

SERVICE DATE
MAR 30 1990

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,)	
)	
Complainant,)	DOCKET NO. U-89-2688-T
)	
vs.)	
)	
PUGET SOUND POWER & LIGHT COMPANY,)	
)	
Respondent.)	
.....)	
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION)	
)	
Complainant,)	DOCKET NO. U-89-2955-T
)	
vs.)	
)	
PUGET SOUND POWER AND LIGHT COMPANY,)	FIFTH SUPPLEMENTAL ORDER ON RECONSIDERATION
)	
Respondent.)	
.....)	

On January 17, 1990, the Commission entered its Third Supplemental Order in this matter. The order authorized the company to file tariff revisions to produce an increase in revenues of \$104,161,623, including a rollover into general rates of approximately \$75 million which had been included in the company's prior ECAC proceedings.

On January 29, 1990, Petitions for Reconsideration were filed by Puget, the Commission staff, and Public Counsel. Public Counsel also filed a document entitled "Petition for Clarification of the Third Supplemental Order". That document will be treated as a petition for reconsideration.

The Commission requested answers from the parties. Answers were filed on February 13 by intervenor WICFUR, and on February 14 by Puget, the Commission staff, and Public Counsel.

Reconsideration was requested by one or more parties on the majority of issues in this complex case. Some of the requested changes are properly characterized as mathematical corrections. Other substantive issues include the following:

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Bonneville Exchange Power, the company's conservation programs, power costs, rate of return, cost of service, rate spread and rate design, and various individual adjustments to rate base and results of operations. These issues will be discussed separately below. The section on each issue will briefly address the parties' positions and will include the Commission's discussion and conclusions. Revisions to the tables included in the original order are attached to this order as Appendix A and incorporated by this reference.

I. Bonneville Exchange Power

In his Motion for Reconsideration, Public Counsel asks the Commission to modify its determination of the value of Puget's Bonneville/WNP-3 contract in six ways. First, Public Counsel requests the Commission change its order on the prudence of WNP-3. Public Counsel indicates that the Commission overlooked material evidence and that at least 40% of the cost of WNP-3 was imprudently incurred. Puget, in its answer to Public Counsel's petition, disagrees stating that there is no support in the record for Public Counsel's recommendation.

Second, concerning the method the Commission used to value the WNP-3 contract in its Order, Public Counsel suggests that the Commission made an error in its valuation of Operations and Maintenance (O&M) costs. The Commission, citing its decision in U-86-131, used 38 mills/kwh. Public Counsel suggests that this number is in levelized 1987 dollars and that a figure of 43.11 mills/kwh, which is in 1990 dollars, should be used. In its Answer to Public Counsel's motion for reconsideration, the Commission staff agrees with Public Counsel's position on this point. Puget, in its Answer, disagrees with this assertion; it contends that the Commission did not confuse 1987 and 1990 dollars and that both the capital and O&M portions of its evaluation methodology were in 1987 dollars.

Third, Public Counsel suggests that the Commission erred in valuing the Bonneville contract. Public Counsel suggests that the \$96.981 million valuation of plant in service should be reduced by 23.67% to prevent the double recovery of such elements as taxes, in order to be consistent with the theory the Commission adopted in the order. Commission staff supports the suggestion. Puget answers that the revenue requirement should be given its 1987 present value, rather than the 1990 value, which would yield a valuation exceeding \$100 million. It also contends that selection of the 75-mill per kwh midpoint of Dr. Reading's valuations failed to weigh sufficiently Mr. Myers' testimony that some contracts have a value as great as 100 mills per kwh.

Fourth, Public Counsel requests the Commission deduct, from the capital portion assigned to the BPA contract, \$9.2 million which he contends is the amount that should be assigned to Puget's obligation to supply BPA with power from its combustion turbines. The Commission staff disagrees with Public Counsel on this adjustment.

Fifth, Public Counsel asks the Commission to use the life of the Settlement Contract, rather than ten years, to amortize the capital prudently incurred in excess of the rate-based amount. The Commission staff disagrees with Public Counsel on this.

Sixth, Public Counsel asks the Commission to recognize a value of \$30 million for Construction Work in Progress by deducting this amount from the addition to rate base.

Commission Discussion. The Commission will not grant reconsideration on Public Counsel's first point: the prudence of WNP-3. The Commission examined the entire record created in Cause No. U-89-2955-T and concluded that the "expenses incurred in connection with WNP-3 were prudent" (Third Supplemental Order, p. 20). The Commission has not changed its mind.

The Commission will not grant reconsideration on Public Counsel's second point: using 43.11 mills/kwh instead of 38 mills/kwh for the O&M costs. The Commission's valuation method for both the total value (75 mills/kwh) and the O&M portion (38 mills/kwh) is intended to be in 1987 dollars, which is the time when power was first received under the contract.

The Commission rejects Public Counsel's third challenge to the Bonneville Exchange Power contract valuation.

The Commission's highest judgment is called into play in determining issues as complex and exceptionally significant as the power contract valuation. This is not a simple question, and we know from the record and the arguments that it defies a simple answer. We believe that the result is within the range of reasonableness the law allows for Commission discretion, and find no compelling reason to change the result on reconsideration.

First, it should be noted that Public Counsel's challenge fails to complete the proposed adjustment. While he would decrease plant in service from about \$97 million to about \$74 million, he does not complete the adjustment by increasing the amount to be amortized from \$55.7 million to 79.9 million. Doing so would reduce the company's revenue requirement by only about \$815,000, approximately 2 1/2% of the revenue deficiency

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we find. The present value of the revenue requirement over the life of the adjustment is about the same in either instance.

We can test the reasonableness of the result in several ways. The plant in service valuation of \$96.981 million produces a levelized revenue requirement of approximately 37 mills/kwh for capital costs when discounted back to 1987, the year the Commission used to evaluate the contract. Because of the lack of capital recovery in the first three years of the contract, the present value of the revenue requirement is equivalent to the rate base amount and, therefore, there is no need to make a rate base/revenue requirement adjustment on reconsideration.

Similarly, updating the operating and maintenance values to 1989 dollars and retaining the 1989 BEP contract valuation would yield a result which is lower, but well within the range of other analyses.

Puget argues on brief that discounting the BEP contract value back from 1989 to 1987, so that the figure is comparable with the operating expense figure, would yield a plant in service valuation of \$101,150,000. Using this number, the amortization would become \$51,484,240 and the gross revenue requirement would increase by about \$148,000 over the result of the prior order.

Another test of the order's validity is to review the valuation of the contract. The witnesses' valuation of contract power fell within a range of 65 to 100 mills. The result of the Third Supplemental Order would flow, based on Dr. Reading's analysis, from a contract valuation nearer the midpoint of all record testimony as to value than the 75 mills selected in the Third Supplemental Order. If we were to substitute 85 mills, for example, in the view of Dr. Reading's formula urged by public counsel, the result would be plant in service of approximately \$94 million, amortization of approximately \$58.6 million and a gross revenue deficiency only about \$105,000 different from our prior order, or about a third of one per cent of the non-ECAC revenue requirement we find appropriate.

In sum, we believe that the result of the Third Supplemental Order is well within the zone of reasonableness allowed for Commission discretion in matters of such complexity and importance. It is appropriate when viewed in light of differing 1987 and 1989 valuations and when viewed in light of the range of testimony as to contract values. The arguments presented to us do not convince us that we must change the result of the order on reconsideration, and we reaffirm the previously determined revenue deficiency resulting from this adjustment.

The Commission will not grant reconsideration on Public Counsel's fourth point: the \$9.2 million adjustment for combustion turbines. The Commission agrees with the Commission staff that Dr. Reading's valuation of the WNP-3 contract took into account Puget's obligation to BPA for its combustion turbines.

The Commission will not grant reconsideration on Public Counsel's fifth point: the use of the life of the BPA contract, rather than 10 years, to amortize the amount of capital costs not accorded a rate of return. As the Commission noted in its Order, the 10-year amortization approach "will be consistent with our prior decisions regarding extraordinary expenses and provides a fair sharing of responsibility between stockholders and ratepayers." (Third Supplemental Order, U-89-2688-T, p. 22)

Finally, the Commission will not grant reconsideration on Public Counsel's sixth point: the recommended adjustment for CWIP. The Commission has determined that Puget's investment in WNP-3 was prudent. If ratepayers had not contributed CWIP earlier, Puget would have been seeking more in the present case. If the Commission had found that all or a portion of Puget's WNP-3 investment was imprudent, then a corresponding adjustment for CWIP would have been appropriate. Since the Commission found all of Puget's WNP-3 investment to be prudent, no CWIP deduction is appropriate.

In answer to the petition on reconsideration, all the parties agreed that the value of WNP-3 on the books of the company as of December 31, 1989 was \$152,634,240. As shown in Revised Table I, the sum of the amount to be included in the rate base (\$96,981,958) and to be amortized (\$55,652,282) is \$152,634,240. The Commission agrees with this change to the order. This change will cause the amortization expense to be \$5,565,228 instead of \$5,204,282.

The parties also agree that the amount to be included in the rate base should not be reduced by the \$1,013,550 for Deferred Taxes. The Commission agrees with this issue. The adjustment to the rate base for the inclusion of WNP-3 will be \$95,218,650, not the \$94,205,100 as was shown in the order.

The Federal Income Taxes were also contested in the petition. The Commission now agrees with the company that the Federal Income Taxes for the test year were \$1,168,120, not \$1,887,114 as shown in the order. The Commission also agrees that the calculation of the Federal Income Tax for this adjustment was done incorrectly. The Commission staff states that this calculation can be done in many different ways. The

company calculates the Federal Income Tax by depreciating and amortizing the WNP-3 investment over 27.5 years. The Federal Income Tax effect of BEP adjustment as calculated by the company is (\$1,168,697). The Commission accepts this calculation for purposes of this order. The net operating income effect of the BEP adjustment is (\$3,540,932).

II. Power Costs

The Commission in its order adopted a power cost adjustment in the amount of \$30,549,903, which was the figure included by Public Counsel in his brief as adjustment 2.11R. The use of this figure was the direct result of the Commission's acceptance of Public Counsel's alternative recommendation of 40 mills per kwh for the Hanford Exchange issue. The Commission noted in its order that the parties had not included in their presentations breakdowns of the power cost adjustment sufficient to allow the Commission to accept different parties' positions on different individual issues.

Puget, the Commission staff, WICFUR and Public Counsel all asserted that the record contains information sufficient to allow such a breakdown. None of the petitions or responses included those figures or references to their locations in the record. The approach that seems to have been taken by each party is a clarification of that party's positions on the individual issues, rather than a provision of the tools to allow the Commission to accept the individual adjustment components of more than one party and calculate the resulting amounts. Each party's position was clear. The "unbundling" of the various elements was not clear.

The parties expressed their concerns that the adjustment accepted a "bundle" of components without adopting the underlying rationale for each component. The concern was expressed that such an approach would not withstand scrutiny on court appeal.

Without accepting the parties' arguments concerning the legality of "bundling" adjustments, the Commission has reconsidered its findings regarding the power cost adjustment and provides the following discussion of the individual issues.

a. Updating of Test-Year Contract Prices

The Commission reaffirms its acceptance of the figure of 40 mills per kwh as the most reasonable included in this record. The Commission specifically rejected the company's rebuttal proposal as inappropriate.

The company's petition for reconsideration attempted to introduce new evidence in the form of an affidavit attached to the petition, regarding a settlement of the cost of Hanford Exchange Power. This additional material is not part of the record and will not be considered.

b. New Contracts

None of the parties on brief took exception to Mr. Bailey's pro forma adjustment for new contracts. The Commission did state that the company in future proceedings should distribute updated material as soon as it is received, so that the other parties have the opportunity to explore the issues. The company's rebuttal adjustment reflecting the Montana Power agreement is acceptable.

c. Production Factor

The Commission accepts the Commission staff's method of application of the Production Factor. Application of the Production Factor to the results of the Production Costing System model reflects a proper balancing of all the resources.

d. Thermal Interchange Prices

The Commission accepts the Commission staff's adjustment to thermal interchange prices used in the Production Costing System model. The company's method as described by Mr. Bailey is not persuasive. Mr. Bailey could not provide the identities of persons contacted during telephone conversations to "sellers". He could not provide notes of the conversations. He could not describe the manner in which the responses were used, nor state what questions were asked. This type of informal survey without backup documentation is not acceptable to support the company's position.

The Commission staff adjusted the thermal interchange prices based on actual recorded plant operating and maintenance costs, increased by a factor for inflation to the rate year. This method is preferable to that used by the company.

e. Historical Streamflow Data

The parties on reconsideration repeated their arguments in support of the number of historical water years to be used.

The Commission accepts the Commission staff position, using a 40-year rolling average. The Commission notes that The Washington Water Power Company and Pacific Power & Light Company

both use a 40-year rolling average. A rolling average will result in less cumulative error.

The Commission rejects Public Counsel's alternative proposals to exclude the driest years of record.

The Commission would like to see an evaluation by the three investor-owned electric utilities and other interested parties regarding the best method to use for the entire state.

f. Result

As a result of the individual decisions on issues listed above, the Commission adopts a power supply adjustment in the amount of (\$30,549,903).

The Commission is concerned about complex adjustments composed of several parts. The Commission expects the parties in future cases to provide backup numbers sufficient to allow the Commission to accept the positions of individual parties on individual parts of the adjustment. Each party should clearly explain its own position. In addition, each party should provide information sufficient for the Commission to make the required calculations to accept any party's position on any single part of a multi-part adjustment.

III. Conservation

The Commission in its order directed Puget to file a review of its water heater program by May 1, 1990. The Commission indicated its intention to consider changes to the program on a prospective basis.

Public Counsel in his petition requested that the Commission specifically direct the company to include in its review the availability of energy-efficient natural gas water heaters in areas where gas is available. Public Counsel also repeated his arguments that the water heater program as presently constituted is inconsistent with tariffs and not energy efficient, and that only those water heaters which exceed minimum state energy code should qualify as conservation-related.

The company in its response opposed additional directives from the Commission regarding the content of the review due by May 1. The company also opposed Public Counsel's arguments regarding the energy efficiency of water heaters installed under the current program.

The Commission staff recommended the elements of the water heater program be considered in connection with the

company's May 1 filing. The Commission staff further recommended removal from the rates in this filing of the rate base and expenses associated with the water heater rental program. In this manner, the costs and the program could be considered together.

The Commission denies reconsideration of these issues in this proceeding. The Commission declines to specify which elements and issues the company should include in its May 1 review of the program. These issues should be left open so that participants in the review can cover a full range of issues and concerns.

The Commission will not remove the rate base and expenses of the program from this case. The review of the water heater program can proceed without this step. If the review results in a determination that changes to the program are necessary, the Commission may on its own motion file a complaint against those tariffs.

IV. Rate of Return

The petitions and responses of the parties address three main rate of return issues. The filings challenge the capital structure, the return on equity, and the evaluation of other financial indicators made by the Commission.

Public Counsel urged the Commission to adjust the capital structure to reflect a \$10.2 million WNP-3 write-off. Public Counsel in his petition reduced the equity component and recalculated the overall rate of return. The company in its response opposed Public Counsel's recommended change. The company contended that the Commission's 41.5% common equity component is still below reasonable levels and should not be further reduced. The company referred to its recommended 42.5% equity component as the minimum reasonable level.

The Commission rejects Public Counsel's recommended changes to the capital structure. The Commission in accepting the Commission staff's recommended capital structure took into account the effects of its decision on the Bonneville Exchange Power/WNP-3 issue. In addition, Public Counsel's proposal is incomplete. An adjustment to the equity portion of the capital structure would also require an adjustment to the debt portion of the capital structure.

The Commission also rejects the company's challenge to the level of the equity component. No new arguments have been advanced.

The company requested the Commission reconsider the cost of equity by raising the level 30 basis points to reflect the effects of the elimination of the ECAC proceeding. The petition refers to the testimony of Dr. Olson, as well as the recommendations of Dr. Lurito and Dr. Legler regarding impacts of the ECAC process. Responses of Commission staff and Public Counsel opposed this increase.

The Commission rejects the company's argument. The ECAC process was eliminated in part because the company did not comply with the Commission's directive to quantify the impact of the ECAC on the company's cost of capital. The Commission would be inconsistent, arbitrary and capricious if it chose a figure after termination of the ECAC to reflect the very phenomenon the company did not quantify.

Public Counsel in his petition repeated his argument that the cost of common equity should not be adjusted to reflect market pressure and financing costs because the company would not be issuing common equity through a public offering during the rate year. He recommended the cost of equity be reduced to 12.25%. The company in its response opposed Public Counsel's proposed reduction to the cost of equity.

The Commission rejects Public Counsel's recommended reduction to the cost of equity. Public Counsel's arguments and the testimony cited in his petition were fully considered by the Commission in its acceptance of the Commission staff's recommendation. Market pressure and financing costs are properly considered in setting of the cost of equity.

The company in its petition and response repeated its arguments regarding the impact of the Commission staff's recommendations on the company's financial integrity. The Commission is satisfied that the rate of return included in its Third Supplemental Order will allow the company to maintain its financial integrity. Dr. Lurito's analysis was properly performed to reflect the company's return on its entire amount of book equity, not just the electric service rate base in Washington. Dr. Lurito's analysis calculates earnings per share at \$2.12. The Commission will not change this portion of the order.

V. Adjustments to Rate Base and Results of Operations

a. Property Sales

The company's petition contended the Commission order failed to address the issue of retroactive ratemaking and was based on legal precedent which has since been discredited and reversed. The Commission staff and Public Counsel supported

the Commission's order, but recommended that specific findings and conclusions be added to this order so that the Commission's decision would be clear to a reviewing court.

The Commission in its determination considered and rejected the company's argument that the property sales adjustment constituted retroactive ratemaking. In Cause No. U-85-53, the Commission adopted the principles underlying Democratic Central Committee v. Washington Metropolitan Area Transit Commission, 485 F.2d 786 (D.C. Cir. 1973), cert. denied, 415 U.S. 935 (1974). The holding and supporting rationale have not been reversed by the court, and the case has recently been cited in Nevada Power Company v. Public Service Commission of Nevada, 779 P.2d 531 (1989). The Commission ruled in its Second Supplemental Order in Cause No. U-85-53 that an adjustment was required, and instructed the Commission staff to perform an audit so that the proper amount of the adjustment could be determined in the next rate proceeding.

The Commission accepts the Commission staff's adjustment presented by Mr. Nguyen, with the exception that the net operating income portion be amortized over 15 years. The Commission's order does not constitute retroactive ratemaking. It merely adjusts the rate base on a prospective basis for previous gains on sales of real estate.

The Commission rejects the company's challenge to the adjustment for property sales. Additional findings and conclusions will be included in this order regarding the adjustment.

b. Wage and Salary Increase

The company in its petition repeated its arguments regarding the management wage increases. The Commission has already rejected the company's position and has directed the company to present a study of "slippage" as part of its next general rate case. The Commission will not reconsider these arguments.

The Commission in its order suggested the company make a single-issue filing to reflect the new union wage contract after the close of this record. The Commission notes that Docket No. UE-900106 was approved by the Commission at an open meeting on February 20, 1990.

c. Production Adjustment

The company and Commission staff included in their petitions proposed corrections to the production adjustment. The parties agree on the methodology for the calculation.

Based on its decisions in other contested adjustments as revised in this order, the Commission accepts the calculation included in the answer of the Commission staff. This results in an increase to NOI of \$1,362,026 and a reduction to rate base in the amount of \$44,420,990.

d. Sales for Resale

The company on petition recommended the Commission accept its original number on this adjustment.

Based on its decisions on reconsideration, the Commission affirms its adjustment increasing NOI by \$2,144,102.

e. Tax Benefit on Pro Forma Interest

The parties noted that this calculation should be revised, based on their corrected rate base recommendations.

The Commission has recalculated this adjustment as shown in revised Table III in Appendix A. The amount decreased NOI by \$2,544,456.

f. FIT Pro Forma Tax

The company in its petition repeated its arguments regarding bond redemption costs. The company contended it had already flowed through to customers tax benefits associated with retirement of various bond issues. The company also contended the Commission staff's treatment constituted retroactive ratemaking.

The Commission will not reconsider these issues. No new arguments have been presented.

VI. Rate Spread and Rate Design

Public Counsel has raised five issues involving rate design and rate spread (Motion for Reconsideration at 24, et seq.; Motion for Clarification at 11). These include: (1) a request that the Commission provide more explicit guidance concerning the methodology to be used for determination of customer-related costs; (2) a request that the Commission reconsider its adoption of a \$4.55 customer charge; (3) a request that the Commission examine the methodology employed by Puget in determining rates for each of the three residential blocks; (4) a request that the Commission reexamine the cost allocation to large industrial customers; and (5) a request that the interest on customer deposits be set at the same rate as a late payment charge. No other party directly asked

the Commission to reconsider rate design or rate spread issues, but the Commission staff, WICFUR and the company responded to the Public Counsel's request.

1. Customer Cost Methodology. Public Counsel asks the Commission to provide further guidance concerning the appropriate costs to be included in a calculation of costs which are customer related. The Commission staff provides four options concerning which costs should be included, and points out that the Commission's order would be consistent with a decision which accepted the first option, taking into account considerations of rate shock. The company disagrees that the Commission should provide any further guidance beyond what is in the Order. We agree with the company. Except for the minimum system methodology, which we have rejected in this and previous orders, the Commission intends to continue to consider various approaches and to avoid mechanical applications of results of any individual methodology.

2. Customer Charge. Public Counsel argues that the Commission ordered a customer charge that is at the high end of the range testified to by the Commission staff and unfairly penalizes small usage customers. The Commission staff and company note that the charge ordered by the Commission is in fact consistent with the range testified to by the Commission staff. We decline to reconsider this issue but note that, as stated above, parties are free to advocate different approaches in the next case.

3. Residential Rates Structure. Following the company's filing of its new rates on January 18, 1990, Public Counsel filed a letter on January 23 arguing that the filed rates were not consistent with the Commission's order. The Commission allowed the filed rates to go into effect, but indicated that it would consider the Public Counsel's argument if presented in a Request for Reconsideration or Motion for Clarification. Public Counsel repeated and elaborated on his arguments in his Motion for Reconsideration.

The Commission's Order on page 79 provided:

That portion of the revenue requirement spread to the residential class should be apportioned among the three blocks on the basis recommended by the Commission staff. The first, second, and third blocks should receive a uniform percentage increase to the existing rates.

Unfortunately, three factors combined to make it impossible for the company to comply with the literal terms of

this order: first, the increase in customer charge, combined with the increased size of the new third block, produces so much additional revenue that it is impossible to give an increase to all three classes; second, since the Commission staff recommended a 10% summer-winter differential and the Commission only approved a five percent differential, the revenue requirement cannot be allocated "on the basis recommended by the Commission staff." Finally, because the three residential blocks established in this case are sized differently from the former blocks, it was unclear to the parties what was meant by the phrase "the first, second, and third blocks" in the above quotation.

The company's solution to the problem was to allocate an equal amount of revenue to each of the new blocks. Because the new third block is much bigger than the former third block (now 1,000 kwh and above as opposed to 1,500 kwh and above), this resulted in a lower rate increase than to the first two blocks. Public Counsel argued that the Commission's order language that there be "a uniform percentage increase to the existing rates" meant that the kwhs in the "over 1500 kwh" block should receive the same increase as those in the lower usage blocks.

Both interpretations are arguably consistent with the Order. We will adopt the company's interpretation for two reasons. First, those customers who use over 1,000 kwh a month will be experiencing a significant rate increase because their usage between 1,000 and 1,500 kwh will now be charged at the high tailblock rate. Adoption of the company's filed tariff will mitigate the impact of moving those kwhs into the tailblock. Second, while the effect of the company's interpretation is to narrow the gap between the middle block and the tailblock, the inverted structure still exists except for the top .2% of customers. Thus, the signals generally remain intact, albeit somewhat diluted from the previous rate structure.

We will take this opportunity to note our concern that apparently not all parties were provided with the company's tariffs filed in compliance with the order. In the future, the company should provide copies of its filed tariffs to all parties at the same time as they are filed with Commission, in order to ensure that all parties are given an opportunity to argue that the tariffs are inconsistent with the Commission's orders.

4. Contribution of Large Industrial Customers.
Public Counsel asked the Commission to reconsider the order declining to revisit the revenue contribution from the high voltage classes. The company and WICFUR disagreed with Public Counsel that the Commission should revisit this issue now. The

Commission staff agreed with the principles enunciated by Public Counsel, but urged the company to provide cost studies and appropriate rate design in future cases.

Public Counsel is here rearguing his brief and has not presented any new arguments or evidence. We decline to alter our original order.

5. Late Payment Charge. Public Counsel argued that the Commission should "clarify" whether the interest on customer deposits should be the same as the 1% monthly late payment fee (Public Counsel Motion for Clarification). We agree with the company that our Order was clear. There is no compelling reason why the late-payment fee, designed to recover carrying costs of the company, should be the same as the interest on customer deposits, established pursuant to WAC 480-100-051(6). We decline to "clarify" our order further.

O R D E R

WHEREFORE, IT IS HEREBY ORDERED, That the petitions for reconsideration of the Third Supplemental Order are granted in part, to the following extent:

1. Findings of Fact Nos. 7, 10, 11, and 15 of the Third Supplemental Order are stricken. The following revised findings should be substituted:

7(a). Respondent's rate base adjusted for its Washington electric operations is \$1,841,573,894.

10(a). Respondent's test year operating net income after all adjustments is \$122,281,080 under the rates approved by the order in Cause No. U-85-53.

11(a). A deficiency exists in adjusted test period gross annual revenues in the amount of \$105,757,092 above the rates approved by the order in Cause No. U-85-53, calculated on the rate of return herein found appropriate.

15(a). The tariff revisions filed by respondent on February 17, 1989, and on May 26, 1989, should be rejected in their entirety. Respondent should be authorized to file revisions which will not exceed \$105,757,092, as determined in the body of this order. The design of the tariff revisions shall conform with the directions and findings set out in the Third and Fourth Supplemental Orders. The tariff revisions herein authorized will result in rates and charges that are fair, just, reasonable and sufficient.

2. The following additional findings should be added:


28. The discussion included in the Second Supplemental Order in Cause No. U-85-53, relating to the "Transfers of Property" adjustment, is incorporated in this order. The Commission accepts the calculation provided by Mr. Nguyen, with the exception that the net operating income portion of the adjustment will be amortized over 15 years. The unamortized balance should be reflected as a rate base deduction over the same period. The Commission in Cause No. U-85-53 determined that an adjustment is necessary to reflect that gains on the transactions should be considered as income for ratemaking purposes. Such an adjustment is not retroactive ratemaking, since it not only adjusts net operating income, it also adjusts rate base on a prospective basis.

3. Tables I, III, IV(a) and IV(b), VI, and IX are stricken. Revised Tables I, III, IV(a) and IV(b), VI, and IX are substituted. The revised tables are included in Appendix A, attached hereto and by this reference made a part hereof.

4. Conclusion of Law No. 2 is revised to indicate that revision of rates and charges to respondent's tariffs made in accordance with findings contained in the Third Supplemental Order, and revised in part by the Fourth Supplemental Order, will yield a fair rate of return on respondent's rate base found proper in the Fourth Supplemental Order, and, if filed pursuant to this authorization, will be fair, just, reasonable and sufficient.

DATED at Olympia, Washington, and effective this 30th day of March, 1990.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION


 RICHARD D. CASAD, Commissioner


 A. J. PARDINI, Commissioner

SEPARATE CONCURRING OPINION OF COMMISSIONER A. J. PARDINI

I concur with, and I have signed, the majority opinion. In my view, the challenges to the result of the Third Supplemental Order fail to meet the tests required for reconsideration, and I am satisfied that the result we here affirm is appropriate to balance the interests of ratepayers with the interests of stockholders.

I do believe that there is another test of reasonableness which may be applied to support the result of the Third Supplemental Order, and I set it forth here.

In the parties' wide-ranging proposals, a great deal of emphasis has been placed on the value of power when, in fact, the Bonneville Exchange Power Agreement may not be so easily susceptible of valuation. The Commission in this proceeding again affirms the prudence of the company's investment; according to the company on brief, it totals \$178,672,039. The company makes a compelling argument, which we have accepted, that it should be compensated for this investment. One means of doing that, of course, would be to include the entire sum in rate base. We can reflect on history for a moment, and recall that the company has in prior proceedings requested and received alternative treatment of this investment, for reasons including the need to enter a period of rate stability. We allowed that treatment and that stability in order to improve the company's financial strength and its viability during a period of explosive growth, and believe that it had the desired effect. It secured the approval of appropriate governmental agencies, including this Commission, and was generally accepted by the investment community.

Under that treatment, the company accelerated the flow back of certain deferred investment tax credits below the line and retained a level of earnings acceptable to the investment community without penalty to stockholders. The amount of investment tax credit accelerated under the agreement was approximately \$60,000,000 as represented by Public Counsel in his brief, based on evidence from witnesses Dittmer and Sonsteli.

The Commission is fully tested in balancing the interests of ratepayers and the interests of stockholders on this issue. The company's investment is large, but not imprudent, in part because the unique nature of the investment caused delays in construction. It is difficult to value the exchange power strictly upon market value. Resolving this issue is indeed a matter requiring the Commission's highest judgement.

A pragmatic test of the appropriateness of the result of the Third Supplemental Order might be to acknowledge the value of ratepayers' contributions to the prior period of rate stability and offset the company's investment with the \$60,000,000 accelerated investment tax credit flowed back below the line. This would leave \$118,632,039 to be considered the company's plant in service figure for the resulting Bonneville Exchange Power.

Dividing this rate base amount by the 2,621,123 mwh to be generated under the contract, the result is approximately 45.28 mills per kwh. Adding to this the 38 mill operating and maintenance expense expected, the total is slightly over 83 mills per kwh. This is within the range of value supported by Dr. Reading; it is well within the range of the witnesses' testimony; and it would produce a gross revenue deficiency very close to that which we authorize. Accordingly, it provides a further check on the reasonableness of the result we have reached. That result is a fair, just and reasonable determination in light of all the factors of record, when subjected to review under several alternative analyses.



A. J. PARDINI, COMMISSIONER

SEPARATE OPINION OF CHAIRMAN SHARON NELSON
CONCURRING IN PART AND DISSENTING IN PART

It is with deep regret that I must decline to endorse this Order. While I concur with the technical corrections and join in the rejection of most of the other requests for reconsideration, I agree with Public Counsel and Commission staff that a substantial error occurred in the calculation of the rate base effect of the value of the BEP contract. I draw the majority's attention to the following language from the Third Supplemental Order:

"The Commission agrees with the basic approach taken by Commission staff."
(page 21)

"The Commission believes that Mr. Reading's range of avoided cost rates (65 to 85 mills) represents a reasoned analysis. It is only reasonable to base this decision on the midpoint in that range. Of the 75 mills per kwh which we find to be the value of the BEP agreement, we must determine the portion which is associated with capital investment. The record in Cause No. U-86-131 provides a figure of 38 mills per kwh associated with O & M expenses. We adopt that figure and calculate the rate base asset [emphasis supplied] on the remaining 37 mills per kwh. We calculate the net present value of the power received over the course of the contract using the energy numbers found in the company's response to Bench Request No. 4, Exhibit 834, at a discount rate of 10.22 per cent to be 2,621,134 Mwh. Multiplying that number by 37 mills/kwh provides us with a total rate base of \$96,981,958."
(pages 21 and 22)

Earlier in the Order, we had identified Dr. Reading's rate base figure for the 75 mill power as \$70,618,000. (Order at page 18) Nowhere in the Order did we attempt to explain why we had accepted Dr. Reading's basic value of power methodology but not his mathematical calculation of the rate base effect. The reason for this omission is simple. The Commission had an inadequate record on which to determine exactly how Dr. Reading had reached his \$70,618,000 number. Therefore, it was necessary to set out our calculation in the detail shown above. Doing so was designed to have the result we now

see. Namely, the parties could see our methodology and point out any errors. Public Counsel and staff have done so, and we can now set matters right. But the Commission has chosen not to do so. For this reason, I must respectfully dissent.

My colleagues attempt to justify their disregard for our patent error by now engaging in a series of analyses designed to show that the result of our prior order is in a "range of reasonableness." One such analysis is based on compensating the company for deferring rate base treatment of WNP-3 for the first three years of the BEP contract (relying on the affidavit supplied by the company). Such an analysis played no part in the Third Supplemental Order. If we had performed such an analysis to reject Dr. Reading's calculation, we would have been compelled by the Administrative Procedure Act to set this forth in the Order in a Finding of Fact. See, for example, RCW 34.05.461(3). In fact, our Order explicitly stated exactly what we were trying to do. We were trying to duplicate the effect of exchanging the defunct WNP-3 project for a new resource. That new resource, Bonneville Exchange Power, began to provide energy and capacity in 1987. Puget elected to not seek rate base recognition in rates at that time. In our Order, we noted that this delay was the company's decision, a decision made easier by the Investment Tax Credits which the Commission transferred to the company in 1987. For numerous reasons discussed in the Third Supplemental Order, we denied the company's request that a "side record" of carrying costs, be included in rate base. If we had intended that the 75 mill value of power be enhanced to reflect the "present value of revenue requirements" suggested by the majority, we would have mentioned this as a further justification for denying the "side record". That we did not do so further demonstrates that it was the Commission's intention to adopt Dr. Reading's analysis using our own estimate of O & M costs (38 mills). Therefore, our patent error in failing to take into account the tax effects of such a treatment must be corrected.

Another analysis presented in the majority opinion suggests that our choice of a 75 mill value of power was not as reasonable as might be inferred from the Third Supplemental Order. We had adopted Dr. Reading's theory that the 75 mills value of power was the midpoint of a reasonable range of 65 to 85 mills. The majority now sees the 65 to 100 mills range as reasonable and suggests that an 85 mills value would be acceptable. It is suggested further that the effect of such a judgment on revenue requirement is only one-third of one percent. In fact, the difference in rate base between Dr. Reading's 75 mills value and the majority's 85 mills value is

more than \$22 million. Over the 27.5 year life of the BEP agreement, this rate base amount will cost ratepayers more than \$20 million. Even though the present value of this dollar amount is small, the principle involved is large.

I cannot subscribe to the reasoning to which my colleagues have resorted to avoid the admission of a gross error. We made many difficult and principled decisions in the course of producing an immensely complex order. We should continue to adhere to those underlying principles but we should re-examine the findings which led us to our erroneous calculation. If the majority's use of an 85 mills value of power represents a revised Finding of Fact, then I applaud adherence to proper procedure. Nevertheless, I continue to believe that we were correct when we adopted Dr. Reading's valuation. It is unfortunate that the credibility of an otherwise admirable Commission order will be impaired by this effort to justify a plain mathematical error.



SHARON L. NELSON, CHAIRMAN

APPENDIX A

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TABLE I

Bonneville Exchange Power
for the Year Ended 9-30-88

<u>Line No.</u>	<u>Description</u>	<u>Amount</u>
1	Depreciation of \$96,981,958 Over 27.5 years	\$3,526,617
2	Amortization of \$55,652,282 Over 10 years	5,565,228
3	Charged to Expense During Test Year	(5,550,336)
4	Federal Income Taxes	(1,168,697)
5	Federal Income Taxes During Test Year	<u>1,168,120</u>
6	Total Operating Expense	<u>\$3,540,932</u>
7	Net Operating Income	<u>(\$3,540,932)</u>
8	Plant in Service	\$96,981,958
9	Less Depreciation Reserve	1,763,308
10	Less Deferred Tax EOP	<u>0</u>
11	Rate Base	<u>\$95,218,650</u>

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TABLE III

Puget Sound Power & Light Company
Calculation of Pro Forma Interest Effect on Tax

<u>Line No.</u>	<u>Description</u>	<u>Commission</u>
1	Rate Base	\$1,841,573,894
2	CWIP	<u>18,387,409</u>
		\$1,859,961,303
2	Weighted Cost of Debt	<u>0.0429</u>
3	Pro Forma Interest	\$79,792,340
4	Actual Interest Expense	<u>87,276,033</u>
5	Adjustment to Interest Expense	(\$7,483,693)
6	Federal Income Tax Rate	<u>0.34</u>
7	Tax Effect of Adj. Interest	<u>\$2,544,456</u>
8	Adj. to Net Operating Income	<u><u>(\$2,544,456)</u></u>

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TABLE IVA

Puget Sound Power & Light Company
Restating Actual and Pro Forma Adjustments
12 Months Ending September 30, 1988

<u>Line</u> <u>No.</u>	<u>Description</u>	<u>Commission</u>
1	NOI - Actual	<u>\$176,942,425</u>
	Uncontested Adjustments	
2.01	2 General Revenues	(\$19,883,780)
2.02	3 Upper Baker Rewind	98,752
2.03	4 Depreciation	531,713
2.05	5 Colstrip Housing	4,478
2.09	6 Temperature Adjustment	2,224,915
2.10	7 Lease Income OBC Land	271,973
2.18	8 Interest on Customer Deposit	(325,590)
2.19	9 Bad Debts	(1,292,183)
2.19	10 Rate Case Costs	(130,495)
2.21	11 Storm Damage	636,240
2.24	12 Pebble Springs	18,112
2.25	13 Skagit/Hanford	36,732
2.26	14 Company Insurance	926,449
2.30	15 Colstrip Transfer	254,854
3.01	16 FICA Tax Increase	(248,843)
3.02	17 Wash. State Unemp. Ins.	75,456
3.03	18 Fed. Unempl. Tax Adjust.	(3,918)
3.05	19 Wash. Utility Tax Adj.	<u>(469,575)</u>
20	Total Uncontested Adj.	<u>(\$17,274,710)</u>

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TABLE IVb

Puget Sound Power & Light Company
Restating Actual and Pro Forma Adjustments
12 Months Ending September 30, 1988

<u>Line</u> <u>No.</u>	<u>Description</u>	<u>Commission</u>
	Contested Adjustments	
2.04	21 Property Sales	\$487,064
2.06	22 Adjust Operating Expense	682,565
2.07	23 Late Pay Charge	0
2.08	24 Field Charge	0
2.11	25 Power Costs	(30,549,903)
2.11	26 Power Cost - PC	0
2.12	27 1989 Pro Forma ECAC Rev.	0
2.13	28 Sales for Resale Other	2,144,102
2.15	29 Wage and Salary Increase	(586,430)
2.16	30 Investment Plan	(141,325)
2.17	31 Employee Insurance	(510,935)
2.22-B	32 Conservation Program Addit.	(6,726,264)
2.23	33 Retirement Plan	476,839
2.27	34 Bonneville Exchange Power	(3,540,932)
2.28	35 Production Adjustment	1,362,026
2.29	36 Employee Benefits	6,326
2.31	37 Water Heater Program	202,104
3.04	38 Property Taxes	(128,654)
3.06	39 Montana Energy Tax	8,918
3.07	40 Montana Corp. License Tax	259,440
3.08	41 FIT Pro Forma Tax	1,712,880
3.08	42 Deferred Taxes	0
2.09	43 Tax Benefit on Pro Forma Int.	(2,544,456)
4.01	44 Overhead	<u>0</u>
	45 Total Contested Adj.	(\$37,386,635)
	46 NOI - Adjusted	<u>\$122,281,080</u>

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TABLE VI

Puget Sound Power & Light Company
Restating Actual and Pro Forma Adjustments
12 Months Ending September 30, 1988

<u>Line No.</u>	<u>Description</u>	<u>Commission</u>
1	Rate Base - Actual	<u>\$1,838,294,709</u>
	Uncontested Adjustments	
2	Depreciation	\$2,641,381
3	Colstrip Housing	(189,352)
4	Adjust Operating Expense	(129,278)
5	Lease Income OBC Land	48,673
6	Colstrip Transfer	<u>(2,239,817)</u>
7	Total Uncontested Adjustments	<u>\$131,607</u>
	Contested Adjustments	
8	Property Sales	(\$8,493,705)
9	Working Capital	(40,842,878)
10	Conservation Program Amort.	(5,114,463)
11	Conservation Program Addit.	9,795,039
12	Bonneville Exchange Power	95,218,650
13	Production Adjustment	(44,420,990)
14	Employee Benefits	(199,075)
15	Water Heater Program	0
16	FIT Pro Forma Tax	<u>(2,795,000)</u>
17	Total Contested Adjustments	<u>\$3,147,578</u>
18	Rate Base - Adjusted	<u>\$1,841,573,894</u>

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TABLE IX

Puget Sound Power & Light Company
Calculation of Revenue Requirement

<u>Line No.</u>		<u>Commission</u>
1	Rate Base	\$1,841,573,894
2	Rate of Return	<u>10.22%</u>
3	Line 1 Times Line 2	\$188,208,852
4	Conservation Investment	\$97,365,090
5	Return on Conservation	<u>0.0083</u> <u>808,130</u>
6	Net Operating Income Requirement	\$189,016,982
7	Net Operating Income Adjusted	<u>122,281,080</u>
8	Net Operating Income Deficiency	\$66,735,902
9	Conversion Factor	<u>0.6302472</u>
10	Revenue Requirement Deficiency	\$105,888,454
11	Rev. Req. Ass. to W/S Customers	<u>131,362</u>
12	Required Tariff Increase	<u>\$105,757,092</u>
13	ECAC Offset	<u>74,598,263</u>
14	Net Rev. Req. (10 - 13)	<u><u>31,290,191</u></u>