

# **EXHIBIT A**

Agenda Date: September 11, 2002

Item Number: A1

Docket: UE-021023

Company: Puget Sound Energy, Inc.

Staff: Roland Martin, Regulatory Consultant, Energy

**Recommendation:**

Authorize Puget Sound Energy, Inc., to dispose of certain real property, while retaining an easement, subject to the following conditions: 1) a net gain shall be calculated by treating the transaction as a sale at the property's independently-appraised market value (net of the easement value); and 2) the gain will be deferred and included as a benefit in future determination of customer rates consistent with the treatment of real property transfers previously approved by the Commission.

**Discussion:**

On August 9, 2002, Puget Sound Energy, Inc. ("PSE" or "Company"), filed an Application requesting an order from the Washington Utilities and Transportation Commission ("Commission") authorizing the Company to dispose of certain real property rights to the following entities (collectively, the "Public Grantees") as tenants-in-common: the City of Bellingham, Whatcom County, the State of Washington itself (the Department of Natural Resources and Washington State Parks and Recreation Commission), and a fourth party which has not been named, but was expected to be Skagit County. Because of concerns about liability associated with the property, Skagit County has proposed that the property might be donated to a nonprofit group instead of Skagit County. Those arrangements have not been finalized, but Staff will update the Commissioners as new information is made available. PSE proposes to donate the property to these entities, but to retain an easement.

The transfer will be accomplished by execution and delivery to the Public Grantees of a Quitclaim Deed (in the form provided as Attachment 1 to the Application). At the same time, the Public Grantees will execute and deliver to PSE an Easement Deed (in the form provided as Attachment 2 to the Application).

The property in question is approximately 18.6 miles of PSE's Pacific Northwest Traction Company (PNT) right-of-way located in the vicinity of Chuckanut Drive and running from Skagit County north to Bellingham along Puget Sound. Staff estimates the strip of land averages about 80 feet wide along its length. PSE describes the property as rural, with panoramic vistas, and it will be used by the Public Grantees to provide recreational uses to the general public. The Public Grantees are interested in using the land to extend the existing Interurban Trail and to further develop a regional public trail, which could be a substantial addition to the Washington State Coast Millennium Trail, stretching from King County to Vancouver, British Columbia.

PSE has an existing overhead electrical distribution system on a portion of the PNT right-of-way located in Skagit County, and an overhead and underground system in a section in Whatcom County. The total book value of the real property in question is approximately \$21,000. The Company has employed the services of a real estate appraiser to provide an estimate of the values of the property to be transferred and the easement to be retained. The cost associated with the transferred property will be retired while the value of the retained easement will be accounted for as a component of electric plant in service. According to the Company's estimates, the value of the property to be transferred may be approximately \$1.8 million. The Company will provide an independent assessment of the value of the property to be transferred when that appraisal has been completed.

Because the property transfer is by donation, PSE will not receive the full market value of the transferred property, but the transaction would generate some benefits to PSE by way of a charitable deduction for federal income tax purposes. Under the Company's proposed accounting, these anticipated tax benefits, net of related transaction costs, would accrue to the ratepayers by inclusion of the net benefits in future determination of customer rates.

The Commission treats the gains or losses from real property transfers as sales based on the fair market value of the property at the time of transfer. This is provided in the Stipulation and Order of Dismissal dated May 26, 1992 by Puget, the Commission and Public Counsel in Washington Court of Appeals No. 29404-1. The property being transferred was previously included in the utility's rate base that has been supported by ratepayers. The ratepayers are entitled to the gain on that sale. Absent an arms' length transaction, the sales price should be determined based on an independent assessment.

#### Review and Analysis:

RCW 80.12.020 requires that a utility shall not transfer properties "which are necessary or useful in the performance of its duties to the public" without prior Commission authorization. In its application, PSE states that the public interest is not harmed given the Company's reservation from the conveyance certain easement rights which are necessary or useful in the Company's performance of its duties to the public. This will be accomplished by deed, as described above. According to PSE, the easement is necessary for future reliability of PSE service. On this basis, Staff believes that the transfer of property, with the easement retention, is reasonable and should be authorized.

However, Staff considers PSE's proposed accounting treatment to be inadequate because the ratepayers would be accorded only the net tax benefits of a charitable donation, and are denied the more substantial benefits of an arm's length sale. To be consistent with prior Commission orders, and to afford ratepayers the benefits to which they are entitled, the proposed transfer should be treated as a sale similar to transfers of utility properties to subsidiaries. The calculated net gain based on fair market

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value at the time of sale should redound to the ratepayers because they have been supporting the property as an asset in rate base since it was purchased. Therefore, such gain should be the amount included in the determination of customer rates in the Company's next general rate case.

Recommendation:

Staff recommends the Commission authorize Puget Sound Energy, Inc., to transfer certain real property rights described in the Application to the named Public Grantees subject to the following conditions: 1) a net gain shall be calculated by treating the transaction as a sale at the property's independently-appraised market value; and 2) the gain will be deferred and included in future determinations of customer rates consistent with the current treatment of real property transfers. The net tax benefit of the charitable donation of the property to be transferred accrues to the Company.