BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Application of **AVISTA CORPORATION** for Authority to Sell its Interest in the Coal-Fired Centralia Power Plant	)	**DOCKET NO. UE-991255**
In the Matter of the Application of **PACIFICORP** for an Order Approving the Sale of its Interest in (1) the Centralia Steam Electric Generating Plant, (2) the Rate Based Portion of the Centralia Coal Mine, and (3) Related Facilities; for a Determination of the Amount of and the Proper Rate Making Treatment of the Gain Associated with the Sale, and for an EWG Determination.	)	**DOCKET NO. UE-991262**
In the Matter of the Application of **PUGET SOUND ENERGY, INC.** for (1) Approval of the Proposed Sale of PSE's Share of the Centralia Power Plant and Associated Transmission Facilities, and (2) Authorization to Amortize Gain Over a Five-Year Period.	)	**DOCKET NO. UE-991409** **INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES' POST-HEARING BRIEF**

INTRODUCTION

On November 23, 1999, the Washington Utilities and Transportation Commission

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("WUTC" or "Commission") issued an Order of Consolidation in the above-referenced proceedings involving the applications of PacifiCorp, Avista Corporation ("Avista"), and Puget Sound Energy, Inc. ("PSE") (collectively "the Companies") for approval to sell their respective interests in the Centralia Power Plant and certain related facilities (collectively "the Centralia facilities") to TECWA, a wholly-owned subsidiary of TransAlta. The amount of the TECWA bid exceeds each of the Companies' current net book values for the Centralia facilities. Thus, the Commission is presented in these consolidated Dockets with the issue of how to allocate the above-book proceeds from the proposed sale.

The Industrial Customers of Northwest Utilities ("ICNU") submits this Post-Hearing Brief. ICNU believes that: (1) based on Commission precedent and Washington law, customers are entitled to the entire gain associated with the sale of major rate-based generating facilities, like the Centralia facilities; and (2) customers will be harmed if the Commission adopts any of the Companies' proposals to allocate a portion of or all of the gain to shareholders. Therefore, ICNU respectfully requests that the Commission issue an Order instructing the Companies to defer and return 100% of the gain to customers, with interest, in each Company's next rate case.

ARGUMENT

I. The Commission Should Apply the Approval Standard Set Forth in Its PSE Colstrip Order

A. Washington Law Requires that Asset Sales be in the Public Interest

Under RCW 80.12.020, the Companies must obtain Commission approval to sell

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the whole or any part of their facilities, including the Centralia facilities. In addition, the Commission's rules regarding property transfers provide: "If, upon the examination of any application and accompanying exhibits, or upon a hearing concerning the same, the commission finds the proposed transaction is not consistent with the public interest, it shall deny the application." WAC 480-143-170.

In a recent proceeding involving PSE's application to sell its interest in the Colstrip facilities, the Commission reiterated and applied the following public interest standard, which it first articulated in the Washington Natural Gas ("WNG") and Puget Sound Power & Light Merger proceeding: 1) the transaction should not harm customers by causing rates or risks to increase, or by causing service quality and reliability to decline, compared with what could reasonably be expected to have occurred in the absence of the transaction; 2) the transaction, with conditions required for its approval, should strike a balance between the interests of ratepayers, shareholders, and the broader public that is fair and that preserves affordable, efficient, reliable, and available service; 3) the transaction, with conditions required for its approval, should not distort or impair the development of competitive markets where such markets can effectively deliver affordable, efficient, reliable, and available service; and 4) the jurisdictional effect of the transaction should be consistent with the Commission's role and responsibility to protect the interests of Washington gas and electricity consumers. In re Puget Sound Energy, Inc., WUTC Docket No. UE-990267, Third Supplemental Order at 5-7 (Sept. 30, 1999).

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Of these four principles underlying the public interest standard, two are essential for purposes of analyzing the proposed sale of the Centralia facilities. First, the transaction must not increase risks to customers. This principle requires a showing of customer benefit in this case to offset the risks of increased costs created by the sale of the Centralia facilities. Second, the transaction must balance the interests of customers and shareholders. Given that customers have borne all of the risk and financial burden of the Centralia facilities since the facilities were placed in rate base, the gain must be provided to customers to achieve a fair balance of the interests of customers and shareholders.

B. Federal Law Requires a Showing of Customer Benefits

Federal law requires that the Commission find customer benefits before approving the proposed transactions. Under the terms of the proposed transaction, the sale of the Centralia facilities is conditioned upon the purchaser obtaining a favorable Exempt Wholesale Generator ("EWG") determination from the Federal Energy Regulatory Commission ("FERC").1/ *See, e.g.*, PacifiCorp Application, Exhibit 1, Section 3.3(b) and Schedule 3.3(b). Federal law explicitly requires this Commission to find that an EWG determination for the Centralia facilities, and the associated removal of the Centralia facilities from rate base, will benefit customers. Energy Policy Act of 1992, 15 U.S.C. 79z-5a ("EPAct").

In the EPAct, Congress was concerned that, by obtaining EWG status, generating

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1/ On October 13, 1999, the Commission issued an Order conditioning EWG approval on its ultimate approval of the sale of the Centralia facilities being considered in these consolidated dockets. Thus, the Commission has effectively left the required federal EWG determinations to be resolved in the larger context of these proceedings.

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assets could be removed from state rate base, thereby creating an incentive for utilities to avoid state jurisdiction. Therefore, to avoid any potential conflict between state and federal jurisdiction, Congress required explicit state consent:

> [I]n order for the facility to be considered an eligible facility, every State commission having jurisdiction over any such rate or charge must make a specific determination that allowing such facility to be an eligible facility (1) will benefit consumers, (2) is in the public interest, and (3) does not violate State law . . . .

15 U.S.C. 79z-5a(c). A plain meaning analysis of this section, entitled "State Consent for Existing Rate-Based Facilities," suggests that the Commission must make a specific determination that conferring EWG status, and the resulting removal of the asset from rate base, will benefit consumers. Id.

This plain meaning analysis is supported by the legislative history of the EPAct, which provides that because of the significant regulatory impact of an EWG determination, Congress included the state consent requirement. *See* Legislation to Amend PUHCA: Hearings Before the Senate Subcommittee on Security, Banking, Housing and Urban Affairs (1992) (Prepared Testimony of Philip R. O'Connor, Ph.D., Palmer Bellevue Group) ("[t]he PUHCA reform proposals, by establishing clear lines of regulatory responsibility with respect to EWGs, largely eliminates not merely the reality of certain jurisdictional problems, but the even more damaging suspicious anticipation by state regulators that utilities and others may attempt to escape state regulation"). Granting the states more authority over the wholesale generators was viewed as a means of protecting the public interest. The National Energy Security Act of 1991:

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Hearings before the House of Representatives Subcommittee on Energy and Power (1991) (Prepared Testimony of the Michigan Public Service Commission).

The requirements of the EPAct are consistent with the third component of the public interest standard, which provides that the jurisdictional effect of the transaction should be consistent with the Commission's role and responsibility to protect the interests of Washington utility consumers. In re Puget Sound Power & Light Co., WUTC Docket Nos. UE-951270 and UE-960195, Fourteenth Supplemental Order at 16 (Feb. 5, 1997).

The Companies may argue that the finding of customer benefit applies only to the classification of a generating asset as an EWG, and not to the sale of the asset. This interpretation ignores the language and context of the state approval requirement in the EPAct. To read the EPAct in this manner would render the state consent requirement meaningless, because the classification of the Centralia facilities as eligible for EWG status alone is unlikely to produce any customer benefit. The only reasonable reading of the EPAct is that the removal of the facilities from rate base must benefit customers. As described below, none of the Companies' individual proposals satisfy this standard.

II. Ratepayers are Entitled to the Entire Gain

A. Allocation of 100% of the Gain to Ratepayers is Supported by Past Precedent

Based on the Commission's traditional treatment of the gain from the sale of rate base assets, customers should receive 100% of the book gain from the sale of the Centralia facilities. The Commission was presented with this issue in the proposed sale of PSE's share of

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the Colstrip facilities. In that case, the Commission described the appropriate analysis as follows:

> The answer to [the question of whether the proposed sale is in the public interest] depends, in part, on the answer to a second question: Is [the] proposed accounting treatment for this sale consistent with the public interest? The answer to this question in turn depends on the degree to which the sale produces gains and power-cost savings, and how those benefits (or costs) are distributed.

In re Puget Sound Energy, Inc., WUTC Docket No. UE-990267, Third Supplemental Order at 2. In the Colstrip case, the Commission found it necessary to condition its approval on ratepayers receiving 100% of the gain from the sale. Id. at 1. A similar condition is required in these consolidated proceedings to offset the long-term risks of increased energy costs ratepayers will bear if Centralia is sold. Ex. T-400, Elgin Direct at 13, lines 12-17.

In addition, in Docket No. UE-87-1533-AT, the Commission addressed a related issue regarding whether Washington Water Power ("WWP") could sell its Othello turbine generating facility, and how the accounting for the transaction should be handled. In re Washington Water Power, WUTC Docket No. UE-87-1533-AT, Order Granting Application at 1 (Nov. 30, 1989). The Commission granted the application, stating: "The authorization herein is based upon the premise that 100 percent of the after tax gain on the turbine sale is returned to the ratepayers." Id. at 3. The Commission explicitly rejected WWP's proposal to pass the gain onto shareholders, reasoning that "the Turbine has been included in Water Power's rate base for approximately 14 years. During that time, the Commission has set rates which have included a return on that plant investment." Id. at 2-3.

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The Commission's approach in Colstrip and in Othello is not novel. Allocating 100% of the gain from the sale of a rate base asset to customers is also supported by the analysis of the landmark case of Democratic Cent. Comm. of the Dist. of Columbia v. Washington Metro. Area Transit Comm'n, 485 F.2d 786 (D.C. Cir. 1973). In that case, the D.C. Court of Appeals explained that "the right to capital gains on utility assets is tied to the risk of capital loss," and that "he who bears the financial burden of particular utility activity should reap the benefit resulting therefrom." Id. at 806. That court also found that ratepayers normally shoulder the risk and financial burdens associated with assets that have been placed in rate base. Id. at 808-10. Thus, the court concluded that "consumers have the superior claim to capital gains achieved on depreciable assets while in operation . . . ." Id. at 811.

The "benefits follow risk" approach set out in the Democratic Central Committee decision has been followed by other state commissions facing asset divestiture. For example, the Massachusetts Department of Telecommunications and Energy ("DTE") allocated gain based on the principle of having reward follow risk. Re Cambridge Electric Light, D.T.E. Docket No. 98-78/83-A at 22 (Dec. 23, 1998) . In support of allocating gains to ratepayers, the DTE reasoned that the Company and its shareholders have received a return on the use of these parcels while they have been included in rate base, and are not entitled to any additional return as a result of the sale." Id. at 24. Therefore, past precedent from both this Commission and other jurisdictions support allocating 100% of the gain to ratepayers.

B. The Factual and Policy Issues Raised in the Testimony Supports An Allocation of 100% of the Gain to Customers

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Since the Centralia facilities were placed in rate base, customers have borne the risks and the financial burdens of owning and operating these facilities. *See, e.g.*, WUTC v. Washington Water Power, WUTC Docket No. U-83-26, Fifth Supplemental Order at 14-16 (Jan. 19, 1984). In return for paying all of the costs of the Centralia facilities, ratepayers have historically been entitled to the benefits of the power produced by the plant. These ratepayer benefits include both the actual use of the power produced and any profits associated with the market sale of excess power. The value of these benefits that customers would enjoy in the future, absent the proposed sale, is very difficult to quantify with any certainty. *See* Ex. T-400, Elgin Direct at 9-10. However, it is certain that once the Centralia facilities are sold, these future benefits will not be available to ratepayers.

ICNU does not oppose PacifiCorp's proposal to sell its interest in the Centralia facilities2/. However, the sale of a partially-depreciated generating plant, like Centralia, has the potential to harm customers because the depreciation of utility generating plants is typically front-end loaded in rates. Ex. T-600, Wolverton Direct at 6, line 5; Ex. T-500, Lazar Direct at 20, lines 10-11; Ex. T-400, Elgin Direct at 16, lines 14-21. As a result, ratepayers pay a disproportionate amount of the capital costs in the early years of the plant's operation, based on the expectation that over the life of the facility ratepayers will receive the benefits of power produced by the facility. Ex. T-600, Wolverton Direct at 6, lines 5-8; Ex. T-500, Lazar Direct at

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2/ ICNU does not contest the value being received for the Centralia facilities. As long as the auction process was conducted within acceptable parameters to allow a fair market valuation, the open market sale of the asset is the best possible method of valuing the asset.

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20, lines 5-8; In re Avista Corp., WUTC Docket Nos. UE-991255, et al., Transcript of Hearing, January 7, 10 and 11, 2000 ("Tr.") at 190, lines 10-16. When a generating plant is sold, ratepayers are deprived of the future value of the plant's operation, which may harm customers, because the costs of the plant are typically lower in the later years. Accordingly, it would be inequitable to adopt any proposal that allocates a portion of the gain resulting from the sale of the Centralia facilities to shareholders. Ex. T-500, Lazar Direct at 20, lines 5-8. The Commission should reject such a result:

> If utilities have the right to charge ratepayers for expensive new generating plants, at cost, in the early years, when the power may not be economically competitive, and then sell off the asset to another entity once inflation makes the power cost-effective, and keep the profit for the stockholders, ratepayers are in an untenable bind. Every coal plant in the country built more than 5 years ago will change hands, as will all of the nuclear power plants placed in operation prior to 1980, so that utilities can revise their rate base up to 'replacement cost' or fair value.

Theodore Eisenberg, Bankruptcy in the Administrative State, 50 Law & Contemp. Probs. 3, 39 (1987).

In addition to paying all of the costs associated with the Centralia facilities, ratepayers have provided shareholders an opportunity to earn a reasonable rate of return on the undepreciated portion of their investment. Ex. T-600, Wolverton Direct at 6, lines 12-17. Shareholders have already received a partial return of their capital investment and a return on their undepreciated investment since the Centralia facilities were included in rate base. When the sale closes, shareholders will recover their remaining capital investment in the Centralia facilities. Ex. T-600, Wolverton Direct at 6, lines 19-21. Therefore, shareholders will be

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completely compensated for their investment in the Centralia facilities, and allocation of any gain to shareholders will result in excessive returns. Ex. T-600, Wolverton Direct at 6, line 21, at 7, lines 1-2; Ex. T-400, Elgin Direct at 14, lines 13-20, at 18, lines 1-6.

The gain from the sale represents a reasonable proxy for the value of the Centralia facilities that customers will be denied as a result of the sale. Ex. T-400, Elgin Direct at 14, lines 11-16. While the gain from the sale is easily calculable, the benefits from the sale, if any, are much more difficult to ascertain. The full sale price approximates the net present value of the benefits customers would have enjoyed absent the sale. Ex. T-600, Wolverton Direct at 5, lines 7-23, at 6, lines 1-3. To allocate less than 100% of the gain to ratepayers would decrease the benefits ratepayers would have enjoyed absent the sale. Ex. T-600, Wolverton Direct at 6, lines 1-3. In other words, allocation of less than 100% of the gain to ratepayers would harm ratepayers. To avoid harm to ratepayers, the Commission must condition its approval of the sale on ratepayers receiving 100% of the net book gain.

PACIFICORP'S PROPOSAL

III. PacifiCorp's Proposal to Allocate the Gain Using the Depreciation Reserve Methodology Would Harm Customers

The proposed sale of PacifiCorp's interest in the Centralia facilities will result in an $83 million after-tax gain. PacifiCorp Application at 6. PacifiCorp proposes to allocate Washington's share of the after-tax gain based on the depreciation reserve method. Ex. T-213, Wright Direct at 3, lines 5-10. Under the depreciation reserve method, ratepayers would receive a percentage allocation of the gain equal to the amount of the gain multiplied by the depreciated

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book value of the plant divided by the plant's initial book value. In the case of Centralia, the depreciation reserve method would allocate 64% of the gain to ratepayers and 36% of the gain to shareholders. Ex. 214 (RW-1). PacifiCorp proposes to apply the ratepayers' share of the gain to "write down" certain generation-related regulatory assets. Ex. T-213, Wright Direct at 4, lines 6-8.

ICNU strongly opposes PacifiCorp's proposed regulatory treatment of the gain from the sale, including the proposed "write down" of certain regulatory assets. Application of the depreciation reserve methodology in this case would result in excessive shareholder returns and would deprive ratepayers of the value of their investment in this rate base asset.

A. Shareholders Are Not Entitled to the Gain Because They Have Not Borne the Risk of Loss During Ownership of the Centralia Facilities

PacifiCorp's depreciation reserve method relies on the notion that shareholders have placed up front capital at risk to construct and maintain the Centralia facilities. Ex. T-213, Wright Direct at 13-15. PacifiCorp's position is illusory. While PacifiCorp may have expended up-front capital to construct the Centralia facilities before they were included in rate base, ratepayers have been paying PacifiCorp both a return on investment and depreciation expense for its initial investment since the Centralia facilities first came on line. Ex. T-600, Wolverton Direct at 13, lines 18-19. Also, any undepreciated portion of the investment will be returned to PacifiCorp as a consequence of this sale. Ex. T-600, Wolverton Direct at 11, lines 20-21. This shows that ratepayers, rather than shareholders, are at risk once an asset is found to be prudent and put into rate base. Furthermore, the fact that utilities believe they are entitled to stranded

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cost recovery for the cost of above-market assets demonstrates that shareholder capital is not at risk for rate base assets. Ex. T-600, Wolverton Direct at 8, lines 10-18.

PacifiCorp is unable to provide any logical or legal rationale to support its approach other than the fact that the 64/36 split appears to be an equitable outcome from the company's perspective. Under cross-examination, PacifiCorp's witness Wright conceded that this methodology may not always be appropriate and that it should be reviewed on a case-by-case basis. Tr. at 407, lines 13-25. Applying the PacifiCorp case-by-case policy approach places the Commission in a precarious position. Rather than developing a clear and consistently applied approach, the Commission will be subject to criticism that its decision is arbitrary and capricious because its approach differs based on the particular asset and the particular utility. Allowing the utility to select the appropriate methodology based on the specifics of the particular asset will undoubtedly harm customers.

To the extent that the shareholders claim to have shared the risk, any portion of the risk borne by shareholders has already been adequately compensated through existing rates, which include an opportunity to earn a reasonable return on equity.

B. The Depreciation Reserve Method Provides An Excessive Return to Shareholders

There is no support in Washington statutes or in past Commission precedent to justify providing the excessive return to shareholders requested by PacifiCorp in this proceeding. Since the Centralia facilities were placed in rate base, PacifiCorp has been provided a reasonable opportunity to earn a return on the undepreciated investment in the Centralia facilities. Ex.

T-400, Elgin Direct at 15, lines 9-10; Ex. T-600, Wolverton Direct at 6, lines 17-21. Approximately 64% of the shareholders' principal investment has been returned over that time. The other 36% of its investment, the net book, is being returned to PacifiCorp as a result of the sale. Ex. T-600, Wolverton Direct at 6, lines 19-21. Thus, PacifiCorp has received an opportunity to earn a complete return of its investment, irrespective of how the gain is allocated. Id. The portion of the gain that would be allocated to shareholders by the depreciation reserve method represents a *de facto* return which exceeds a reasonable return on its investment. Ex. T-400, Elgin Direct at 25, lines 8-10. RCW 80.28.010(1) precludes PacifiCorp from making, demanding or receiving an unreasonable or excessive return on its investment in the Centralia facilities. WUTC v. Northwest Natural Gas Co., WUTC Docket Nos. U-88-2126-C and 88-2127-C, Fourth Supplemental Order (May 18, 1989) (indicating that a utility's rates must be just, fair, and reasonable).

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C. The Depreciation Reserve Method Provides Inappropriate Utility Incentives

The depreciation reserve method provides several inappropriate incentives to utilities contemplating the sale or divestiture of its generation assets. Ex. T-600, Wolverton Direct at 8, lines 10-18. First, the depreciation reserve method could encourage a utility to sell its below market generation assets and retain its above-market generation assets. Ex. T-600, Wolverton Direct at 8, lines 10-14. Under the depreciation reserve method, a utility only stands to gain if it sells an asset that has a market value that exceeds its net book value. The logical result is that a utility will sell its low-cost resources and share in the gain and keep its high-cost resources, which will remain in rates or be recovered as stranded costs. The Oregon Public Utility Commission ("OPUC") recognized the danger of this incentive in its proceeding involving the proposed restructuring of Portland General Electric ("PGE"):

> Our decision here requires that we determine a value for all of the generation assets which PGE will have discretion to sell in accordance with this order. This is necessary so that there will be no incentive for PGE to attempt to increase its total recovery by selling some assets whose market value is greater than their book value while retaining less valuable assets for full recovery in rates.

Re Portland Gen. Elec. Co., OPUC Docket No. UE 102, Order No. 99-033 at 41 (Jan. 27, 1999).

Second, the depreciation reserve method provides an incentive for a utility to sell a generation asset, rather than sell the generation output from that asset, even if the output could be sold at a higher effective price. This is true because the depreciation reserve method would allocate shareholders a portion of the gain from the asset sale, while merely selling the generation output would provide no shareholder benefit. If the output of the resource is sold, ratepayers

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receive the benefits because of the Commission's practice of incorporating the revenues associated with wholesale power sales from rate base assets into rates. Therefore, the depreciation reserve method would provide an incentive to utilities to make decisions that reduce potential ratepayers benefits.

Third, the depreciation reserve method could logically provide an incentive for utilities to make unwarranted investments in relatively depreciated resources in order to increase its share of the gain. Under the depreciation reserve method, the net book value of an asset is returned to shareholders before the gain is calculated. Accordingly, under the depreciation reserve method a utility could have an incentive to make bad investments in relatively depreciated resources to recapture a portion of the gain that would otherwise flow to ratepayers. Ex. T-600, Wolverton Direct at 13, lines 6-11.

D. <u>The Depreciation Reserve Method Is Not Easily Applied to Purchased Power Resources</u>

Another flaw in PacifiCorp's proposed depreciation reserve method is its inability to allocate the costs or benefits associated with a sale of non-depreciable assets. PacifiCorp and PSE have a significant amount of generation resources that are provided through power purchase contracts, rather than depreciable assets. Power purchase contracts give the utility the right, and in some cases the obligation, to purchase power that it does not generate. These contractual generation resources have no book value as generating assets.

The treatment of any costs or benefits associated with PacifiCorp's purchased power resources is critically important within the larger context of industry restructuring because

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a large percentage of PacifiCorp's and PSE's potential stranded costs are associated with the purchased power contracts executed pursuant to the Public Utility Regulatory Policy Act of 1978 ("PURPA"). PacifiCorp refers to these PURPA contracts as regulatory assets, and believes that its shareholders are entitled to recover 100% of the above-market costs associated with these assets. Ex. T-213, Wright Direct at 4, lines 6-8. That argument is not compelling, however, unless the benefits of all of PacifiCorp's purchased power contracts are allocated 100% to ratepayers. Ex. T-600, Wolverton Direct at 11, lines 3-12. For example, in addition to the stranded costs associated with the PURPA contracts, 100% of the stranded benefits associated with the Mid-Columbia power purchase contracts would have to be allocated to ratepayers. A symmetrical valuation and netting of the costs and benefits of all assets including regulatory assets is necessary to properly implement restructuring. While restructuring has not yet occurred in Washington, allocation of a portion of the Centralia gain to shareholders could adversely affect customers in future stranded cost calculations.

AVISTA'S PROPOSAL

IV. Avista's Proposal To Allocate the Entire Gain to Shareholders is Inappropriate and Unjustified in this Case

Avista takes the extremely "aggressive" position that shareholders should retain the entire gain from the sale of the Centralia facilities. Ex. T-306, Dukich Direct at 3, lines 8-9. Avista argues that it is entitled to the entire gain because: 1) it has failed to earn its authorized return on equity in the past; 2) it has taken write-offs in the past; and 3) its rates have consistently been among the very lowest in the United States. Id. at 4. Avista's request is

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tantamount to a petition for retroactive ratemaking; something the Commission cannot do under the law. Hardy v. Claircom Communications, 86 Wash. App. 488, 937 P.2d 1128 (1997), overruled on other grounds by Tenore v. AT&T Wireless Services, 136 Wash. 2d 322, 962 P.2d 104 (1998), cert. denied, 119 S.Ct. 1096 (1999) [hereinafter Hardy]. The Commission should therefore reject each of these arguments for the reasons provided below.3/

A. Avista's Failure to Earn its Authorized Return on Equity Does Not Entitle It to Keep the Gain

It is a basic tenet of utility law that retroactive ratemaking is not allowed. Hardy 86 Wash. App. at 493, 937 P.2d at 1131. "'Retroactive ratemaking' refers to an improper recovery of costs that were properly recoverable in a past period or periods." Leonard Goodman, The Process of Ratemaking 165 (1998). The rationale underling the prohibition against retroactive ratemaking is based on three principles. First, the prohibition exists to ensure that customers "pay for their own services, and not for past deficits." Id. at 166. Second, the prohibition serves to preclude utilities from using the regulatory process to effectuate "a guarantee, rather than the opportunity, for a fair rate of return." Id. Finally, it ensures that a utility "bear losses and enjoy gains that depend on their own managerial efficiency." Id.

These considerations are based, in large part, on the filed rate doctrine, which declares that the only lawful rate that a regulated entity may charge is the filed rate approved by the Commission. Arkansas Louisiana Gas Co. v Hall, 453 U.S. 571, 577 (1981) [hereinafter

3/ In apparent recognition of its extreme position, Avista proposes an alternative, that the depreciation method proposed by PacifiCorp would also be appropriate for Avista. It is not. *See* Section III.

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Arkansas Gas]; Texas & Pac. Ry. v. Abilene Cotton Oil Co., 204 U.S. 426 (1907). Under the filed rate doctrine, "No court may substitute its own judgment on reasonableness for the judgment of the Commission," and, "except where the Commission permits a waiver, no regulated seller of [energy] may collect a rate other than the one filed with the Commission." Arkansas Gas, 453 U.S. at 577. In application, the filed rate doctrine dictates that, where an action requests relief that amounts to disguised retroactive ratemaking, then such an action will be barred by the filed rate doctrine. Tenore v. AT&T Wireless Services, 136 Wash.2d 322, 341 n.87, 962 P.2d 104, 113 n.87 (1998); Arkansas Gas, 453 U.S. at 578-79.

Avista's argument as to why it should be awarded the gain from the sale of Centralia falls squarely under the filed rate doctrine and the prohibition against retroactive ratemaking. In effect, Avista argues that it is entitled to the gain simply because its shareholders have not earned an ideal rate of return and have taken write-offs in the past. Avista, then, seeks to transform its failure to take advantage of the opportunity to earn its authorized rate of return into a guarantee that its shareholders will realize that return. Avista's request is tantamount to a request for retroactive ratemaking, and is precluded by the filed rate doctrine. Arkansas Gas, 453 U.S. at 578-79.

Furthermore, Avista's proposal directly conflicts with the policies underlying the prohibition against retroactive ratemaking. Avista seeks to use this proceeding to "make up" for its managerial inefficiency, and to have customers pay for Avista's failure to earn its authorized rate of return; this is precisely the sort or behavior that the rule against retroactive ratemaking

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precludes. Leonard Goodman, The Process of Ratemaking 165-66 (1998). The appropriate remedy for Avista to address inadequate returns is to seek a rate increase, which it elected not to do for 13 years. Customers cannot be expected to provide a panacea for Avista's managerial ills. Rather, under the filed rate doctrine, customers have been paying the filed rate approved by the Commission, and it would be unlawful for Avista to recover monies in additional to that filed rate as a consequence of this proceeding. Arkansas Gas, 453 U.S. at 577. Thus, as a matter of law, Avista's failure to earn its authorized rate of return on equity cannot provide any rationale for it to keep the gain in this proceeding.4/

B. Avista's Past Write-Offs Were Justified Under the Circumstances

Avista's argument that its past tax write-offs somehow justify its retention of the gain from Centralia must similarly be rejected. As previously discussed, utilities are afforded the opportunity to earn their authorized rate of return, but such a return is never guaranteed. Leonard Goodman, The Process of Ratemaking 165-66 (1998). Rather, the burden is on the utility to either bear losses or enjoy gains, depending upon its managerial efficiency. Id. Avista nevertheless ignores this well-established principle, and suggests that in the interest of "fairness," Avista's shareholders should realize all of the gain from the sale of Centralia. Ex. T-306, Dukich Direct at 6, lines 4-19. In particular, Avista posits that as a result of the losses experienced by its shareholders as a consequence of several unexpected tax write-offs, its shareholders should

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4/ In order to seriously consider Avista's proposal, putting aside the legal deficiencies, this Commission would have to conduct an exhaustive investigation regarding the reasons Avista did not earn its ROE for specified years. There is insufficient evidence in this record to allow the Commission to make this determination.

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consequently benefit from the proposed sale. Id.

"Fairness," however, cannot obfuscate either the filed rate doctrine or the idea that retroactive ratemaking (*i.e.* remedies for past losses) is not permissible under the law. *See supra*, Section IV(A). As Avista itself admits, "Fairness in past Commission decisions is not really the issue here. . . . What is relevant is that shareholders took risk in making these investments in order to discharge the utility's public service obligations. The net result is that shareholders did not realize a return on their investment, or did not recover all of their investment, or both. In other words, [Avista's shareholders] took a risk and lost." Ex. T-306, Dukich Direct at 6, lines 4-12.

Indeed, a utility's authorized rate of return is not guaranteed, but a utility has an opportunity to earn a fair return on and of its investments. Ex. T-400, Elgin Direct at 15, lines 13-14. It is up to the utility's managers and shareholders to ensure that company will earn up to its authorized rate of return. Ex. T-600, Wolverton Direct at 16, lines 6-15. The shareholder/management problem concerning historic under-performance is not a ratepayer responsibility. Id. Avista has presented no legitimate reason to deviate from the general rule that ratepayers are entitled to all of the gain from the sale of a rate base asset.

PSE'S PROPOSAL

V. PSE's Proposal To Amortize The Gain During The Rate Plan is Inconsistent with The Public Interest Because it Harms Ratepayers and Is Not Permitted Under the Merger Order

PSE proposes to amortize the gain from the sale of the Centralia facilities over a

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five year period beginning January 1, 2000. Ex. T-108, Karzmar Direct at 4, lines 20-21. PSE's current proposal is very similar to its proposal regarding the amortization of the gain from the proposed Colstrip sale. The Commission should reject PSE's current proposal for the same reason it rejected the Colstrip proposal: "PSE's proposal to amortize the gain from the sale over a five-year period, and to retain any power-cost savings during the Rate Plan period would harm ratepayers, and is not consistent with the public interest." In re Puget Sound Energy, Inc., WUTC Docket No UE-990267, Third Supplemental Order at 24 (Finding of Fact No. 8).

As in the Colstrip case, PSE maintains that the merger Order entitles shareholders to retain the all power cost savings and the gain from the sale of the Centralia facilities that is amortized during the Rate Plan. Ex. T-116, Karzmar Rebuttal at 2, lines 18-21; Ex. T-113, Wright Direct at 3, lines 8-17. The Commission has specifically rejected this argument: "The Commission in its order approving the merger did not grant PSE permission to sell used and useful generation assets as a power cost savings." In re Puget Sound Energy, Inc., WUTC Docket No. UE-990627, Third Supplemental Order at 18.

The merger record provides strong support for the Commission's conclusion in the Colstrip order that the sale of major generating assets was not contemplated in the Rate Plan. PSE contends that it is entitled to retain the gain because it represents a "power stretch goal" that the merger Order contemplated would be kept by shareholders. Tr. at 140, lines 10-14. There is nothing in the merger record, however, to support PSE's interpretation of either the Rate Plan or "power stretch" savings. The merger record is clear about what the "power stretch" goals

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actually entail. During the merger proceeding, WNG witness James P. Torgerson indicated that the term "power stretch" goals referred to the reduction of purchase power costs, as opposed to the sale of PSE-owned generating assets:

> Q. Is the financial community aware of these stretch goals?
>
> A. They generally know that we will be pursuing best practices as part of our merger integration and reductions in *purchased* power costs but that is the extent of our public disclosures."

Ex. 118 at 38 (emphasis added). Mr. Torgerson also testified that these reductions in purchased power costs would be achieved through the renegotiation of power contracts and, if necessary, through litigation related to the contracts.

> Q. Second area. You referred to--and this is with respect to power stretch goals--you referred to litigation and renegotiation of contracts. Would it be correct to say that the companies, either Puget or Puget Sound Energy, will intend to vigorously litigate and renegotiate those contracts?
>
> A. I think so, yes, the companies whether we say vigorously litigate I think we need to renegotiate, and I think litigation is an option.
>
> Q. I guess my question is, is it the company's intent to do whatever is necessary legally to reduce the costs of power contracts either through litigation or renegotiations?
>
> A. Yes, we are . . . .

Ex. 118 at 50-51. Finally, perhaps the most compelling evidence from Mr. Torgerson's testimony in the merger proceeding was his statement that the estimates of the "power stretch" savings that were presented to rating agencies were calculated by assuming a percentage

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reduction in the cost of PSE's PURPA contracts. Ex. 118 at 51.

To avoid the intent of the Rate Plan, PSE raises a red herring. PSE attempts to obscure the issue by claiming that only sales of non-depreciable property are outside the Rate Plan. Ex. T-116, Karzmar Rebuttal at 3-4. PSE relies on the fact that sales of non-depreciable property are specifically excluded from the Rate Plan, while sales of major generating assets are not similarly excluded.

The Commission recognized that under the merger Order, PSE is "to continue to follow the practice of deferring gains and losses of property sales until they could be passed through to ratepayers in the next general rate case proceeding." In re Puget Sound Energy, Inc., WUTC Docket No. UE-990267, Third Supplemental Order at 18. While there were limited, specific property sales that were explicitly exempted, these did not, however, include used and useful generation assets. Id. The sale of the Centralia facilities is in no way related to the merger. Therefore, the Commission should reject PSE's proposal, and the gain should be deferred and given to ratepayers in PSE' next rate case.

VI. The Gain Should be Deferred and Returned to Ratepayers in the Companies' Next Rate Cases

At a minimum, allocation of the gain from the sale of the Centralia facilities should be deferred until each Company's next rate case. A rate case is a more appropriate forum than this proceeding for deciding the ratemaking treatment of the gain for several reasons. First, the sale of the Centralia facilities cannot be properly implemented in rates until the Centralia facilities are removed from rate base in the context of a rate case. Ex. T-400, Elgin Direct at 3,

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lines 18-21, at 4, lines 1-4. Second, rate case proceedings provide an excellent forum for litigating the allocation and other ratemaking issues related to the sale of the Centralia facilities. Finally, the allocation of the gain raises contentious issues between the Companies and the other parties in these consolidated Dockets. The additional time and broader context associated with rate cases may be helpful in resolving these disputes.

CONCLUSION

For the reasons provided above, ICNU respectfully requests that the Commission reject the proposed allocation methodologies of PSE, Avista and PacifiCorp and rule that approval of the sale should be conditioned upon customers' receiving 100% of the gain to be allocated in the utilities' next rate proceeding.

Respectfully submitted,

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