ORIGINAL

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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 Facilities, and
(2) Authorization to Amortize Gain Over a Five-Year Period.

Docket No. UE-991409

PUGET SOUND ENERGY'S POST-HEARING BRIEF

January 28, 2000

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TABLE OF CONTENTS

I. INTRODUCTION.......... 1

II. FACTUAL BACKGROUND.......... 4

III. LEGAL STANDARD.......... 5

IV. DISCUSSION.......... 7

A. Selling the Centralia Facilities Is Consistent with the Public Interest.......... 7

1. The Sale Reduces Substantial Risks to Customers that Arise From Continued Ownership of the Facilities.......... 7

2. The Near-Term Economic Benefits of the Sale Should be Given Greater Weight Than the More Speculative Longer-Term Economic Benefits of Keeping The Plant.......... 10

3. PSE's Customers are Receiving Benefits Now, Under the Rate Plan.......... 11

4. Public Counsel's Analysis Rests On Flawed Assumptions.......... 12

B. PSE's Proposed Accounting Treatment is Consistent with the Public Interest, the Rate Plan and Precedent.......... 13

1. The Proposed Centralia Sale Differs in Important Respects from the Proposed Colstrip Sale.......... 13

a. The Benefits of the Centralia Sale Include Significant Qualitative Benefits that Were not a Part of the Colstrip Sale.......... 13

b. The Quantitative "Risk" To Customers of the Centralia Sale is One-Tenth the Magnitude of the Quantitative Risk to Customers from the Colstrip Sale.......... 14

c. PSE Will Have to Absorb Power Cost Losses During the Rate Plan Period as a Consequence of the Sale.......... 14

2. The Proposed Sale and Associated Accounting Treatment is Consistent with the Five-Year Merger Rate Plan.......... 14

a. The Five-Year Rate Plan was the Foundation of the Commission's Decision Approving the Merger.......... 14

b. The Proposed Sale Does Not Fall Within One of the Specific Exceptions to the Rate Plan.......... 15

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TABLE OF CONTENTS

c. The Proposed Sale is Not Subject to the Specific Accounting Treatment of Certain Regulatory Assets Set Forth in the Rate Plan. 15

d. The Proposed Accounting Treatment For the Sale Is Reasonable and Consistent with Established Precedent. 16

3. Ignoring the Rate Plan Will Violate the Rule Against Single-Issue Ratemaking and Principles of Regulatory Estoppel 17

4. Commission Staff's Proposal to Defer Savings Based On a Forecast of Savings not only Violates the Rate Plan, but also Violates the Colstrip Order and Basic Principles of Ratemaking. 17

C. NWEC's Issues are Appropriate for Another Proceeding. 19

V. CONCLUSION 19

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1 ## I. INTRODUCTION

2 PSE seeks Commission approval to sell its 7% minority ownership interest in the
3 Centralia facilities, an environmentally-challenged coal-fired generation plant, located in the
4 shadow of Mt. Rainier. Before the Commission are two important questions:

5 - Is the proposed sale consistent with the public interest?
6 - If the Commission approves the sale, is PSE's proposed accounting treatment the
7 appropriate treatment to apply?

8 The remainder of this brief addresses those questions. A short summary follows.

9 **Reasons why the sale should be approved:** With one exception, all parties to the
10 proceedings agree that the sale should be approved. Although a number of different reasons
11 support the decision, the principal reason is straightforward and easy to understand: the sale will
12 eliminate significant risks for customers, by eliminating potentially enormous environmental
13 costs associated with a coal-fired plant and mine located at the foot of one of the nation's
14 treasured national parks. These costs could sharply increase the cost of operating the facilities;
15 indeed, the costs could become significant enough to force early closure, which would eliminate
16 the benefits of operating the plant while saddling customers and owners with nearly half a billion
17 dollars in potential mine reclamation costs. If the plant is sold, these risks fall on the new owner,
18 instead of customers and the current owners.

19 The sale will eliminate other risks, as well. For example, the risk of costs associated with
20 plant life extension will be eliminated. The plant has a design life of 40 years. It was placed in
21 service in 1972. Although it is possible to extend the life of coal-fired generation facilities, any
22 such extension will require significant capital expenditures. It is not clear what the magnitude of
23 those expenditures may be. Selling the plant places that risk on the new owners, instead of on
24 customers.

25 In the face of these benefits, one party, Public Counsel, argues against approving the sale.
26 Public Counsel's arguments are flawed, though, in several respects. First, the analysis itself was

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1 riddled with error and had to be completely redone after it was filed, shortly before the hearings.
2 At the hearings, further errors were uncovered. The errors were not insignificant: correcting the
3 errors changed the results by hundreds of millions of dollars. Second, Public Counsel's
4 economic analysis rests on three key assumptions, all of which are open to question. Public
5 Counsel presents a model that shows that customers will benefit if the sale is blocked, but those
6 benefits will occur principally in the out years. These out-year benefits, though, depend on the
7 following assumptions:

8 - that customers will have a traditional "ratepayer" relationship with the utilities
9 more than 10 years from now, and thus will be in a position to reap the
10 speculative out-year benefits;
11 - that the plant will be a productive facility for at least 12 and as many as 14 years
12 beyond its design life; and
13 - that the out-year forecasts, which everyone concedes are highly speculative, will
14 turn out to be accurate.

15 All of these assumptions are open to serious challenge. PSE submits that it would be
16 inconsistent with the public interest to burden customers with the known risks of continued
17 ownership of the Centralia facilities based on an error-riddled analysis that rests on questionable
18 assumptions.

19 **Reasons why PSE's proposed treatment is consistent with the public interest and the**
20 **Merger Rate Plan:**[1] PSE seeks a result that is consistent with the public interest and with the
21 Merger Rate Plan. PSE requests approval to amortize the gain on the sale over a five-year
22 period, starting in 2000. This is an amortization period consistent with regulatory precedent and
23 the law. Power cost benefits/costs are recorded as they occur. PSE does not propose to defer for

[1] The rate plan is the plan approved in the Commission's order approving the Puget/WNG merger. *See* Fourteenth Supplemental Order, *In Re Merger of Puget Sound Power and Light and Washington Natural Gas*, Docket No. UE-961095 (February 5, 1997) ("Merger Order"). The order included the parties' stipulation. Throughout this brief, "Merger Order" refers to the order and "Stipulation" refers to the stipulation included as part of the Merger Order.

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1 later pass through to customers any of the power cost losses projected to occur during the Rate
2 Plan period. (Those power cost losses are driven in large part by the fact that the significant
3 capital expenditures that must be made for installation of scrubbers roll into Centralia costs over
4 time.) PSE would absorb those losses.

5 Commission Staff proposes a much different approach. Staff proposes that PSE's
6 shareholders pay more than $5 million to customers for the right to sell the plant. Using an
7 outdated forecast of power costs, Staff asserts that PSE will reap a projected $4.1 million in
8 power cost savings during the remainder of the Rate Plan period. Although Staff admits that the
9 same analysis using updated forecasts show a projected *loss* of $1.1 million, Staff insists that
10 PSE defer and pass through to customers $4.1 million in "projected savings" and the entire gain
11 on the sale, while absorbing the $1.1 million in losses that are now projected to occur. In other
12 words, in Staff's view, if PSE wants to protect customers from the risks associated with
13 continued ownership of the Centralia facilities, PSE must pay more than $5 million. It is difficult
14 to understand why, under these circumstances, PSE would ever agree to sell.

15 PSE's proposal, on the other hand, is not only fair, but also is consistent with the Merger
16 Rate plan. PSE's proposal accounts for the sale just as it would in the absence of the Rate Plan.
17 It applies a reasonable amortization period – five years – and spreads the gain over that time
18 period. Consistent with this approach, PSE's proposal does not ask for special treatment of
19 projected power cost losses.

20 Under PSE's proposal, customers benefit in numerous ways. First and most important,
21 they benefit by eliminating the enormous risks associated with continued ownership of the
22 Centralia facilities. Second, they continue to receive the benefits of the Merger Rate Plan, which
23 indisputably has resulted in rates lower than what otherwise would have been possible. The
24 small amount of the gain on the sale amortized during the Rate Plan period helps fund these
25 benefits. Third, customers benefit by being shielded from power cost losses (that result from the
26 sale, because the significant capital expenditures required for scrubber installation are rolled into
27 Centralia costs over time, rather than immediately) during the Rate Plan period. PSE and its

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1 shareholders are not receiving a windfall. Net benefits resulting from this transaction essentially
2 fund a portion of the significant up-front benefits PSE delivered to customers under the Merger
3 Rate Plan. Thus, unlike Staff's proposal, PSE's proposal is consistent with the public interest
4 and with the Merger Rate Plan.

5
II. FACTUAL BACKGROUND

6 PSE proposes to sell, under the terms of the Centralia Plant Purchase and Sale Agreement
7 (Ex. 102), its 7% minority ownership interest in the Centralia plant, together with associated
8 transmission assets, to TECWA Power, Inc., a Washington corporation and an indirect subsidiary
9 of TransAlta Corporation. TransAlta, a Canadian energy company with $5 billion (Canadian) in
10 assets and the leading producer of independent power in Canada, would act as guarantor of
11 TECWA Power's obligations under the Agreement. *See* Ex. 102.

12 Currently, PSE is one of eight owners of the Centralia Plant. The other owners are:
13 PacifiCorp (47.5%), Avista Corporation (15%), Seattle City Light (8%), Snohomish County PUD
14 (8%), Tacoma (8%), Grays Harbor PUD (4%), and Portland General Electric (2.5%).[2] Ex. T-101
15 (Gaines Direct Testimony) at 4:20-5:2. The owners decided to sell the plant to a single buyer for
16 several reasons. Although the owners faced an imminent need to make capital expenditures to
17 outfit the plant with new equipment to comply with regulatory deadlines for emissions, and
18 although approval for such expenditures required the achievement of unanimous consent from
19 eight disagreeing owners, at the same time the prospect for recovery of utility-plant investments
20 has been dwindling in the face of utility industry deregulation trends. See Ex. T-201 (Miller
21 Direct Testimony) at 14:10-15:8. As a result of these and other expected difficulties and
22 potential liabilities arising from the continued operation of the plant (some of which might be
23 avoided if the plant was controlled by just one owner), the owners decided to offer the facility
24 for sale and engaged the services of an investment banker to manage the bidding process. Ex. T-
25 101 (Gaines Direct Testimony) at 7:3-14. After comparison and evaluation of the bids, PSE and

[2] PGE has sold its 2.5% share to Avista. *See* Ex. T-101 (Gaines Direct Testimony) at 5, n.3.

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1 the other owners negotiated the details of a sales agreement with TransAlta/TECWA, and PSE
2 obtained approval from senior management and the board of directors to proceed with the
3 transaction. *Id.* at 7-8. A more detailed description of the sales process is provided in
4 Exhibit T-201, the prefiled direct testimony of C. Alex Miller.

5 **III. LEGAL STANDARD**

6 The parties agree that the standard to be applied is the public interest standard. This
7 standard was explained in detail in the Commission's decision approving the Puget/WNG
8 merger. *See* Merger Order at 15-20. In its order, the Commission recognized that the merger
9 would be governed by the public interest standard that applies to property transfers, and thus
10 analyzed the issue under the same property transfer statute and regulations that apply here. *See*
11 Merger Order at 15. The Commission explicitly relied on the legal framework governing
12 property transfers:

13 Under RCW 80.01.040(3), the Washington Utilities and Transportation
14 Commission is authorized to regulate, in the public interest, the rates, services,
15 facilities, and practices of public utilities.

16 Chapter 80.12, RCW deals with transfers of property. Specifically,
17 RCW 80.12.020 provides that:

18 No public service company shall sell, lease, assign or otherwise dispose of
19 the whole or any part of its franchise, properties or facilities whatsoever,
20 which are necessary or useful in the performance of its duties to the public,
21 and no public service company shall, by any means whatsoever, directly or
22 indirectly, merge or consolidate any of its franchises, properties or
23 facilities with any other public service company, without having secured
24 from the commission an order authorizing it so to do. . . .

25 Merger Order at 15.

26 The Commission explained further that under the WAC provision governing property
27 transfers, the "Commission must be satisfied that the transaction is consistent with the public
28 interest" before granting approval. Merger Order at 15 (citing WAC 480-143-050). The
29 Commission recognized that "the relevant Commission rules do not establish specific review
30 standards for determining consistency with the public interest." Merger Order at 16. The
31 Commission also recognized that although "some precedent [had] been established in

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1 Commission orders in past merger or transfer of property application proceedings, [none of
2 those] prior decisions . . . provide[d] a specific enunciation of standards generally to be met when
3 judging the public interest in cases of property transfer." *Id.* The Commission then established
4 specific review standards. *See* Merger Order at 16.

5 The Commission first set forth the policy concerns that underlie the Commission's
6 overarching goal of regulating in the public interest. These policies are established by statute:

7-8 (1) Preserve affordable natural gas and electric services to the residents of the state;

9-10 (2) Maintain and advance the efficiency and availability of natural gas and electric services to the residents of the state;

11-12 (3) Ensure that customers pay only reasonable charges for natural gas and electric service;

13 (4) Permit flexible pricing of natural gas and electric service.

14 Merger Order at 19 (*citing* RCW 80.28.074). Applying these principles, the Commission set
15 forth a detailed explanation of the factors to be considered in making a public interest
16 determination:

17-20 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.

21-23 This component of the standard considers the consequences of the transaction for those customers directly served by the company(s) proposing the merger or property transfer.

24-27 2. The transaction, with conditions required for its approval, should strike a balance between the interests of customers, shareholders, and the broader public that is fair and that preserves affordable, efficient, reliable, and available service.

28-31 This component of the standard considers the way interests are indirectly, as well as directly, affected by the transaction. The broader public in this component includes state policies concerning environmental, low income, and gas and electricity resource issues.

32-35 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.

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1 Competition is entering the electric and natural gas industries, and its influence
2 will likely continue to grow. However, competition is not, in itself, an enunciated
3 state policy objective for utility service. Competition is an important tool, as is
4 regulation, for accomplishing the policy objectives of affordable, efficient, reliable
5 and available service. Consequently, a transaction's effects on competition must
6 be considered not in isolation, but rather in light of the effect the transaction, and
7 any conditions placed upon it, will have on these policy objectives.

8 4. The jurisdictional effect of the transaction should be consistent with the
9 Commission's role and responsibility to protect the interests of
10 Washington gas and electricity customers.

11 We are concerned that mergers and property transfers should not take place
12 simply to accomplish a change in jurisdictional oversight for the companies
13 involved. Any impact on the Commission's ability to continue to look out for the
14 interests of Washington's customers must be considered carefully.

15 Merger Order at 19-20. This is the test that applies here.

16 In its recent decision in the Colstrip proceeding, the Commission endorsed this standard
17 while recognizing that it allowed flexibility in its application to different transactions. The
18 Commission explained:

19 Over time, and across different industries and transactions, different considerations may
20 prove relevant to determining the public interest. Nevertheless, we find that in this
21 specific case, all four of the principles enunciated in the PSE merger are appropriate in
22 assessing the public interest. These principles are not minimum standards; rather they are
23 guidelines that, when taken together, can be used to determine whether there is, at least,
24 no harm to the public interest.

25 Third Supplemental Order Approving Sale, Docket No. UE-990267, (September 30, 1999) at 5.

26 **IV. DISCUSSION**

27 **A. Selling the Centralia Facilities Is Consistent with the Public Interest.**

28 **1. The Sale Reduces Substantial Risks to Customers that Arise From**
29 **Continued Ownership of the Facilities.**

30 It would be a mistake to rely solely on the wide range of potential replacement power cost
31 scenario analyses in making a public interest determination. It would be a mistake to rely on any
32 one scenario as a point estimate and all of the scenarios rest on forecasts that become
33 increasingly speculative over time. More important, there are factors beyond the market forecast
34 scenario analyses that favor approving the sale. The most important of these factors is the
35 elimination of substantial risks to customers if the sale is approved.

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1 As a coal-fired generation plant with an associated coal mine, located in an
2 environmentally sensitive area (i.e., in the shadow of Mt. Rainier National Park), the Centralia
3 facilities face significant environmental risks and costs. The most obvious of these costs is the
4 reclamation liability associated with closure of the mine. Ex. T-101 (Gaines Direct Testimony)
5 at 4:8-15; Ex. 103. Whenever the mine closes – and it may be much sooner than planned if the
6 plant ceases operations for economic or environmental reasons – the owners will be forced to
7 undertake extensive reclamation of the mine. Ex. T-101 (Gaines Direct Testimony) at 14:7-15:4.
8 Current estimates show that cost to be approximately $486 million. *See* Ex. 103. This figure is
9 based on the assumption that current law would be applied. Although it may be possible to
10 persuade regulators to accept a less burdensome reclamation plan, even under those scenarios the
11 reclamation liability is in the range of $240 million to $355 million. Ex. 103. Under traditional
12 principles of regulation, customers would be subject to those costs. If the plant is sold, that risk
13 is eliminated.
14 The facilities face other environmental risks as well. Stringent air regulation has resulted
15 in required installation of expensive scrubbers over the next few years. Ex. T-101 (Gaines Direct
16 Testimony) at 3, n.1. The cost is estimated to be approximately $200 million. Ex. 104 at 3. If
17 the plant is subject to additional NOX emission regulation, those costs could increase
18 significantly. Moreover, as environmental regulatory pressures continue, it is conceivable that
19 additional abatement technology will be required. Coal-fired generation facilities – and
20 especially those located in environmentally sensitive areas – are particularly at risk for this sort of
21 regulation.[3] Ex. T-101 (Gaines Direct Testimony) at 13:20-14:6. The additional abatement
22 technology may make it impossible to continue operation of the plant – for environmental
23 reasons or for economic reasons or both. If that happens, customers again will suffer a

[3] For example, on May 1, 1997, the Environmental Protection Agency extended the reach of the Toxic Release Inventory reporting requirements under Section 313 of the Emergency Planning and Community Right-to-Know Act of 1986 (EPCRA) to coal-fired generating plants. 62 Fed. Reg. 23,834 (1997); *see also* Section 313 Emergency Planning and Community Right-to-Know Act Guidance Document, Electricity Generating Facilities, EPA 745-B-97-016.

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1 significant loss. In addition, as a coal-fired generation facility, the plant is at risk for potential
2 costs associated with the imposition of a carbon tax, and the risks of increased generation taxes
3 and coal severance taxes.[4] Ex. T-101 (Gaines Direct Testimony) at 14:1-6; Tr. at 704:4-705:18;
4 Ex. 508; Ex. 511. If the plant is sold, all of these risks are eliminated.

5 Closely related is the risk of early closure. Early closure may stem from any number of
6 factors. As mentioned above, increasingly stringent environmental regulations may require it. A
7 shift in plant economics may also precipitate early closure. If plant costs continue to increase as
8 a result of environmental regulation, increasing maintenance and/or rehabilitation costs, and if
9 the estimates of energy market prices turn out to be too high, then the plant may become
10 uneconomic to run. If that happens, customers will suffer all the costs associated with early
11 closure, including accelerated mine reclamation costs, mine closure payments, facility shutdown
12 costs, etc., with no associated benefits. If the plant is sold, this risk is eliminated.

13 Customers also face risk with respect to expenditures necessary to extend the life of the
14 plant. The current capital budget covers only five years. *See* Ex. 324. It includes scrubber
15 installation and generator rewinds, but it does not include any budget for replacement of the
16 boilers. Ex. 324. The original design life of the plant is 40 years. Ex. T-216 (Weaver Rebuttal
17 Testimony) at 10:15-21. There is no assurance that the boilers will last longer than the design
18 life of the plant. Expensive replacement of the boilers would likely be borne by customers. If
19 the plant is sold, this risk is eliminated.

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[4] Coal-fired generation is especially at risk. The 1998 Legislature commissioned the Washington Utilities and Transportation Commission and the Department of Community Trade and Economic Development, Energy Division to submit a report on Washington's electric utility industry on a number of issues that may require consideration in policy changes affecting electricity services. The Electricity System Study ESSB 6560 noted that "electricity production is a significant source of carbon dioxide. *Most of the carbon dioxide produced by electric generators that serve Washington loads is produced by the Centralia and Colstrip coal-fired power plants.*" (Emphasis added.) The study further stated: "The 1997 Kyoto Protocol, negotiated by more than 150 countries, would require the U.S. to reduce its greenhouse gas emissions to 7% below 1990 levels by 2008-2012. Scientists indicate that substantially greater reductions (50-70%) would be necessary to stabilize the climate." Finally, the study concluded: "Even though most of our power comes from hydroelectricity, internalization of carbon costs in power prices *could have a significant effect on prices in Washington*, depending on how it is accomplished." (Emphasis added.)

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In addition, changing technologies may make Centralia obsolete. Changing technologies may offer cleaner, more fuel-efficient resources that could make Centralia an above-market resource. Ex. T-101 (Gaines Direct Testimony) at 10:13-22. Selling Centralia will not only allow PSE to take advantage of market flexibility – and the possibility that fierce price competition in the wholesale markets will drive prices lower than forecasts – but also will permit PSE to take advantage of emerging technologies, such as distributed generation and related technologies. *Id.* The likelihood of the availability of these technologies increases in the out years. If PSE is tied to an aging coal-fired generation facility, it will not be able to take advantage of these technologies and its customers may suffer as a result.

Finally, the current ownership structure poses its own unique risks. As described by PacifiCorp, the current divided structure allows any one owner to frustrate the attempts of the other owners to make necessary capital improvements to the facilities. *See* Ex.T-201 (Miller Direct Testimony) at 6:11-21. Scrubber installation provides an example of this problem. As explained at the hearing, even now not all of the parties have agreed to pay for scrubber installation. Tr. at 258:2-22. The current approval is contingent on sale of the plant; it is not clear what will happen if the sale is not approved. Tr. at 707:21-708:4. This problem of divided ownership and the risks it poses to the owners and their customers is eliminated if the sale is approved.

2. The Near-Term Economic Benefits of the Sale Should be Given Greater Weight Than the More Speculative Longer-Term Economic Benefits of Keeping The Plant.

Even ignoring all of the factors mentioned above, the market forecast scenarios show significant near-term benefits. These near term benefits should be given greater weight than the out-year economic projections for at least the following reasons:

- The out-year "benefits" are based on highly speculative long term forecasts. Ex. T-113 (Gaines Rebuttal Testimony) at 5:1-6; Tr. at 684:23-685:2.
- The out-year "benefits" assume that Centralia won't be closed or effectively closed by increasingly stringent environmental regulations.

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1 • The out-year "benefits" ignore the additional costs that may be necessary to
2 extend the life of the plant.
3 • The out-year "benefits" assume that customers will still be ratepayers in a
4 traditional regulatory environment and thus in a position to capture the benefits.
5 Moreover, if the correct market price forecasts are the "low" forecasts rather than the "medium"
6 forecasts, the benefits of the sale increase by approximately $90 million, just for PSE's portion of
7 the facilities. *See* Ex. 105 at 1. In any event, in light of the assumptions underlying the out-year
8 benefits, it makes little sense to use the speculative out-year benefits of continuing to hold
9 Centralia as an excuse not to approve the sale and force customers to continue bearing the risks
10 of ownership in the Centralia facilities.

11 **3. PSE's Customers are Receiving Benefits Now, Under the Rate Plan.**

12 Commission Staff and Public Counsel both analyze the proposed transaction without
13 considering the benefits customers are receiving now as a result of the Rate Plan. *See, e.g.*, Ex.
14 T-113 (Gaines Rebuttal Testimony) at 3:1-17. Mr. Lazar, for example, analyzes the benefits of
15 the transaction by segregating pre- and post-Rate Plan benefits – and then considering only post-
16 Rate Plan benefits in his analysis. *See* Ex. 501. Yet customers are receiving real benefits now as
17 a result of the Rate Plan. As Mr. Gaines explained during the hearing, the benefit to customers
18 from the Rate Plan is hundreds of millions of dollars in lower rates. Tr. at 169:11-20. Staff and
19 Public Counsel's apparent justification for not including those benefits in the analysis is that
20 because the Rate Plan is already in effect, customers will receive the benefits of the Rate Plan
21 regardless of whether the sale is approved.

22 There are several flaws in this reasoning. The first and most important is that it ignores
23 the basic premise of the Rate Plan: customers were *guaranteed* lower rates than otherwise would
24 have been possible for a five-year period and, in return, PSE was granted the opportunity to
25 manage its business aggressively during that period and retain all of the savings and benefits it
26 generated as a way of paying for the up-front customer benefits. The second flaw in this
27 reasoning is closely related to the first. Under Staff and Public Counsel's rationale, PSE should

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1 not be permitted to keep any of the savings or benefits it generates during the Rate Plan period
2 because rates are fixed without consideration of whether PSE meets, or fails to meet, its
3 management goals. Taken to its logical conclusion, Staff and Public Counsel's reasoning
4 suggests that PSE should be allowed only to capture enough savings to prevent it from having to
5 file for emergency rate relief during the Rate Plan period – and the Commission should
6 confiscate all other savings and benefits. This position is not the "balance" struck in the Rate
7 Plan, however, nor can it be reconciled with the Merger Order itself.

8 **4. Public Counsel's Analysis Rests On Flawed Assumptions.**

9 Relying on an analysis that ignores qualitative factors and that relies heavily on
10 speculative benefits from out-year projected savings, Public Counsel argues that the Centralia
11 facilities should not be sold. *See, e.g.,* T-500 (Lazar Direct Testimony) at 2:3-20. Public
12 Counsel's analysis is flawed for the following reasons. First of all, it is unclear whether Public
13 Counsel has removed all of the errors in the quantitative analysis. The initial submission was so
14 flawed that it had to be replaced in its entirety. *See* Ex. 501. Even then, the analysis was infected
15 with additional errors. *See* Tr. at 694:20-697:10, 757:1-19, 760:23-761:17. Second, the analysis
16 ignores qualitative factors. These qualitative factors are especially important for a plant that
17 faces the environmental risks faced at Centralia. Third, the supposed benefits on which Public
18 Counsel relies occur principally in the out years. Those benefits are based on forecasts –
19 forecasts that become increasingly speculative as the length of the forecast period increases. Tr.
20 at 684:23-685:2. Fourth, the analysis ignores the additional costs that may be necessary to extend
21 the life of the plant beyond its design life. Public Counsel extends the analysis to 2025, some 13
22 years past the end of the plant's design life. *See* Ex. 501 at 1. Finally – and perhaps most
23 important – Public Counsel's analysis assumes that customers will still be in a ratepayer
24 relationship with the utilities 10, 20, even 25 years from now, and thus in a position to capture
25 these out-year benefits. Although it is difficult to imagine what the regulatory environment will
26 be then, the risk of a dramatic change – including open access – is indisputably significant.
27 Public Counsel's analysis ignores that risk.

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B. PSE's Proposed Accounting Treatment is Consistent with the Public Interest, the Rate Plan and Precedent.

PSE's application seeks approval of the sale together with approval for its proposed accounting for the gain. PSE's proposal is consistent with the public interest. The PSE plan provides for normal and reasonable regulatory accounting for both the gain and power costs. No rate adjustment is appropriate as the merger order and rate plan have already addressed that issue. PSE does not believe the Commission needs to consider the issue of "gain sharing" in light of the Rate Plan, for PSE is proposing to amortize the entire gain "above the line," and, as previously discussed, customers are already receiving all of the benefit. This issue is discussed in more detail below. *See* Section B.2, below.

In addition, it would be inappropriate to blindly apply the Colstrip order here to hold that the gain must be deferred. For the reasons outlined in the next section, Colstrip presented a much different set of circumstances than those presented here – and those differences alone justify different treatment of this transaction.

1. The Proposed Centralia Sale Differs in Important Respects from the Proposed Colstrip Sale.

a. The Benefits of the Centralia Sale Include Significant Qualitative Benefits that Were not a Part of the Colstrip Sale.

As discussed above, unlike Colstrip, the Centralia facilities are located in an environmentally sensitive area. The risks of current and future environmental regulation of the facilities is enormous – and some of it has already materialized. In addition, mine reclamation costs are a significant risk, unlike Colstrip. The point here is not to repeat all the qualitative factors discussed in Section A, above, but rather to emphasize that the elimination of these risks results in a real benefit to customers. It may be difficult to quantify the benefit of eliminating these risks with any precision, but the qualitative benefits are nevertheless real benefits and of significant magnitude. The elimination of these risks was not part of the Colstrip analysis. In considering the public interest and how to account for the sale, these unique benefits should play a role.

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b. The Quantitative "Risk" To Customers of the Centralia Sale is One-Tenth the Magnitude of the Quantitative Risk to Customers from the Colstrip Sale.

In its order approving the sale but requiring deferral of the entire gain and all power cost savings in the Colstrip proceedings, the Commission analyzed pre- and post-Rate Plan benefits separately. *See* Third Supplemental Order, Attachment A. The post-Rate Plan analysis showed a potential risk to customers of more than $80 million. In this case, the post-Rate Plan analysis shows a risk to customers of about $8 million. *See* Ex. 114. This small risk – which itself is based on speculative long-term market forecasts – must be balanced against the significant benefits customers receive as a result of the sale.

c. PSE Will Have to Absorb Power Cost Losses During the Rate Plan Period as a Consequence of the Sale.

In the Colstrip proceeding, projections showed significant power cost savings during the Rate Plan period. *See* Third Supplemental Order, Attachment A. The opposite is true here. As a price for selling the Centralia facilities, PSE must absorb power cost losses during the Rate Plan period. This, too, should be factored into any analysis of the appropriate treatment to apply.

2. The Proposed Sale and Associated Accounting Treatment is Consistent with the Five-Year Merger Rate Plan.

a. The Five-Year Rate Plan was the Foundation of the Commission's Decision Approving the Merger.

Although the Commission considered a variety of issues in approving the Puget/WNG merger, the central focus of its decision was the five-year Rate Plan. *See, e.g.,* Merger Order at 21-27 (evaluating, modifying and approving the Rate Plan). The plan itself rests on an important premise: for the five years following the merger, rates are fixed at levels specified in the order. As the Commission recognized in its order, those rates were set at levels beneficial to customers. *See, e.g.*, Merger Order at 21 ("If past rate changes are any guide to what rates would do in the next five years, the Rate Plan is beneficial to Puget's customers"). In other words, customers were guaranteed a benefit – lower rates – as a result of the merger. Customers are receiving those benefits now.

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Under the terms of the Rate Plan, subject to a few specific exceptions, PSE may not seek rate relief. *See, e.g.*, Stipulation at 10:27-11:9. In return for assuming this risk, PSE and its shareholders were given the opportunity to retain any and all financial benefits as a way of paying for the up-front benefits provided to customers – including benefits achieved through managing "resource cost pressures" – achieved during the Rate Plan period. The Commission explained this trade-off in its order:

> [T]he Rate Plan reflects the implicit balance struck by the stipulating parties between five years of 'rate certainty' for customers, and five years of opportunity for the company to manage its resource cost pressures. Within the five-year window, PSE's financial results will be a function of management's ability to achieve savings in order to provide shareholders with an opportunity to earn a reasonable return on investment.

Merger Order at 21.

b. The Proposed Sale Does Not Fall Within One of the Specific Exceptions to the Rate Plan.

The Rate Plan provides that changes in rates "shall only be as provided" in the Stipulation. Stipulation at 4:22-24. The Rate Plan sets forth specific exceptions to the general rule against straying from the Rate Plan's specified rates. Unless one of these exceptions apply, there is no basis for changing rates. Indeed, under the fundamental maxim of statutory construction (expressio unius est exclusio a Herius), the "enumeration of exclusions ... indicates that the statute should apply to all cases not specifically excluded." Norman J. Singer, Sutherland Statutory Construction § 47.23 (4th ed. 1984).

c. The Proposed Sale is Not Subject to the Specific Accounting Treatment of Certain Regulatory Assets Set Forth in the Rate Plan.

The Rate Plan provides for treatment of specific regulatory assets. *See* Merger Order at 22. The Stipulation also provided that "[c]urrent accounting treatment of other regulatory assets shall continue unaffected by the merger." Stipulation at 9:23-24.

The Stipulation provided special treatment of real property transfers of the type specified in the Stipulation. *See* Stipulation at 9:7-22. Those provisions do not apply here, for they apply only to non-depreciable real property. The Stipulation also provided special treatment for gains

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1 or losses from non-depreciable property transactions that are a direct result of the merger. *Id.*
2 That language does not apply here, either, because again this is not a non-depreciable property
3 transaction. In analyzing this issue in the Colstrip order, the Commission ignored this
4 distinction. *See* Third Supplemental Order at 18-19. In the end, neither the Merger Order nor the
5 Stipulation provides for special treatment of this transaction. Thus, applying the maxim of
6 construction set forth above regarding interpretation of exclusions, the Commission should apply
7 the general rule that the gain should be amortized just as it would be amortized in the absence of
8 the Rate Plan.

9 10 **d. The Proposed Accounting Treatment For the Sale Is Reasonable and Consistent with Established Precedent.**

11 Decisions from this Commission, and other utility commissions, demonstrate that PSE's
12 five-year amortization proposal is reasonable, and indeed, even conservative. This Commission
13 and others have recognized that a sale of facilities is an extraordinary event that distorts income,
14 and thus the gain should be spread over some period of time. In determining the proper
15 amortization period, utility commissions consider a number of factors, including: the amount
16 under consideration for amortization; the value of such an amount to ratepayers based on certain
17 amortization periods; and the impact of the adjustment on the utility's finances and income. *E.g.,*
18 *Fitchburg Gas and Electric Light Co.,* D.P.U. 84-145-A at 54 (1985).

19 After weighing these factors, utility commissions commonly select amortization periods
20 of three to five years for gains resulting from the sale of facilities. *See WUTC v. Puget Sound*
21 *Power & Light Co.,* 147 P.U.R.4th 80 (1993) (three year amortization period for sale of utility
22 property); *In re Florida Power Corporation,* 1998 WL 995268, *2 (Fla. P.S.C. 1998) (addressing
23 the proper amortization period for the sale of a combustion turbine and stating that "[t]ypically,
24 gains from sales of utility assets are amortized over five years"); *In re Hawaii Electric Company,*
25 *Inc.,* 1995 WL 785932 (Hawaii P.U.C. 1995) (five year amortization period selected for gain on
26 sale of land and utility substations); *In re 1997 Depreciation Study,* 1997 WL 796537 (Fla.
27 P.S.C.) (five year amortization on sale of warehouse and land; four year amortization on sale of

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hydraulic plant); *In re Southern States Utilities, Inc.*, 1996 WL 7810127 (Fla. P.S.C.) (five year amortization for gain on sale of real property); *In re Kotonda West Utility Corp.*, 1996 WL 263657 (Fla. P.S.C.) (five year amortization on sale of equipment); *Nevada Power Co. v. Public Service Comm'n of Nevada,* 779 P.2d 543, 107 P.U.R.4th 436 (Nev. 1989) (gain on sale of land and utility's office building amortized over three years); *In re Carolina Power & Light Co.*, 55 P.U.R.4th 582 (N.C.U.C. 1983) ($37 million gain on sale of generating units amortized over three year period).

3. Ignoring the Rate Plan Will Violate the Rule Against Single-Issue Ratemaking and Principles of Regulatory Estoppel.

The rule against single-issue ratemaking prohibits the fixing of rates in this way in order to ensure that a regulatory body establishes rates consistent with its statutory or policy mandate to consider and weigh all relevant factors before ordering new rates. *See In re US WEST Communications, Inc.*, 1993 WL 255090 (WUTC, Apr. 15, 1993). Effectively changing rates now, by requiring deferral of the gain beyond the end of the Rate Plan period, would violate the rule against single-issue ratemaking. In addition, it would violate basic principles of estoppel.

4. Commission Staff's Proposal to Defer Savings Based On a Forecast of Savings not only Violates the Rate Plan, but also Violates the Colstrip Order and Basic Principles of Ratemaking.

Commission Staff also insist that the Commission should use a forecast of future savings as a basis for confiscating all benefits of the sale. *See* Ex. T-403 (Martin Direct Testimony) at 8:19-9:13. Even if it were somehow appropriate to ignore the prohibition against single-issue ratemaking and even if it were appropriate to rewrite the Merger Order, there is no basis in ratemaking principles generally or in precedent for Mr. Martin's proposal. The proposal violates a number of ratemaking prohibitions, including the prohibition against setting rates based on anything other than known and measurable costs and revenues. *See generally* WAC 480-09-330.

More important, as explained during the hearings and the cross-examination of Mr. Buckley, there are no savings to defer. Based on current market estimates, PSE will suffer approximately $1.1 million in losses during the Rate Plan period as a result of the sale. During

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1 the hearings, Commission Staff conceded that applying updated market forecasts would result in
2 projected power cost losses:

3
4 Q. Once you substitute the updated Aurora prices, you get a very different result,
5 don't you? You get net savings that are negative in the first year, which would
6 be 2000, and then slightly positive savings in the second year of 2001, with an
7 overall savings during the rate plan period of a negative slightly more than a
8 million dollars; do you see that?
9
10 A. Yes. If you pluck out those numbers out of that later Aurora forecast and use
11 those in my exhibit without doing the calculation, I'll accept that subject to
12 check, but that looks like the values that you would come up with.
13 . . .
14
15 Q. But you do agree, don't you, that if those numbers are plugged in, it would
16 appear as if PSE will actually lose money on power costs during the rate plan
17 period.
18
19 A. Yes.
20
21 Q. And if you go down to your last example, which is the No. 3 on Exhibit 406, if
22 you substitute the new updated numbers in there -- I've gone ahead and done
23 that, substituted the updated forecast – would you accept subject to check that
24 once you add in your plus 1 adder for firming to the current Aurora forecast,
25 that in the year 2000, the net power cost savings are, in effect, power cost loss
26 of approximately 1.9 million dollars, and in 2001, you show a net power cost
27 loss of about four-hundred-thousand dollars. Would you accept that subject to
28 check?
29
30 A. I would, except you said that I show that.
31
32 Q. No, you didn't show that. You showed savings. So if, in fact, the latest
33 Aurora forecast turns out to be accurate and PSE wants to go ahead and sell
34 the plant, PSE will have to, under Staff's proposal as we understand it, forego
35 all of the gain, receive none of the gain on the sale, defer approximately 4.1
36 million dollars, set it aside in an account, accrue interest on it, flow it through
37 to ratepayers at some point in the future, and then also, if these forecasts turn
38 out to be accurate, absorb the power cost losses that it's going to suffer during
39 the rate plan period.
40
41 A. Yes. If the forecasts that you put on the exhibit you gave to me ended up
42 being the numbers, then that's what happens.

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1 Tr. at 593:1-595:22 (Ex. 410 shows the losses).

2 Although it is impermissible in the first instance to confiscate power cost savings, it 3 becomes absurd when the proposal is to defer more than $4 million of phantom savings, based on 4 outdated projections, while making PSE absorb power cost losses. The proposal should be 5 rejected.

6 **C. NWEC's Issues are Appropriate for Another Proceeding.**

7 The Energy Coalition seeks to have the Commission adopt a piecemeal approach to 8 "green power" issues by introducing the question of the characteristics of power cost replacement 9 into this proceeding. Those sorts of decisions can and should be made in the context of a 10 proceeding where the utilities' entire resource portfolios are before the Commission, together 11 with replacement alternatives. This is not such a proceeding.

12 **V. CONCLUSION**

13 For all of the reasons set forth above, PSE urges the Commission to approve the 14 application as filed.

15 DATED this 28th day of January, 2000.

16
17 Respectfully submitted,
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19 SUMMIT LAW GROUP, PLLC
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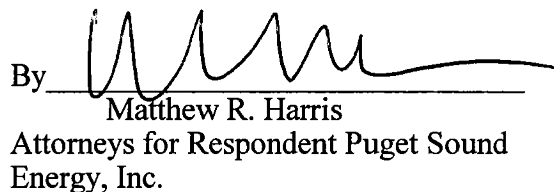
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1 BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

ORIGINAL

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 Facilities, and (2) Authorization to Amortize Gain Over a Five-Year Period.	Docket No.: UE-991409 CERTIFICATE OF SERVICE

10 Alizabeth Rasmussen declares under penalty of perjury of the laws of the State of Washington as
11 follows:

12 That she is an employee with Summit Law Group, 1505 Westlake Ave N., Seattle, Washington,
13 98109; that on the 28th day of January 2000, she caused to be served upon counsel of record at the
14 address and in the manner described on the attached page, the following documents:

15 **PSE'S POST-HEARING BRIEF**

16 **CERTIFICATE OF SERVICE**

17 I declare under penalty of perjury that the foregoing is true and correct.

18 Executed on this 28th day of January, 2000, at Seattle, Washington.

19

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21

Alizabeth Rasmussen

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