

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

For a Declaratory Order Regarding the
Transfer of Assets to Jefferson County
Public Utility District.

NO. _____

PETITION FOR
DECLARATORY ORDER

I. INTRODUCTION

1. In accordance with RCW 34.05.240, WAC 480-07-370, and WAC 480-07-930, Puget Sound Energy, Inc. ("PSE"), hereby petitions the Washington Utilities and Transportation Commission ("Commission" or "WUTC") for a declaratory order related to the transfer of certain assets from PSE to Public Utility District #1 of Jefferson County ("JPUD").

2. PSE is engaged in the business of providing electric and gas service within the State of Washington as a public service company, and is subject to the regulatory authority of the Commission as to its retail rates, service, facilities and practices. Its full name and mailing address are:

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07772-0324/LEGAL18718993.1

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3. JPUD is a public utility district organized under the laws of the State of Washington.

4. The following rules or statutes may be brought into issue by this petition: RCW 80.01.040, RCW 80.12.020, RCW 80.28.010, RCW 34.05.240, WAC 480-07-370, WAC 480-07-930, WAC 480-143-120, and WAC 480-143-180.

II. BACKGROUND AND STATEMENT OF FACTS

5. PSE is currently providing electric service to customers located in Jefferson County, Washington in accordance with the rules and regulations of the WUTC, including, but not limited to, PSE rates and tariffs on file therewith.

6. In November 2008, the citizens of Jefferson County voted to approve Proposition 1, authorizing JPUD to construct or acquire electrical facilities for the

generation, transmission or distribution of electric power in Jefferson County. JPUD is so authorized pursuant to RCW 54.16.040.

7. State law also provides JPUD with authority to acquire PSE's assets by eminent domain. RCW 54.16.020. In July of 2009, JPUD retained outside counsel to assist JPUD in the acquisition, by purchase or by condemnation, of PSE's assets in Jefferson County.¹ With the assistance of counsel, JPUD initiated settlement negotiations with PSE in July of 2009 to acquire PSE's transmission and distribution assets within Jefferson County under threat of condemnation.² These settlement negotiations led to a tentative settlement agreement that was memorialized in a Letter of Intent ("LOI") dated April 30, 2010.³

8. On June 11, 2010, PSE and JPUD entered into an Asset Purchase Agreement ("APA") as the definitive settlement agreement contemplated under the LOI. The transactions described therein are proceeding under JPUD's threat of condemnation.⁴ If consummated, the APA will constitute a settlement between the parties and a disposal of property to a special purpose district pursuant to RCW 80.12.020(2). The APA is provided herein as the Second Exhibit to the Prefiled Direct Testimony of PSE witness Karl R. Karzmar, Exhibit No. KRK-3. A map generally depicting the geographical area ("Service Territory") at issue in this petition is attached to the APA as Exhibit G.

9. The APA identifies certain regulatory approvals that must be satisfied as a condition precedent to closing the transactions contemplated by the APA. These approvals include, but are not limited to, an order from the Commission confirming (a) the purchase

¹ See Exh. No. KRK-1CT at 3:16 - 18.

² See *id* at 3:18-19.

³ See Exh. No. KRK-10.

⁴ See Exh. No. KRK-3 at 5.

price is an amount that is sufficient to fully compensate PSE for the sale of the assets; (b) that the provisions of this APA pertaining to PSE's transition of its responsibilities to provide electrical service to its customers in the Service Territory are consistent with PSE's public service obligations; and (c) that the transfer of the assets is authorized by RCW 80.12.020(2). This Petition therefore arises from obligations assumed under the APA and the need to address the uncertainty surrounding these regulatory contingencies in order to settle threatened condemnation proceedings and close the transactions contemplated by the APA. The APA requires PSE to submit this Petition to the WUTC for its consideration on or before July 15, 2010.⁵

10. First, for the reasons set forth below, PSE believes the transfer of the assets described in Exhibit A of the APA (the "Assets") is authorized by RCW 80.12.020(2). PSE requests an order declaring that the transfer of the Assets is so authorized and that the Commission need not undertake any further review of the proposed transaction for purposes of RCW 80.12.020. However, if the Commission reaches a contrary conclusion with respect to its statutory jurisdiction, PSE requests approval of the proposed transaction and the transfer of the Assets for purposes of RCW 80.12.020.

11. Second, for the reasons set forth below, PSE requests an order declaring that the amount of the \$103 million purchase price described in the APA is an amount that is sufficient to fully compensate PSE for the sale of the Assets.

12. Third, for the reasons set forth below, PSE requests an order declaring that the provisions of the APA pertaining to PSE's transition of its responsibilities to provide

⁵ See *id.* at 20.

electrical service to its customers in the Service Territory are sufficient and consistent with PSE's public service obligations.

III. DISCUSSION

A. Commission Approval of the Asset Transfer is Unnecessary

13. No public service company may sell, lease, assign or otherwise dispose of property that is necessary or useful in the performance of its duties to the public without having secured from the Commission an order authorizing it to do so. RCW 80.12.020. Similarly, WAC 480-143-120 states,

A public service company may not complete a transfer of property necessary or useful to perform its public duties unless the company first applies for, and obtains, commission approval.

One exception to these provisions, however, is a transfer of assets to a special purpose district, defined in RCW 36.96.010 to specifically include public utility districts.⁶

Accordingly, since JPUD is a public utility district, the transfer of Assets to JPUD is authorized by RCW 80.12.020(2) and the Commission need not undertake any further review of the proposed transaction for purposes of RCW 80.12.020.

14. However, if the Commission reaches a contrary conclusion with respect to its statutory jurisdiction, PSE requests approval of the proposed transaction and the transfer of the Assets for purposes of RCW 80.12.020.

⁶ See RCW 80.12.020(2).

B. The Amount of the Purchase Price is Sufficient to Fully Compensate PSE for the Sale of the Assets

15. This Petition also seeks to determine whether the \$103 million purchase price for the Assets is sufficient to fully compensate PSE for its investment.⁷ The proposed transition is a settlement entered into under threat of condemnation. The proposed purchase price constitutes JPUD's last and best offer of settlement.⁸ PSE did not solicit any offers to sell, and does not want to sell the Assets, nor does PSE wish to discontinue providing service to its customers in the Service Territory. PSE is an unwilling seller but does respectfully defer to the will of the people, as expressed in response to Proposition 1 in the November 2008 election. At this juncture, PSE's only other "option" is to reject JPUD's offer of settlement and place PSE and its customers at substantial litigation risk in the context of defending a hostile acquisition in condemnation proceedings. PSE does not think that this would ultimately be in its customers' best interest.

16. Similarly, a failure to consummate this settlement would potentially harm JPUD's ability to execute its desired transition plan. JPUD has advised PSE that extended litigation may well frustrate JPUD's ability to acquire power from the Bonneville Power Administration ("BPA") at a preferred rate by 2013, which is a substantial factor in JPUD's plan of service and a material factor bearing on JPUD's ability to secure long-term financing. In order for JPUD to satisfy BPA's standards of service, among other things, it needs to own

⁷ In seeking this determination, PSE is not seeking any determination as to the accounting treatment of the sale proceeds or allocation of the sale proceeds as between its customers and investors. PSE will file an accounting petition regarding the sale proceeds if and when the transaction is ultimately completed. Rather, PSE seeks only to determine that the Commission is satisfied that PSE's customers are not entitled to claim proceeds for the sale of these Assets in an amount *in excess of* \$103 million. Were the Commission to so determine, PSE has the right to terminate the APA and proceed to seek such amount in condemnation proceedings.

⁸ See Exh. No. KRK-1CT at 5:10.

the Assets. Therefore, JPUD has insisted that the APA include provisions that ensure prompt resolution of the all regulatory contingencies, including the determination of whether the proposed purchase price of \$103 million is sufficient to fully compensate PSE for the sale of the Assets.

17. As noted above, the Assets in question are listed in Exhibit A of the APA and are generally defined as an asset, facility or property that "constitutes a real property interest located in the Service Territory or an improvement or fixture located thereon that is used by and useful to PSE to provide retail electric service to customers located in the Service Territory in accordance with the rules, regulations of, and the rates and tariffs on file with the WUTC."⁹ No generation facilities are involved in this transaction, nor are any generation facilities affected by this transaction. The list of Assets in the APA is fixed as of the effective date of the APA; however, the APA provides for due diligence activities (i.e., confirmation that the asset list is complete and accurate) and for improvements to the existing transmission and distribution system¹⁰ that are likely to occur during the 18 to 36 month transition period.¹¹ These adjustments will be overseen by a Transition Advisory Committee ("TAC") and corresponding adjustments to the purchase price will be made by the TAC to reflect the net book value of any improvements made to the Assets (a price increase) and the value of any Assets removed from service (a price decrease) during the transition period.¹² This mechanism also ensures that there is no financial disincentive

⁹ Exh. No. KRK-3 at 9.

¹⁰ *See id.* at 18

¹¹ The closing of the transactions contemplated under the APA is to take place on a date that is no earlier than eighteen (18) months, and not later than thirty-six (36) months from the Effective Date of the APA. *See id.* at 25.

¹² *See id.* at 15.

during the transition period to make investments necessary to maintain safe and reliable service to PSE's customers.

18. In his Prefiled Direct Testimony, Exhibit No. KRK-1CT, Mr. Karzmar describes in detail the methodology the parties used to determine the fair market value of the Assets as well as alternatives to the sale and risks associated with such alternatives. In summary, JPUD and PSE both used the Replacement Cost New Less Depreciation ("RCNLD") and Reproduction Cost Less Depreciation ("RCLD") as the preferred methodologies to establish a price range for purposes of settlement negotiations. The primary contingency influencing PSE's price range was real estate values; the primary contingency influencing JPUD's price range was not disclosed to PSE. The proposed purchase price of \$103 million falls within the price range established by the parties for purposes of negotiation reflecting the fair market value of the Assets and providing a substantial premium over the net book value of these Assets.

19. In view of uncertainty regarding real estate values, PSE included a contingency in the APA that afforded PSE the opportunity to obtain the opinion of a third-party appraiser in order to verify real-estate values. This contingency was set to expire on July 1, 2010. On June 29, 2010, PSE was advised by its appraisers that their determination of real estate values was *less than* the number that PSE had used for purposes of negotiations. Based upon this information PSE determined that the contingency in the APA allowing PSE to confirm real estate values had been satisfied and so informed JPUD on June 30, 2010. Using the mid range of these numbers for real estate values (\$15 million) and its RCLD determination of value of the facilities (\$85 million), PSE's "all in" assessment of the fair market value of the Assets is \$100 million. The proposed purchase price is \$103 million. This amount is sufficient to fully compensate PSE for the sale of the Assets.

20. The Purchase Price is particularly favorable when considered in light of the risks associated with the alternative of condemnation. Condemnation damages in cases such as this are typically awarded by a jury. In his Prefiled Direct Testimony, Exhibit No. KRK-1CT, Mr. Karzmar explains that JPUD's low RCNLD number (\$58 million) and PSE's highest number (\$136 million) were selected as benchmarks establishing a reasonable range of litigation risk. Much of the "upside" for PSE's is embedded in speculative real estate values (e.g., corridor values) or potential arguments to support claims for "going concern" damages (\$15 million to \$20 million). These numbers would be difficult to prove, and the tangible evidence of fair market value appeared to be fully reflected in PSE's RCLD determination (inclusive of real estate) of \$100 million. This is a complex transaction, and it is possible that a jury could be persuaded to return an award for an amount substantially less than the proposed purchase price. Therefore, due to the elimination of the risk of an unfavorable award, and the avoidance of substantial litigation costs, delay, and uncertainty, the purchase price of \$103 million is sufficient to fully compensate PSE for the sale of the Assets.

C. The APA Provisions Regarding PSE's Transition of its Responsibilities to Provide Electrical Service to its Customers in the Service Territory are Sufficient and Consistent with PSE's Service Obligations.

21. At closing, JPUD shall assume full and complete responsibility for providing electric service to PSE's existing customers in the Service Territory.¹³ During the transition period the APA provides:

PSE will, during the Transition Period, construct, operate and maintain the Assets, and provide electric service to its customers in the Service Territory, at substantially the same quality and level of service that

¹³ See *id* at 25.

PSE provides to its other customers, and to so construct, operate, maintain and serve in accordance with the rules and regulations of the WUTC (including, but not limited to, PSE rates and tariffs on file therewith).¹⁴

However, it is within JPUD's discretion to determine when it is ready to close and displace PSE as the service provider. Without suggesting or implying that JPUD is not fully capable of making this determination, it does raise the question of whether the Commission believes that anything further is necessary in order for PSE to fully discharge its public service obligations up through and to the date of closing.

22. The APA does contain provisions that are intended to reflect a smooth transition. As noted above, the APA contains provisions that ensure that PSE has no disincentive to continue to make investments that are necessary to maintain safe and reliable service to PSE's customers. The APA also provides a structure pursuant to which the parties will facilitate such efficient transition with agreed upon measures for transition of customer data, maps and any materials related to the location and configuration of the Assets, arrangements regarding requests for transmission interconnections and transmission services, billing records, electric service cut-over planning and procedures, and security and communication protocols.¹⁵ As noted above, the APA also provides for a TAC comprised of three (3) members appointed by PSE and two (2) members appointed by JPUD, whose purpose is to facilitate the cooperative efforts of the Parties to transfer the assets to JPUD in accordance with the terms and conditions of the APA.¹⁶

¹⁴ *Id.* at 19.

¹⁵ *See id.* at 35

¹⁶ *See id.* at 15.

23. PSE has provided both the means and the obligation in the APA to continue to serve its customers consistent with the rules and regulations of the WUTC and PSE rates and tariffs until such time as JPUD closes and takes title to the Assets. At closing, JPUD will take title to these Assets and will have both the means and the responsibility under state law to serve these customers. At closing, PSE will be unable to serve and will have no responsibility to do so. For these reasons, PSE requests an order declaring that the transition of its responsibilities to provide electrical service to its customers in the Service Territory are sufficient and consistent with PSE's service obligations.

IV. APPROPRIATENESS OF DECLARATORY ORDER

24. By authority of WAC 480-07-930 and RCW 34.05.240(1), the Commission may enter a declaratory order upon a showing:

- (a) That uncertainty necessitating resolution exists;
- (b) That there is actual controversy arising from the uncertainty such that a declaratory order will not be merely an advisory opinion;
- (c) That the uncertainty adversely affects the petitioner;
- (d) That the adverse effect of uncertainty on the petitioner outweighs any adverse effects on others or on the general public that may likely arise from the order requested; and
- (e) That the petition complies with any additional requirements established by the agency under subsection (2) of this section.

25. The declaratory order requested by PSE meets these requirements, as set forth below.¹⁷

26. **Uncertainty Necessitating Resolution:** The uncertainty to be resolved by this Petition is threefold: 1) whether RCW 80.12.020(2) authorizes PSE to transfer the Assets without further review or approval by the Commission, 2) whether the price PSE will receive for the Assets is sufficient to fully compensate PSE for the sale of Assets, and 3) whether the provisions of this APA pertaining to PSE's transition of its responsibilities to provide electrical service to its customers in the Service Territory are sufficient and consistent with PSE's public service obligations. These questions require interpretation and application of Washington law and the Commission's rules. Interpretation and application of such rules are within the purview and expertise of the Commission's jurisdiction.

27. **Actual Controversy Arising From the Uncertainty Such That a Declaratory Order Will Not Be Merely an Advisory Opinion:** The APA is entered into under threat of condemnation and as an offer of settlement by JPUD; if the parties do not consummate the APA, JPUD will proceed with condemnation proceedings. The controversy bearing on this settlement and the subject matter of this Petition involves uncertainty surrounding the legal authority for, and implications of, the transfer of Assets to JPUD. A declaratory order addressing the outstanding issues would conclusively resolve these uncertainties, would satisfy a condition precedent in the APA, and would therefore not be merely an advisory opinion.

¹⁷ The Commission has not established additional requirements under RCW 34.05.240(1)(e), but rather requires that petitions for declaratory order comply with the remaining subsections of RCW 34.05.240(1). *See* RCW 34.05.240(2).

28. **The Uncertainty Adversely Affects the Petitioner:** Doubts surrounding the rights and obligations of PSE in transferring Assets and the amount of the purchase price expose PSE to the uncertainty and delay of litigation. If PSE does not pursue resolution of these uncertainties, a condition precedent to closing does not occur and JPUD will likely pursue condemnation. Due to the uncertainties associated with a determination of damages in a complex condemnation proceeding, there is significant litigation risk that adversely affects PSE. See Exhibit No. KRK-1CT for details regarding the potential costs associated with this litigation risk.

29. **The Adverse Effect of Uncertainty on the Petitioner Outweighs any Adverse Effects on Others or on the General Public That May Likely Arise From the Order Requested:** Resolution of the questions raised in this petition will not result in any adverse effect to others or the general public. The public interest is served by avoiding the costs and uncertainty related to a condemnation proceeding.

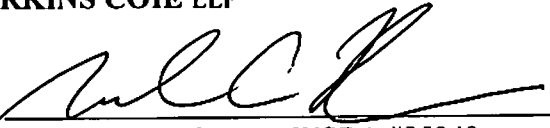
V. RELIEF REQUESTED

For the foregoing reasons, PSE respectfully requests that the Commission enter an order declaring that:

1. Transfer of the Assets is authorized by RCW 80.12.020 (2) and no further action is required by the Commission to approve the transfer of the Assets for purposes of RCW 80.12.020;
2. The amount of the purchase price is an amount that is sufficient to fully compensate PSE for the sale of the Assets; and
3. The provisions of the APA pertaining to PSE's transition of its responsibilities to provide electrical service to its customers in the Service Territory are sufficient and consistent with PSE's public service obligations.

DATED: July 15, 2010

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By 

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