbeck argues convincingly that use of a projected rather than normalized gas value distorts the sharing of risks inherent in the PCA.^{36/} Nevertheless, the philosophical debate between forecasted and normalized costs may have little practical impact on customers at present because the PCA balance will likely surpass the \$40 million cumulative cap in 2005 and, after that point, 99% of variations in power costs will be passed on to customers.^{37/} This cap expires, however, on June 30, 2006. Thus, as Mr. Schoenbeck noted, “once you get beyond July 1, 2006, then it becomes real ratepayer money.”^{38/} In other words, once the PCA cap expires, customers will be harmed by a gas cost that is set too high due to operation of the PCA sharing mechanisms. This highlights an essential point; if rates are set based on predicted results during the rate period, rather than normalized values, then it is essential that gas prices be updated as of the end of the rate period, or in no event later than July 1, 2006. Staff is in agreement with this requirement. Dr. Mariam stated that his recommended gas price would be effective only until June 2006.^{39/} Therefore, the Commission should either adopt a normalized value for gas costs or require that gas costs be updated effective July 1, 2006.

^{36/} Exh. No. 371HC at 7:9 - 8:7 (Schoenbeck Direct).

^{37/} TR. 974:3-9 (Schoenbeck).

^{38/} TR. 974:9-11 (Schoenbeck).

^{39/} TR. 707:16-18 (Mariam).

c. Oil Costs

22

PSE’s power costs are determined based on normalized loads. PSE uses the Aurora model to determine the power costs used to set base power costs in PSE’s rates.^{40/} Aurora is an hourly production cost model that predicts the hourly cost of serving normalized loads.^{41/} In this case, PSE proposes to include \$12.75 million in revenue requirement as an external adjustment to the Aurora results.^{42/} This additional cost is attributable to 200 hours of oil burn during the months of November through February that PSE has assumed during the rate year at the Fredonia, Frederickson, and Whitehorn CTs.^{43/} PSE claims that this oil expense is necessary to “meet load over and above the expected load, which is modeled in Aurora.”^{44/}

23

The Commission’s standard for normalization, described above, dictates that the \$12.75 million in rates for oil expenses be removed from the Company’s filing. PSE itself recognizes that “[t]he objective of normalizing the test year is to determine costs and revenues without regard to the impacts of good or bad weather,” yet instead of assuming normal weather conditions, the Company’s proposal assumes the most atypical conditions.^{45/} This is not the first time PSE has proposed including this type of “phantom” cost in rates.^{46/} In two previous rate cases, PSE proposed adjustments to test year results to cover capacity costs for possible super-peaking events. In both cases, the

^{40/} TR. 702:5-7 (Mariam).
^{41/} TR. 701:17 - 702:10 (Mariam).
^{42/} Exh. No. 101; Exh. No. 102C; TR. 871:24 - 872:24 (Ryan).
^{43/} TR. 874:4-7 (Ryan).
^{44/} TR. 874:9-10 (Ryan).
^{45/} Exh. No. 237C at 23:20-21 (Story Rebuttal).
^{46/} Eleventh Supp. Order at 39.

Commission rejected the Company’s proposals, noting that these types of costs are not appropriate for inclusion in the normalized rates set in a general rate case.^{47/}

24 In Docket No. U-85-53, the Company proposed an adjustment to power costs related to the incremental operation and maintenance expenses for certain CTs.^{48/} PSE proposed to “determine the expense level using 200 hours of combustion turbine operation to meet peak load demand during the winter months.”^{49/} Commission Staff opposed this approach in part because “the turbines ha[d] not been used for peaking purposes in recent years and it [was] not reasonable or prudent to assume 200 hours of turbine operation for peaking each winter.”^{50/} The Commission rejected PSE’s proposal, preferring instead to allow the Company to recover the expenses through its Energy Cost Adjustment Clause, thereby allowing “recovery based upon actual rather than estimated figures.”^{51/}

25 In Docket No. UE-921262, the Company proposed an adjustment to power costs that would add over \$4 million to cover an option to purchase 358 MW of power for “potential extreme winter peaks.”^{52/} Again, the Commission rejected the proposal, finding that the costs were not known and measurable and that PSE’s Periodic Rate Adjustment Mechanism provided “the appropriate place to recover such capacity costs.”^{53/}

^{47/} Id.; WUTC v. PSP&L, WUTC Docket No. U-85-53, Second Supp. Order at 40-41 (May 16, 1986).

^{48/} WUTC Docket No. U-85-53, Second Supp. Order at 40.

^{49/} Id.

^{50/} Id.

^{51/} Id. at 41.

^{52/} Eleventh Supp. Order at 39.

^{53/} Id.

The \$12.75 million that PSE proposes to recover here for additional oil expense related to loads “over and above” the expected loads is no different from the Company’s proposals in these previous cases.^{54/} The oil burn expense does not represent a known and measurable change to the test year. As in Docket No. U-85-53, it simply is not “reasonable or prudent” to assume that PSE is going to experience loads that will necessitate this 200 hours of oil burn each winter, especially when it comes at a cost of \$12.75 million per year to ratepayers.^{55/} Furthermore, if PSE actually experiences the temperatures and loads upon which this oil burn is premised, the cost of that oil will be flowed through the PCA. That is the sharing of risk that was established when the Commission approved the PCA, not the unilateral shifting of risk inherent in PSE’s proposal.

In addition, the evidence in the record demonstrates that Aurora already incorporates the temperature extremes and loads upon which PSE bases the oil expense, yet the Company still maintains that an added cost is necessary. Ms. Ryan acknowledged that Aurora shows no dispatch of the CTs with oil.^{56/} Nevertheless, Ms. Ryan maintained that the cost should be included in rates based on the following argument:

The oil cost is an added cost to the Aurora costs. Because it’s put into the budget or the baseline to cover those days, those hours when we’re running over what we need, what we projected for expected load.

So there’s a placeholder for days when you have load that exceeds average.^{57/}

^{54/} TR. 874:9-10 (Ryan).
^{55/} WUTC Docket No. U-85-53, Second Supp. Order at 40.
^{56/} TR. 877:19-23 (Ryan).
^{57/} TR. 877:22 - 878:3 (Ryan).

28 ICNU questioned how PSE could use average loads to determine revenues but use average loads, plus the \$12.75 million cost of oil, to determine power costs without creating a mismatch.^{58/} Ms. Ryan could not answer the question, but PSE later provided a partial answer in response to a records requisition request.^{59/} According to PSE, “the temperature extremes were included in the determination of the adjustment coefficients and, accordingly, the temperature normalized loads.”^{60/}

29 PSE’s response conclusively demonstrates that the Company is double counting. The temperature extremes that PSE uses to justify the oil expense are included in the normalized loads included in Aurora. Therefore, Aurora purchases fuel and dispatches resources on an hourly basis to meet these loads. As a result, the cost of serving loads associated with the oil expense is already included in the Aurora results. In short, PSE is purchasing oil and gas to service the same loads.

30 The Commission has two remedies available to remove the inappropriate cost of the CT oil expense from rates. First, the Commission could exclude the \$12.75 million cost of oil from revenue requirement. Second, the Commission could remove the cost of gas for the 135,200 megawatt hours assumed to be served by oil.^{61/}

31 The best choice would be to remove the \$12.75 million cost of the oil. As noted above, Aurora predicts no dispatch of oil, and PSE has presented no evidence

^{58/} TR. 880:9-13 (Ryan).
^{59/} Exh. No. 108.
^{60/} Exh. No. 108 at 1.
^{61/} See TR. 875:5-8 (Ryan).

indicating it will actually incur such an expense. In addition, Table 1, below, illustrates that historic records indicate much lower oil burn than that assumed by PSE:

Table 1^{62/}
(MWh)

	Test Year November-February Oil Burn	1994-2003 November-February Oil Burn	1994-2003 November-February Excluding 2000
Fredrickson	33,200	1,542	1,713
Fredonia	68,800	20,717	11,091
Whitehorn	33,200	22,562	12,289
Total	135,200	44, 821	25,093

32 This table demonstrates several things. First, the proposed amount of oil generation is nearly three times the historic oil generation over the most recent ten-year period. Second, much of that oil generation occurred during the energy crisis in 2000, when spark spreads exceeded all historical norms. If the oil generation data from 2000 is excluded, the proposed oil generation exceeds historical generation by an even greater amount. Finally, even assuming that PSE will use some oil to meet expected loads, its gas needs would decline from that projected by Aurora. The oil burn expense should be excluded from revenue requirement because it is not a known and measurable expense, and it violates established precedent for normalizing power costs.

33 If the Commission does allow the oil cost, then the cost of gas to serve the same load should be removed. This adjustment can be calculated by multiplying the

^{62/} Exh. No. 103C at 4; WUTC v. PSE, WUTC Docket Nos. UE-031471, UE-032043, UE-040640 & UE-040641, Affidavit of Julia M. Ryan ¶¶ 4-5, Exh. A (Dec. 30, 2004).

135,200 MWhs assumed to be served by the oil burn by the gas price adopted in this proceeding (in \$/MWhs). Failure to remove either the cost of the oil or the gas cost will result in double recovery of fuel costs to serve the same load.

d. Hydro Normalization

34 In 1993, the Commission adopted a 40-year rolling average methodology for hydro normalization.^{63/} PSE and Staff urge the Commission to abandon that methodology in this case and adopt a 50-year average.^{64/} Adopting a 50-year average would increase revenue requirement by approximately \$9 million compared to the 40-year rolling average.^{65/}

35 The Commission adopted the 40-year rolling average in PSE's 1993 rate case after development of a full evidentiary record, which included participation by Pacific Power and Light and Washington Water Power.^{66/} The debate in 1993 was the same as it is today. The utilities argued that the 40-year rolling average method for normalizing stream flow data should be abandoned because there were no discernable "trends or cycles" in the data.^{67/} The Commission rejected the Company's position and directed PSE to continue to use a 40-year rolling average. The Commission stated:

The Company is put on notice that this will remain the Commission's position on these issues unless and until a clear and convincing argument supports a superior alternative.^{68/}

^{63/} Eleventh Supp. Order at 41-43.

^{64/} Exh. No. 451 at 4:22 - 5:5 (Mariam Direct); Exh. No. 82C at 13:8-10 (Ryan Rebuttal).

^{65/} See TR. 693:5-12 (Dubin); Exh. No. 82C at 13:8-10 (Ryan Rebuttal); Exh. No. 111 at 5:16-18 (Dubin Direct).

^{66/} Eleventh Supp. Order at 41-43.

^{67/} Id. at 42.

^{68/} Id. at 43.

36

The Commission should reject PSE's attempt to opportunistically change the established methodology for normalizing hydro costs. Obviously, PSE is seeking to change the methodology only because it benefits the Company. PSE initially proposed a 60-year average in this case, which inflated the Company's power costs even more than the increase under the 50-year average put forth by Staff.^{69/} PSE's agreement with Staff to use the 50-year average is not based on any rationale; it is merely an effort to make more palatable to the Commission the notion of abandoning the 40-year average that has been the WUTC's standard since 1993.^{70/} The Commission should not be swayed by the agreement of two parties in this case. If the Commission wishes to revisit the issue of hydro normalization, then it should initiate a generic proceeding that allows participation by all utilities.

37

In addition, the Commission should retain the current methodology because PSE and Staff have not satisfied the requirement in the Commission's 1993 order to show by clear and convincing evidence that the 40-year rolling average should be abandoned. As Mr. Schoenbeck pointed out, the Commission rejected the same type of arguments raised in this case when it adopted the 40-year rolling average in 1993.^{71/} Furthermore, Mr. Schoenbeck points out that it would be more appropriate to use all 120 years of available data if the Commission elects to abandon the 40-year rolling average.^{72/}

38

The thesis of PSE's witness, Dr. Dubin, is that the number of years of data used to normalize projected hydro should be increased, and the use of a rolling average

^{69/} Exh. No. 71 at 26:3 (Ryan Direct).

^{70/} See Exh. No. 82C at 13:8-10 (Ryan Rebuttal) (Agreeing with Staff's proposed 50-year average without stating any rationale for doing so.).

^{71/} TR. 984:10-12 (Schoenbeck).

^{72/} TR. 996:22-23 (Schoenbeck).

should be replaced by a simple average. Dr. Dubin admitted that on “statistical grounds, at least, you should use all the data that is available.”^{73/} Likewise, he testified that “it’s always appropriate to use all the available information.”^{74/} Dr. Dubin stated that he did not use data prior to 1928 because it does not exist.

All I can tell you, and maybe I’m wrong about this—and if I am, I will be happy to amend my answer—but my understanding is there is no water information for these rivers before 1928.^{75/}

39 It turns out Dr. Dubin was wrong. Mr. Schoenbeck testified that 120 years of data are available and that the Northwest Power Planning Council uses 110 years of streamflow data from the Dalles to determine Northwest hydro availability.^{76/} Mr. Schoenbeck also stated that the older data not used by Dr. Dubin was actually more accurate than more recent data.^{77/}

40 PSE and Staff have failed to make a clear and convincing case that the 40-year rolling average should be abandoned. Much of the argument put forth to support the 50-year average merely restates arguments that were rejected in 1993. Mr. Schoenbeck made clear at the hearing that the selection of the appropriate data set is significant. Mr. Schoenbeck stated that the use of PSE’s 60-year average would decrease hydro availability by 3.5% compared to the rolling 40-year average, while using a 120-year average would increase hydro availability by 15%.^{78/} If the Commission abandons the

^{73/} TR. 673:12-14 (Dubin).

^{74/} TR. 636:18-19 (Dubin).

^{75/} TR. 683:1-5 (Dubin).

^{76/} TR. 1000:2-6 (Schoenbeck) (Only 110 years of data were available at the time the Northwest Power Planning Council adopted its methodology.).

^{77/} TR. 995:11-19 (Schoenbeck).

^{78/} TR. 985:25 - 986:5 (Schoenbeck).

existing standard, then the only logical approach is to use all available data. The record shows that reliable data exists for 120 years, and the Northwest Power Planning Council uses 110 years of that data. The Commission should prohibit PSE from opportunistically selecting a data set that results in additional revenue, whether that be the 60-year average proposed in the Company's initial case or the 50-year average to which the Company has agreed. The Commission should either retain the current standard pending a review in a generic proceeding or require PSE to use 120 years of stream flow data.

7. Adjustment 2.18—Rate Case Expense

a. Cost Treatment (deferral and amortization vs. expense)

41 PSE requests recovery of three different types of rate case-related expenses in this proceeding: 1) the remaining costs relating to PSE's 2001 rate case, 2) more than \$2.3 million in rate case expenses for expert witness fees and legal costs related to this proceeding, and 3) costs related to PCORC proceedings.^{79/} For the remaining 2001 rate case costs, PSE has proposed to amortize those costs in the rate year.^{80/} For the PCORC costs, PSE has expensed those costs and agreed to Staff's proposal to include a normalized amount of \$650,000 in rates on a going forward basis.^{81/} For its current rate case expenses, PSE is deferring these costs and booking them as a regulatory asset.^{82/} PSE proposes to amortize the deferral balance over a three-year period.^{83/}

^{79/} Exh. No. 231 at 15:4-10 (Story).

^{80/} Id. at 15:4-6 (Story).

^{81/} Exh. No. 237C at 21:17-19 (Story).

^{82/} Exh. No. 421 at 16:5-13 (Russell).

^{83/} Id. at 16:11-13 (Russell).

42 ICNU has not proposed an adjustment related to the remaining 2001 rate case expenses but believes that the Commission should consider revisiting the ratemaking treatment of those costs in light of the discussion in this Initial Brief. The PCORC-related costs are discussed in Section VII of this Initial Brief. Thus, the discussion in this section focuses solely on PSE's rate case expense for the current proceeding.

43 ICNU urges the Commission to adopt a rate case expense adjustment that results in a reasonable amount of normalized rate case expense being included in rates on a going forward basis. The Commission should reject Staff's and PSE's proposals that the Company be authorized to defer and amortize all or part of the 2004 rate case expense.

44 Deferred accounting is inappropriate for rate case expenses. In addition, PSE's legal and expert witness fees related to rate cases have grown out of control and dwarf the resources available to Staff, Public Counsel, and Intervenors to litigate these cases. Authorizing deferred accounting and the creation of regulatory assets related to rate case expenses creates the wrong incentive for PSE and would conflict with the past admonitions to the Company by this Commission to control its rate case costs.^{84/} Finally, the Commission has addressed the creation of unauthorized deferred accounts in previous PSE dockets and, despite the Company's representations to the contrary, the Commission has not automatically authorized PSE to defer and amortize its rate case expense.^{85/} In fact, the Commission specifically ordered PSE in a previous rate case to stop creating

^{84/} Eleventh Supp. Order at 68.

^{85/} See, e.g., *id.* at 53.

unauthorized deferred accounts.^{86/} The Commission should reinforce that directive in this proceeding and deny PSE the authority to defer and amortize these costs.

i. The Commission Should Deny PSE’s Request to Defer and Amortize the Rate Case Expense

45 PSE argues that its proposal to defer and amortize its rate case expense is consistent with the Commission’s historic treatment of these costs for the last twenty years: “For at least the last two decades, the Commission has permitted such costs to be deferred, updated to actual in the Company’s compliance filing, and amortized for recovery over a multi-year period.”^{87/} According to the Company, its proposal to defer and amortize these costs merely “has followed prior Commission direction and precedent in the treatment of rate case costs.”^{88/} PSE’s authority to defer and amortize the rate case expenses is not as clear as the Company would have the Commission believe.

a) The Commission Typically Authorizes Deferred Accounting Only for Extraordinary and Unanticipated Costs

46 PSE and the Commission have not explicitly referred to the treatment of rate case expense as “deferred accounting,” but that is exactly what the Company has done. Deferred accounting is a ratemaking mechanism through which a utility can defer, or record in an account, certain expenses or revenues. This allows the utility to treat the deferred cost as a regulatory asset rather than an expense. The utility may later request to

^{86/} Id.
^{87/} Exh. No. 237C at 22:10-12 (Story Rebuttal).
^{88/} Id. at 25:22 - 26:1.

“amortize,” or recover, those expenses in rates.^{89/} Accounting for the deferred account as a regulatory asset prior to recovery allows the utility to earn a return on the deferred balance.^{90/}

47

In the past, the Commission typically has authorized deferred accounting for unanticipated or extraordinary expenses associated with specific events that occur between rate cases.^{91/} By authorizing the utility to track and recover the expenses or revenues between rate cases, deferred accounting provides an exception to the rule against retroactive ratemaking, which normally would prohibit recovery of costs that had not been included in rates.^{92/} As a result, the Commission has found that explicit Commission approval is necessary to defer the costs, and subsequent approval is necessary to amortize the deferred costs in rates.^{93/}

^{89/} Leonard Saul Goodman, *The Process of Ratemaking* 323 (1998) (“Permission to defer a cost for accounting purposes does not carry with it any promise that the cost will later be allowed in rates The deferral is merely a stop-gap measure to preserve the status quo until the company proves that the cost should be allowed.”).

^{90/} *Id.* at 742, 744 (explaining that when a company creates a “deferred cost” or “regulatory asset,” it thereby capitalizes the unamortized balance and carries it as an asset on its balance sheets).

^{91/} For example, in one case the Commission approved deferred accounting of costs related to extraordinary gas market prices. *Re Avista Corp.*, WUTC Docket No. UG-001980, Order (Dec. 27, 2000). In another, it approved deferral of the costs of a utility’s right-of-way program, which was described as “an extraordinary one-time program” that benefited ratepayers by making service more reliable. *Re PSE*, WUTC Docket No. UE-980877, Order Authorizing Accounting Treatment (July 8, 1998).

^{92/} *Re PSE*, WUTC Docket No. UE-010410, Order Denying Petition to Amend Accounting Order at ¶¶ 7-8 (Nov. 9, 2001).

^{93/} Eleventh Supp. Order at 53; *WUTC v. Avista Corp.*, WUTC Docket Nos. UE-991606 & UG-991607, Fourth Supp. Order at ¶¶ 18, 19 (Nov. 9, 2000); see *WUTC v. Cascade Natural Gas Corp.*, WUTC Docket No. UG-941408, Third Supp. Order at 10 (Oct. 31, 1995) (allowing the Company to defer certain costs “only subject to the Commission’s approval for reasonableness in an appropriate manner”); *Re Avista Corp.*, WUTC Docket No. UE-000972, Order Granting Deferral of Power Cost Expenses Pending Demonstration of Prudence (Aug. 9, 2000).

b) The Commission has Ordered PSE to Not Create Unauthorized Deferred Accounts

48 In this case, PSE currently is deferring its 2004 rate case costs and treating those costs as a regulatory asset by booking them to Account 182.3, Other Regulatory Assets.^{94/} PSE cites a number of prior WUTC orders in support of its contention that the Commission has authorized the Company to defer and amortize its rate case costs in previous years; however, the Company ignores the fact that it never sought, nor did it receive, explicit Commission approval to defer its rate case expense in the first place.^{95/} Although the Commission in previous orders authorized the amortization of rate case expense over a period of time, PSE was put on notice in its last fully litigated rate case that, if the Company wanted to defer rate case expenses or other costs in the future, it needed explicit Commission authorization to do so.^{96/} PSE's attempt to defer and amortize its rate case expense from both the 2001 and 2004-05 rate cases without specifically requesting Commission authorization to do so ignores the Commission's requirements for deferred accounting.

49 In the Twentieth Supplemental Order issued in Docket No. UE-921262, the Commission explicitly addressed PSE's practice of setting up a deferral to recover dollar for dollar certain expenses related to that proceeding:

In reviewing the issue of the recovery of costs of this proceeding, and recalling the numerous issues addressed in the Eleventh Supplemental Order regarding deferral of costs by Puget, the Commission has determined that it is

^{94/} Exh. No. 421 at 16:6-9, 20:1-2 (Russell Direct).

^{95/} Exh. No. 237C at 22:10 - 23: 11 (Story Rebuttal).

^{96/} WUTC v. PSP&L, WUTC Docket Nos. UE-920433, UE-920499, & UE-921262, Twentieth Supp. Order at 20 (Dec. 16, 1994) ("Twentieth Supp. Order").

appropriate now to make it clear to Puget that it may not defer any of the costs of this prudence proceeding. The Commission will look further at the costs when, and if, a request for recovery is made.

Deferred accounting was a recurring issue in the first stage of this case. Puget had set up several deferred accounts, and sought to recover certain expenses dollar for dollar. *The Eleventh Supplemental Order makes it clear that advance Commission approval is necessary before deferring costs.* In one case (storm damage), however, the Commission allowed a deferred amount that it had implicitly allowed to be recovered, even though it did not allow continued deferral.

The Commission has the authority to approve deferral; without such approval the company has no authority to defer.^{97/}

50

In the Eleventh Supplemental Order referred to in this quote, the Commission admonished PSE for creating unauthorized deferrals and regulatory assets related to storm damage and self insurance, despite the Company's claims that the Commission had approved this practice in previous filings.^{98/} With respect to self insurance costs, the Commission stated:

The Commission has not authorized the company to create a regulatory asset through this deferral treatment. The company may not unilaterally decide to do so.

The Commission finds disturbing the company's practice of creating regulatory assets through deferral accounting The Commission orders the company to immediately cease creating unauthorized deferral accounts. If the company believes it has cause for creating a reserve deficit, it is well aware of its obligation to petition the

^{97/} Id. at 20 (emphasis added).
^{98/} Eleventh Supp. Order at 50-53.

Commission for an accounting order authorizing such action.^{99/}

These statements put PSE on notice that if the Company intended to create a deferral and include the deferred costs as an adjustment in future rate cases, it needed advance Commission approval to do so. PSE made no attempt in this case to seek Commission authorization to defer and record as a regulatory asset the rate case expenses.

51 Staff urges the Commission to authorize PSE to defer the 2004-05 rate case expenses through August 2004 in part because PSE may have legitimately misinterpreted prior Commission orders “to allow blanket authority to defer general rate case costs.”^{100/} The Commission should reject Staff’s proposal. First, PSE’s rate case expenses are inappropriate for deferred accounting. These are not extraordinary expenses incurred between rate cases over which PSE has no control. PSE controls both the timing and cost of these cases.

52 Second, Staff’s unsupported claims regarding PSE’s misinterpretation of previous Commission orders ignores the Commission’s unequivocal statements in Docket No. UE-921262. In the Twentieth Supplemental Order, the Commission explained, in the context of the expense of that proceeding, that “[t]he Eleventh Supplemental Order makes it clear that *advance Commission approval* is necessary before deferring costs” and that “[t]he Commission has the authority to approve deferral; without such approval the company has no authority to defer.”^{101/} In that docket, the Commission allowed PSE to recover storm damage costs that were deferred without authorization because the

^{99/} Id. at 53.

^{100/} Exh. No. 421 at 21:1-6 (Russell Direct).

^{101/} Twentieth Supp. Order at 20.

Commission acknowledged that its previous orders may have “tacitly approved” the Company’s actions in the past.^{102/} Neither PSE nor Staff can reasonably claim that any ambiguity still exists, however, after the Commission’s orders in Docket No. UE-921262.^{103/} PSE was on notice that it was improper to defer its expert witness and legal fees associated with a particular proceeding without “advance Commission approval,” and the Company still continued to disregard the Commission’s order by deferring such expenses.

53

This Commission has in the past rejected an argument similar to the ones PSE and Staff put forth here regarding authorization for deferred accounting. In Docket No. UE-991606, Avista argued that because the Commission had recognized that Avista was amortizing certain expenses, it had therefore allowed deferred accounting of those expenses.^{104/} The Commission rejected Avista’s argument, noting that although it had used the amortization amount cited by Avista to represent the amount of costs incurred, it had not in doing so approved deferred accounting for that transaction.^{105/} The Commission issued a specific reminder “that accounting treatment cannot be considered authorized and approved unless actually approved by the Commission.”^{106/} Similarly, the mere fact that the Commission may have in the past recognized that PSE was deferring rate case expenses does not mean that the Commission has authorized deferred accounting of the Company’s current expenses.

^{102/} Eleventh Supp. Order at 51.

^{103/} PSE’s 2001 rate case (Docket Nos. UE-011570 & 011571), was resolved by Commission adoption of a comprehensive settlement. Thus, the treatment of the rate case costs in the settlement is not precedent that changes the Commission’s order in Docket No. UE-921262.

^{104/} WUTC Docket Nos. UE-991606 & UG-991607, Fourth Supp. Order at ¶ 13.

^{105/} Id. at 5.

^{106/} Id.

54

Staff's witness, Mr. Russell, acknowledged at hearing that rate case expense is inappropriate for deferred accounting.^{107/} According to Mr. Russell, "larger dollar items" are appropriate for deferred accounting "[b]ut normal expenditures, whether they are every three years or every year, should be expensed in accordance with the uniform system of accounts."^{108/} Mr. Russell succinctly summarized one of the primary problems with authorizing deferred accounting for costs such as the rate case expense: "I mean, if we defer everything there is absolutely no risk to the Company."^{109/}

55

In addition, the Commission has found in previous cases that amortization of deferred amounts will not be permitted until the costs have been reviewed for reasonableness and prudence.^{110/} In fact, for one Avista deferred account, the Commission explicitly required a "footnote disclosure in all regulatory reporting or financial disclosure statements that include these deferrals, that regulatory approval of their recovery will not be received until the showing of prudence."^{111/} In this case, Staff has not reviewed PSE's rate case expense for reasonableness.^{112/} As such, the Commission should not authorize the deferral and amortization of the rate case expense proposed by either PSE or Staff.

56

PSE implicitly acknowledged the flaw in its claim that the Commission's longstanding practice is to allow deferral and amortization of rate case expenses by requesting the requisite advance Commission approval to defer the PCORC legal and

^{107/} TR. 829:9-20 (Russell).

^{108/} TR. 829:12-18 (Russell).

^{109/} TR. 829:18-19 (Russell).

^{110/} See, e.g., WUTC Docket No. UG-941408, Third Supp. Order at 10.

^{111/} WUTC Docket No. UE-000972, Order Granting Deferral of Power Cost Expenses Pending Demonstration of Prudence at 2.

^{112/} TR. 829:25 - 830:12 (Russell).

consulting expenses. Indeed, PSE submitted a petition for deferred accounting related to the PCORC expenses prior to even filing the case.^{113/} PSE has now agreed with Commission Staff that the Company's deferred accounting application should be denied, and a normalized amount of PCORC costs should be included in rates on a going forward basis.^{114/} There is no difference between PSE's PCORC expenses and the rate case costs that would justify differing ratemaking treatment.

57

Finally, authorization of PSE's deferral, amortization, and creation of a regulatory asset related to the rate case expense creates perverse incentives for a Company whose expenditures in the last two rate proceedings before this Commission have been excessive. PSE spent almost \$1.8 million on the PCORC proceeding and had spent \$2.3 million on this rate case before the hearing even began.^{115/} The Commission has warned PSE in past rate cases that its legal fees were excessive.^{116/} Allowing the Company to defer and amortize all of these expenses provides no incentive to control its rate case expenses. Furthermore, given that recovery through deferred accounting enables the Company to earn a return on the balance of the deferred account, approval of the Company's creation of a regulatory asset related to these costs actually creates the perverse incentive to expend as much on rate cases as possible. This is especially true since the primary purpose of the expenditures is to increase shareholder profits. The Commission should deny the authority to defer in this case and make clear that the policy

^{113/} Re PSE, WUTC Docket No. UE-031471, Petition at 1 (Sept. 12, 2003).

^{114/} Exh. No. 237C at 21:12-19 (Story Rebuttal).

^{115/} Exh. No. 249 at 1; Exh. No. 371HC at 27:20 - 28:2 (Schoenbeck Direct).

^{116/} Eleventh Supp. Order at 69.

related to rate case expense in future proceedings is to include a normalized amount of expense in rates.

ii. The Commission Should Adopt a Normalized Amount of Rate Case Expense to be Recovered Going Forward

58

Although the Commission generally allows utilities to recover reasonable rate case costs, the purpose of such recovery is not to allow a utility to collect and earn a rate of return upon all of its expenses.^{117/} The intent is to normalize the utility’s costs during the rate period. In Docket No. UW-010877 the Commission stated that “[t]he purpose of including [an] amortized portion of rate case costs in rates is to allow the Company to earn an amount that approximates an annual amount of costs related to rate cases before the Commission.”^{118/} For this reason, recovery is limited to “a reasonable recurring level of rate case expenses.”^{119/} Notably, in one recent rate case, the Commission described the recovery of rate case expenses over a period of years as “normalization” rather than amortization, thus indicating that the proper treatment of rate case costs is expense and normalization, rather than deferral and amortization.^{120/}

59

Furthermore, as described above, PSE agrees with Staff’s proposal to normalize PCORC expenses^{121/} but has not offered a legitimate explanation as to why the Commission should treat general rate case costs differently. At the hearing, PSE explained that normalization was appropriate for the PCORC expenses because those

^{117/} WUTC v. Rainier View Water Co., WUTC Docket No. UW-010877, Third Supp. Order at 24 (May 3, 2002).

^{118/} Id.

^{119/} WUTC v. Rainier View Water Co., WUTC Docket No. UW-010877, Sixth Supp. Order at 17 (July 12, 2002).

^{120/} WUTC v. Am. Water Res., Inc., WUTC Docket Nos. UW-031284, UW-010961, & UW-031596, Order No. 08 at ¶¶ 92-100 (Nov. 1, 2004).

^{121/} Exh. No. 237C at 21:15-19 (Story Rebuttal).

cases “are generally not as expensive” as general rate cases and because the Company expects to bring a PCORC case every two years.^{122/} Neither of these reasons is valid. First, even if general rate case costs are greater than costs for PCORC cases, this fact is relevant only to the extent that it explains why the Company would want to defer the higher general rate case costs—deferral allows the Company to treat the costs as a regulatory asset, and greater costs equal greater returns for the Company. Second, with respect to the timing of general rate cases, the Company stated at hearing that it expects “to be back in front of this Commission on a very regular basis year in and year out for the . . . foreseeable future.”^{123/} Thus, rate case expenses appear to be a routine, rather than extraordinary, cost that should be normalized. In addition, if the Company expects to be filing general rate cases with the Commission this regularly, including a reasonable normalized level of expense in rates is the best way to provide an incentive to the Company to control its costs around a known amount.

b. Amount for Recovery

60 The Commission should establish a normalized level of rate case costs to be included in PSE’s rates on a going forward basis. In past cases, the Commission has allowed utilities to recover rate case costs in rates as long as the expenses are reasonable.^{124/} Still, the utility has the burden of proving that its expenses in rate case proceedings are reasonable.^{125/} The Commission’s determination of whether particular

^{122/} TR. 760:23 - 762:10 (Story).

^{123/} TR. 163:1-4 (Reynolds).

^{124/} See Eleventh Supp. Order at 68-69 (disallowing certain rate case costs deemed not to be in the interests of ratepayers).

^{125/} See id. (explaining that PSE had not met its burden of proof as to the reasonableness of certain rate case costs).

costs associated with rate case proceedings are reasonable is fact specific, but past Commission orders set out the general consideration that the amount of the costs must be proportionate to the actual effort or reasonable costs required by the particular proceedings. To determine reasonableness, the Commission has considered whether proposed rate case costs reflect “actual effort,” based on “the number and complexity of the issues and the difficulties in presentations.”¹²⁶

61 PSE has offered no evidence to demonstrate that its costs incurred for this rate case are reasonable or even proportionate to the complexity and number of issues involved. The evidence does show, however, that PSE’s costs seem to be excessive. For example, included in the rate case expense that PSE seeks to defer, amortize, and earn a return on in this proceeding is \$647,703 that PSE spent on testimony related to cost of capital and other issues.^{127/} Public Counsel’s cost of capital witness, Mr. Hill, testified that he was paid approximately \$20,000 for his work in this case and had testified on cost of capital issues in approximately 220 cases since 1980.^{128/} Mr. Hill further testified that PSE’s expenditures were unreasonable:

[M]y experience is that cost of capital witnesses for companies generally make two to three times what cost of capital witnesses for public advocates make, so that would be in the neighborhood of 25 to 50,000. Prior to this case, the highest I had seen was for Mr. Hadaway. He had, I believe, a two-year contract with PacifiCorp to do all their testimony in all their jurisdictions for a quarter of a million dollars. I’ve never seen anything on this scale.^{129/}

^{126/} WUTC Docket No. UW-010877, Sixth Supp. Order at ¶ 69.

^{127/} Exh. No. 249 at 1.

^{128/} TR. 493:16-20, 495:16-17 (Hill).

^{129/} TR. 495:1 - 496:8 (Hill).

Staff's cost of capital witness, Dr. John Wilson, had a "not to exceed" contract in the amount of \$50,000.^{130/} Cost of capital testimony is only one component of PSE's overall case in this proceeding, yet it is obvious that the Company's expense is grossly disproportionate to the expenditures of the other parties in this proceeding.

62

The Commission has sharply criticized PSE in the past for failing to control the Company's rate case expenses. In Docket No. UE-921262, the Commission noted that it was "very concerned about the high level of litigation expense in this case, both for legal counsel and for expert witnesses."^{131/} The Commission urged PSE "to evaluate use of in-house legal counsel to control costs."^{132/} PSE has had over ten years to heed the Commission's advice, yet in a 2003 Legal Budget Analysis, PSE itself acknowledged that it had [REDACTED]

[REDACTED]^{133/} Indeed, In 2003, PSE's annual budget for inside legal counsel was [REDACTED] while its budget for outside counsel was

[REDACTED]^{134/} [REDACTED]

[REDACTED]

[REDACTED]^{135/}

63

PSE argues that the Legal Budget Analysis is irrelevant because it does not specifically address rate case costs.^{136/} Nothing in the record, however, indicates that the Company's rate case expense in this rate case is the result of an inside-to-outside

^{130/} TR. 575:15-25 (Wilson).
^{131/} Eleventh Supp. Order at 68.
^{132/} *Id.* at 69.
^{133/} Exh. No. 240C at 34.
^{134/} *Id.* at 41.
^{135/} *Id.* at 43.
^{136/} Exh. No. 237C at 30:7-11 (Story Rebuttal).

counsel ratio that is any different from that described above. Actually, the record shows the opposite—the bulk of PSE’s expenses in this case come from outside counsel and consultants.^{137/} As of December 10, 2004, of the staggering \$2,318,413 in costs that PSE has accumulated for this case, PSE had spent \$779,053 on outside counsel and \$1,529,218 on outside witnesses and other consultants.^{138/} Furthermore, PSE has added to its list of consultants former PSE employees who left the Company in recent years. Mr. Heidell, for whose services in this rate case PSE has already incurred \$580,319 in expenses, was a PSE employee before he left to work for P.A. Consulting.^{139/} Under these circumstances, PSE’s claims that it is mitigating the Company’s outside rate case expense are unpersuasive.

64

The numbers confirm that PSE is making little headway in its alleged effort to control its rate case expense and legal costs. In PSE’s 1992 rate case, the Commission made clear that it was concerned about PSE’s rate case expenses, which were approximately \$700,000.^{140/} PSE claims that it is well aware of the Commission’s concerns about the Company’s rate case expenses, yet the total costs for the current proceeding are more than three times the amount the Commission was concerned about in 1992.^{141/}

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PSE lists certain actions it has taken that it claims have helped to control its legal costs, but even if PSE has taken those actions, it does not necessarily follow that

^{137/} Exh. No. 249 at 1, 3.
^{138/} Id. at 1.
^{139/} Exh. No. 249 at 1; Exh. No. 272 at 1, 3.
^{140/} Eleventh Supp. Order at 67-68.
^{141/} Exh. No. 237C at 31:8-10 (Story Rebuttal).

should also order, as proposed by Don Schoenbeck, that the Company and customers share the rate case expenses included in rates.^{145/} Requiring the Company to share a reasonable level of normalized rate case expense with customers will either create an incentive to ensure that PSE's costs are not so excessive in the next proceeding or at least not require customers to pay for excessive costs of the Company's efforts to raise rates.

VII. PCORC COSTS (DOCKET NO. UE-031471)

67 ICNU recommends that the Commission reduce the \$650,000 in legal and consulting fees related to PCOR proceedings that PSE and Staff have agreed to in this proceeding to \$250,000.^{146/} This amount reflects an equitable sharing between the Company and customers of a normalized amount of PCORC costs.^{147/}

PSE initially sought authority to recover the expenses related to the 2003-04 PCORC by requesting deferred accounting treatment for these costs even before the PCORC began.^{148/} Both ICNU and Commission Staff recommended that the Commission deny PSE's petition.^{149/} The Commission subsequently consolidated PSE's petition with this general rate case to allow PSE to justify the recovery of the PCORC costs in this case.^{150/}

68 Following the consolidation of PSE's deferred accounting petition in Docket No. UE-031471 with the general rate case, the Company included \$1.3 million in

^{145/} Exh. No. 371HC at 29:4-6 (Schoenbeck Direct).

^{146/} Id. at 30:19-23 (Schoenbeck Direct).

^{147/} Id. (Schoenbeck Direct).

^{148/} Exh. No. 425 at 1.

^{149/} Id.; Re PSE, WUTC Docket No. UE-031471, ICNU Letter to Commissioners (Apr. 23, 2004).

^{150/} Re PSE, WUTC Docket No. UE-031471, Order No. 02, Order of Consolidation (Apr. 28, 2004).

PCORC legal and consulting expenses in its filing in this case.^{151/} ICNU and Commission Staff both submitted prefiled testimony opposing PSE’s requested recovery of the PCORC expense.^{152/} ICNU urged the Commission to deny PSE’s deferred accounting petition related to the PCORC expenses, reduce the total amount of expenses to \$500,000 to reflect a normalized amount, and allow the Company and customers to each bear an equal share of those costs.^{153/} Under ICNU’s proposal, the Commission would include \$250,000 in rates for PCORC expenses on a going forward basis. ICNU urges the Commission to adopt this level of PCORC expense in this proceeding.

69 Staff also recommended that the Commission deny PSE’s deferred accounting petition and grant recovery of \$650,000 in PCORC expenses to reflect a “normal” amount.^{154/} Under Staff’s proposal, ratepayers would bear the entire amount of the normalized PCORC costs—there is no sharing.^{155/} PSE has agreed to Staff’s treatment of the PCORC costs.^{156/}

70 Although the PCORC-related costs that Staff and ICNU recommend be included in rates are relatively close in amount, ICNU urges the Commission to adopt ICNU’s proposal. PSE already recovers a certain amount of cost in rates related to regulatory expenses.^{157/} Amounts that the Company spends in excess of those costs between rate cases typically are the responsibility of shareholders, not ratepayers. Furthermore, both ICNU and Staff expressed concern about the high level of cost

^{151/} Exh. No. 371HC at 29:4 - 30:1 (Schoenbeck Direct).

^{152/} Id. (Schoenbeck Direct); Exh. No. 421 at 18:1-15 (Russell Direct).

^{153/} Exh. No. 371HC at 29:4 - 30:1 (Schoenbeck Direct).

^{154/} Exh. No. 421 at 18:9-10 (Russell Direct).

^{155/} Id.

^{156/} Exh. No. 237C at 21:17-19 (Story Rebuttal).

^{157/} Re PSE, WUTC Docket No. UE-031471, Staff Memorandum at 1 (Mar. 31, 2004).

incurred by PSE for the PCORC, and PSE provided no evidence in this Docket to demonstrate that its \$1.3 million in costs was reasonable for a six-month proceeding. Staff's proposal appears to halve the total amount of costs expended in the 2003-04 PCORC and adopt that amount as a reasonable normalized expense. However, including \$650,000 in rates each year is excessive given that the 2003-04 PCORC was particularly contentious, involved an extended schedule, and the PCA Stipulation from PSE's last rate case contemplates that PCORCs will be processed within four months.^{158/} Under Staff's proposal, PSE would spend over \$200,000 per month in a PCORC that lasted four months. Thus, the \$500,000 normalized amount proposed by ICNU, which PSE and its customers would share equally, is a more reasonable amount to include in rates on a going forward basis.

71 In addition, one of the primary purposes of the PCORC is to reset PSE's power cost baseline in the PCA in the event of a new resource addition. In other words, the typical PCORC filing will result in a customer rate increase. It is doubtful, however, that PSE will file a PCORC in order to lower the baseline if power costs decrease significantly. Given that PSE is in control of when a PCORC is filed, and such a filing generally will result in increased rates for customers, a sharing of the normalized expense of such a proceeding is appropriate.

72 Finally, in the first PCORC, the Commission found that PSE had imprudently managed the Tenaska gas supply since the Company bought out the Tenaska

^{158/} Ex. No. 235 at 6.

contract in 1997.^{159/} Customers have no assurance that the Commission will not find additional imprudence on PSE's part in future PCORCs. Under Staff's proposal, customers bear the entire amount of the normalized PCORC costs and all of the risk of paying for a proceeding in which the Commission finds imprudence. In ICNU's proposal, however, PSE and its customers share a normalized amount of PCORC costs and, as a result, share in the risk of future imprudence findings.

X. CONCLUSION

73 ICNU has addressed issues in this proceeding that pose a number of fundamental questions regarding the method of normalizing costs for purposes of setting PSE's rates. PSE should not be allowed to pick and choose between actual and normalized costs in order to produce higher rates. ICNU urges the Commission to:

- Adopt a normalized gas price in this proceeding that reflects conditions beyond the rate year in recognition of the uncertainty surrounding the time period for which rates will be in effect;
- Order PSE to remove from its filing the \$12.75 million in oil burn expense because it does not reflect a normalized amount and results in the Company double-recovering both the cost of oil and gas to serve the same loads;
- Reaffirm the WUTC policy adopted in 1993 that a 40-year rolling average will be used for hydro normalization until a party puts forth clear and convincing evidence of a superior alternative;
- Establish a reasonable level of normalized rate case expense for PSE to include in rates on an ongoing basis and explicitly reject the Company's unauthorized attempt to defer its rate case expense and treat it as a regulatory asset. In addition, the Commission should require PSE to share the burden of the rate case expense with customers in order to provide incentives for PSE to control its outside legal and consulting expenses, which are unreasonable;

^{159/} Re PSE, WUTC Docket No. UE-031725, Order No. 14 at ¶¶ 87-92 (May 13, 2004).

- Include in rates \$250,000 for PCORC expenses, which reflects a reasonable normalized amount that is shared equally between the Company and customers.

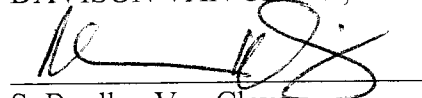
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PSE has not justified the rate increase sought in this case, and the Commission should make all reasonable efforts to ensure that customer rates include only reasonable normalized power costs and rate case expenses. ICNU requests that the Commission adopt the adjustments to PSE's filing discussed in this Opening Brief.

Dated this 17th day of January, 2005.

Respectfully submitted,

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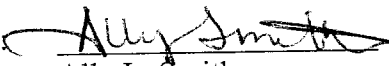
Of Attorneys for Industrial Customers
of Northwest Utilities

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing Initial Brief on behalf of the Industrial Customers of Northwest Utilities upon all parties of record in this proceeding, by mailing a copy thereof in a sealed, first-class postage prepaid envelope to each individual's last-known address, as listed below.

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