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June 10, 2014

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Steven V. King
Executive Director and Secretary
Washington Utilities & Transportation Commission
1300 S. Evergreen Pk. Dr. S.W.
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Olympia, WA 98504-7250

Re: Petition of Puget Sound Energy, Inc. for an Accounting Order Approving the Allocation of Proceeds of the Sale of Certain Assets to Public Utility District #1 of Jefferson County
Docket UE-132027

Dear Mr. King:

Enclosed please find the original and twelve (12) copies of Public Counsel's Brief, together with a Certificate of Service for filing in the above-referenced docket.

Sincerely,

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CERTIFICATE OF SERVICE

**Petition of Puget Sound Energy, Inc. for an Accounting Order Approving the Allocation of Proceeds of the Sale of Certain Assets to Public Utility District #1 of Jefferson County
Docket UE-132027**

I hereby certify that a true and correct copy of *Public Counsel's Brief* was sent to each of the parties of record shown below in sealed envelopes, via: U.S. Mail and E-Mail.

SERVICE LIST

**** = Receive Highly Confidential; * = Receive Confidential; NC = Receive Non-Confidential**

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DATED: June 10, 2014.



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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

For an Accounting Order Approving the
Allocation of Proceeds of the Sale of
Certain Assets to Public Utility District #1
of Jefferson County.

DOCKET NO. UE-132027

BRIEF OF PUBLIC COUNSEL

June 10, 2014

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I. INTRODUCTION

1. The Commission is asked in this case to appropriately allocate between ratepayers and shareholders the gain from the sale of assets used to serve customers in Jefferson County. Before the Commission can decide the appropriate allocation, it must first determine a policy question. The Commission must decide whether proceeds from sales due to municipalization are different than proceeds from other sales, or if such proceeds are similar and should be allocated according to the Commission's existing methodologies.
2. Public Counsel recommends that the Commission decline PSE's invitation to treat such proceeds differently. Instead, the Commission should analyze treatment of the gain consistent with its robust precedent, which applies equitable principles that balance shareholder and consumer interests. Applying the same equitable principles to the facts in this case will result in a fair distribution of gain. Public Counsel recommends that the gain be allocated 95 percent to ratepayers and five percent to shareholders.¹

II. STATEMENT OF FACTS

3. In November 2008, the voters of Jefferson County approved Proposition 1, which authorized Jefferson County Public Utility District (JPUD) to acquire facilities necessary to provide electric service.² Puget Sound Energy, Inc. (PSE) vigorously opposed Proposition 1, along with two other initiatives that would have allowed public utility districts on Whidbey Island and in Skagit County to take steps to provide electric service.³

¹ With PSE's adjusted gain on sale of \$59,864,313, the result of Public Counsel's recommendation is to allocate \$56,871,097 to ratepayers and \$2,993,216 to shareholders.

² Osborne, Exhibit SSO-1T at 2:16-18, 3:3-4; Osborne, Exhibit SSO-5, p.3-4; Osborne Cross Exhibit, SSO-12CX.

³ Osborne, Cross Exhibit SSO-11CX; Osborne, Cross Exhibit SSO-12CX; Osborne, TR. 51:8-17.

4. These ballot measures arose after PSE announced a proposed sale of the Company to a “consortium of foreign investors,” led by the Macquarie Group.⁴ PSE was required to obtain approval from the Washington Utilities and Transportation Commission (UTC) prior to completing the sale and filed an application authorizing the transfer of ownership in December 2007. The UTC granted approval of the transaction in December 2008, subject to conditions.⁵ The debate and approval of Proposition 1 in Jefferson County took place entirely within the pendency of PSE’s application.⁶
5. During the 2008 election debate, ratepayers raised concerns about foreign ownership of the utility, as well as PSE’s rate increases and customer service.⁷ PSE executives attended various town hall meetings to discuss the ballot measures with voters.⁸ The investor consortium was aware that the ballot measures could result in PSE’s service territory being acquired by public utility districts. They understood the ability of Washington customers to take over the means of production through the political process and, ultimately, municipalization.⁹ Despite knowing of the municipalization risk, which has existed in Washington since the 1930s, and the success of Proposition 1, the investor consortium proceeded with the acquisition in 2009.
6. The Jefferson County measure passed with 53 percent of the vote.¹⁰ JPUD expressed its intent to acquire PSE’s facilities, and PSE expressed that it would not be a willing seller.¹¹ To

⁴ Bellemare Cross Exhibit, RCB-5CX (Hittle Report), p. 10. The announcement of the sale occurred in October 2007.

⁵ *In re: the Joint Application of Puget Holdings LLC and Puget Sound Energy, Inc. for an Order Authorizing Proposed Transaction*, Docket U-072375, Order 08 (December 30, 2008).

⁶ Osborne, TR. 53:6 to 54:1.

⁷ Bellemare, Cross Exhibit RCB-5CX (Hittle Report), p. 10; Osborne, Cross Exhibit SSO-11CX; Osborne, Cross Exhibit SSO-12CX; Osborne, TR. 54:6-13.

⁸ Osborne, Cross Exhibit OSS-11CX, p. 2

⁹ Osborne, Cross Exhibit SSO-11CX, p. 2; Osborne, TR. 55:19-25

¹⁰ Osborne, Exhibit SSO-5, p. 4.

¹¹ Osborne, Exhibit SSO-5, p. 4; *See also*, Osborne, Cross Exhibit SSO-12CX.

avoid the uncertainties of a condemnation proceeding, PSE negotiated with JPUD.¹² Ultimately, PSE and JPUD came to an agreement and executed an Asset Purchase Agreement (APA).¹³

7. The APA established a purchase price of approximately \$103 million and required PSE to obtain certain confirmations from the UTC, including that the purchase price was “sufficient to fully compensate PSE customers for the sale of the assets.”¹⁴ The UTC confirmation was a condition precedent to the sale of JPUD being completed.¹⁵

8. PSE filed a Petition for Declaratory Judgment with the UTC under Docket U-101217.¹⁶ The Commission entered an order on February 1, 2011, stating that the purchase price provided for in the APA was adequate compensation for the sale of assets.¹⁷ The condition precedent of obtaining UTC confirmations was satisfied, and PSE completed the sales transaction transferring assets to JPUD.¹⁸

9. In Docket U-101217, the Parties agreed that a determination of a sufficient purchase price would not affect the accounting treatment of the sales proceeds between PSE’s customers and shareholders.¹⁹ The Commission noted that this agreement was significant.²⁰ The Commission expressly reserved allocation of the proceeds and determination of the accounting treatment for a future proceeding, stating:

[O]ur determination does not affect the subsequent accounting treatment of the sale proceeds and does not affect an allocation of the sale proceeds as between PSE’s customers and shareholders. Those questions will be finally determined in

¹² Osborne, Exhibit SSO-1T at 5:17 to 6:16.

¹³ Osborne, Exhibit SSO-3.

¹⁴ Osborne, Exhibit SSO-3, p.10.

¹⁵ Osborne, TR. at 65:5-8.

¹⁶ Osborne, Cross Exhibit SSO-10CX.

¹⁷ *In re Puget Sound Energy’s Petition for Declaratory Order Regarding the Transfer of Assets to JPUD*, Docket U-101217, Order 03 at ¶ 24 (February 1, 2011).

¹⁸ Osborne, TR. at 64:19 to 66:10.

¹⁹ Docket U-101217, Order 03, Appendix A (Settlement Agreement) at ¶ 15.

²⁰ Docket U-101217, Order 03 at ¶ 25.

the context of a future proceeding, most likely one initiated via an accounting petition or in PSE's next general rate case.²¹

10. Ultimately, the sale of assets to JPUD was completed with a purchase price of approximately \$109 million. Net book value of the assets totaled \$46 million and transaction costs totaled almost \$3 million, leaving a net book gain of approximately \$60 million.²² PSE initiated the current proceeding by filing its Petition for Accounting Order seeking approval to allocate 75 percent of the net gain to shareholders and 25 percent to ratepayers.

III. THE REGULATORY COMPACT AND THE APPLICABLE LEGAL PRINCIPLES

11. Electric utilities such as PSE provide an essential service for which there is no substitute. Electric service is affected with the public interest and electric utilities are generally natural monopolies. Natural monopolies occur when competition cannot thrive in the market, resulting in one firm succeeding to provide the service. Monopolies have the ability to restrict output and charge prices that are higher than economically justified. To prevent utilities from abusing monopoly power, they are subject to governmental oversight, with regulation serving as a substitute for competition.²³
12. Regulation imposes upon utilities the obligation to serve in return for the regulator's promise to set rates that will compensate the utility for the costs incurred to meet that

²¹ Docket U-101217, Order 03 at ¶ 26.

²² Marcelia, Exhibit MRM-6.

²³ *Democratic Central Committee of the District of Columbia v. Washington Metropolitan Area Transit Commission*, 485 F.2d 786, 806 (1973) (Ratemaking is fundamentally a balancing of investor and consumer interest. The investor's interest lies in the integrity of his investment and a fair opportunity to earn a reasonable return. The customer's interest lies in governmental protection against unreasonable charges for the monopolistic service to which he subscribes.).

obligation.²⁴ This is the “regulatory compact.” The regulatory compact is not, as Dr. Levin for PSE suggests, solely focused on protecting the utility.²⁵

13. Under the regulatory compact, investors are entitled to the opportunity to receive a return of and a return on their investment. While regulators are not bound to use any particular formula to set rates, they must balance ratepayer and shareholder interests.²⁶ Customers are entitled to safe, efficient, reliable service provided at reasonable rates.²⁷ Shareholders are concerned with the financial integrity of the utility, and revenue should be sufficient enough to cover operating expenses, including cost of capital.²⁸

14. The UTC follows the basic ratemaking formula of $R = O + B(r)$, where R is the utility’s revenue requirement, O is the utility’s operating expenses, B is the utility’s rate base, and r is the rate of return earned on the utility’s rate base.²⁹ The rate base “represents the total investment in, or fair value of, the facilities of the utility employed in providing its service.”³⁰ The rate of return is applied to the rate base and represents the amount necessary to service the utility’s debt and provide its shareholders with a return *on* investment.³¹ Investors receive a return *of* their investment through depreciation included in rates. Investors are made whole and the integrity of the investment is maintained in a process that allows depreciation based on cost.³² The Supreme

²⁴ See Dittmer, Exhibit JRD-1T at 6:24 to 8:8; RCW 80.28.110 (obligation to serve customers who apply for service).

²⁵ Levin, Exhibit SLL-1T at 3:6-8 (referring to the regulatory compact as “certain protections”).

²⁶ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602-603 (1944).

²⁷ *POWER v. WUTC*, 104 Wn.2d 798, 808 (1985).

²⁸ *Hope*, 320 U.S. at 603; *POWER*, 104 Wn.2d at 808; *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-090704 and UG-090705, Order 11 at ¶ 18 (April 2, 2010).

²⁹ *POWER*, 104 Wn.2d 808-809.

³⁰ *POWER*, 104 Wn.2d at 809-810.

³¹ *POWER*, 104 Wn.2d at 810.

³² *Hope*, 320 U.S. at 606.

Court in *Hope* noted that there was “no constitutional requirement that the owner who embarks in a wasting-asset business of limited life shall receive at the end more than he has put into it.”³³

15. In every action taken by the UTC to regulate utilities, it must meet a public interest standard.³⁴ RCW 80.01.040 requires that the Commission regulate in the public interest the rates, services, facilities, and practices of utilities. The Commission’s jurisdiction resides generally in the Legislature’s delegation of power under RCW 80.01.040, and other sections of Title 80 RCW must be read in harmony with that statute to allow the Commission to carry out its duty to regulate in the public interest.

16. Although PSE was not required to obtain Commission approval of the sale of assets to JPUD,³⁵ the Commission is authorized to determine the accounting treatment of the sales proceeds under its rate-setting authority.³⁶ While the Commission generally subscribes to the Uniform System of Accounts (USOA) for utility accounting, ratemaking treatment is not governed by the USOA.³⁷ Instead, when determining the proper accounting treatment for ratemaking purposes, the Commission is bound by the public interest standard, which requires the Commission to balance ratepayer and shareholder interests.

17. As observed by the Court in *Democratic Central*, there is “no impediment, constitutional or otherwise, to recognition of a ratemaking principle enabling ratepayers to benefit from appreciation in value of utility property accruing while in service.”³⁸ PSE’s investors are entitled to receive their original investment, and they are entitled to the opportunity to earn a return on

³³ *Hope*, 320 U.S. at 606 (citation omitted).

³⁴ RCW 80.01.040.

³⁵ RCW 80.12.020(2); *See also* Docket U-101217, Order 03 at ¶ 23.

³⁶ *See* Docket U-101217, Order 03 at ¶ 25-26.

³⁷ *WUTC v. Puget Sound Power & Light Company*, Cause No. U-85-53, Second Supplemental Order at p. 32 (May 16, 1986).

³⁸ *Democratic Central*, 485 F.2d at 800.

the investment during the time the investment is properly included in rates. However, when utility assets are sold at a gain, the Commission has discretion regarding the allocation of the gain for ratemaking purposes. Because the Commission has the authority and discretion to develop a ratemaking principle regarding treatment of gain that is consistent with the public interest, the Commission's ultimate decision rests in policy, not law.

IV. POLICY CONSIDERATIONS IN ALLOCATING SALES PROCEEDS

18. Each of the Parties advocate for the principle that reward follows risk,³⁹ but disagree about how the principle is applied to the facts of this case. PSE believes that its shareholders bear the risk and thus should receive the bulk of the gain. On the other hand, Public Counsel, Commission Staff, and ICNU all advocate that the ratepayers bore the risk and should receive the majority of the gain.⁴⁰

A. Equitable Principles Set Out in *Democratic Central* and Adopted by this Commission are Sufficient to Determine the Allocation of Gain in this Case.

19. The Commission has adopted the equitable principles that reward follows risk and benefit follows burden to evaluate the appropriate allocation of gain from sale of utility assets.⁴¹ These equitable principles were set out in the landmark case *Democratic Central Committee of the*

³⁹ Levin, TR. 137:11-24.

⁴⁰ Public Counsel, Commission Staff, and ICNU agree ratepayers should receive the majority of the gain, but each arrive at a different percentage to be allocated to ratepayers. Public Counsel and ICNU use slightly different methodologies to reach nearly equivalent recommendations. Public Counsel witness Mr. Dittmer recommends 95 percent of the net book gain be allocated to ratepayers and 5 percent to shareholders. This allocation recommendation encompasses the amount equal to accumulated depreciation, but Mr. Dittmer does not first allocate the accumulated depreciation amount, then split the remaining gain between shareholders and ratepayers. ICNU recommends that the amount equal to accumulated depreciation plus 90 percent of the appreciation (the amount of the sales proceeds that exceeds original cost) be allocated to ratepayers. Staff recommends allocating a greater share to shareholders, and follows the same methodology as ICNU. Staff would allocate an amount equal to the accumulated depreciation plus 75 percent of the appreciation to ratepayers and 25 percent of the appreciation to shareholders.

⁴¹ *In re Sale of Centralia Steam Plant*, Dockets UE-991255 (Avista), 991262 (PacifiCorp), 991409 (PSE), Second Supplemental Order (Order Approving Sale with Conditions) at ¶¶ 78-80 (March 6, 2000) (citing *District of Columbia v. Washington Metropolitan Area Transit Commission*, 485 F.2d 786 (1973)).

District of Columbia v. Washington Metropolitan Area Transit Commission.⁴² The first equitable principle is that the right to capital gains is linked to the risk of capital losses. The second equitable principle is that those who bear the financial burden of the particular utility activity should also reap the benefits resulting therefrom.⁴³ The balance is best struck at the point at which the interests of both groups receive maximum accommodation.⁴⁴

20. Notably, neither investors nor ratepayers are automatically entitled to sales proceeds by virtue of ownership and investment or of being users of the service, respectively.⁴⁵ Rather, the specific allocation of gain in a given case is based on the policy determination that reward follows risk and the factual determination of who bears the risk.⁴⁶ The ultimate determination of the precise percentage that is allocated to ratepayers and shareholders depends on the equitable weighing of interests. There is no mathematical formula prescribed for determining the percentages allocated.⁴⁷ The Commission exercises its discretion and judgment in balancing ratepayer and shareholder interests in each case.⁴⁸

21. PSE argues for a different application of reward follows risk to be used in cases such as this one where the utility sells its assets under threat of condemnation and the requirement to serve a group of customers is transferred along with the sale of assets.⁴⁹ PSE asks the

⁴² 485 F.2d 786 (1973).

⁴³ *Democratic Central*, 485 F.2d at 806.

⁴⁴ *Democratic Central*, 485 F.2d at 806.

⁴⁵ *Democratic Central*, 485 F.2d at 805.

⁴⁶ *In re Sale of Centralia Steam Plant*, Second Supplemental Order (Order Approving Sale with Conditions) at ¶ 78.

⁴⁷ Gorman, TR. at 208:20 to 210:14; Dittmer, TR. at 213:15 to 217:20; Keating, TR. at 242:18 to 246:5; *In re Sale of Centralia Steam Plant*, Second Supplemental Order (Order Approving Sale with Conditions) at ¶ 86 (“This is not based on a preconceived formula, but on the equities of this distinctive case.”)

⁴⁸ *In re Sale of Centralia Steam Plant*, Second Supplemental Order (Order Approving Sale with Conditions) at ¶¶ 81-86; *In re Petition of PSE for Order Authorizing Use of Proceeds from the Sale of RECs (In re PSE REC Petition)*, Docket UE-070725, Order 03 at ¶¶ 46-47 (May 20, 2010).

⁴⁹ PSE’s Petition for Accounting Order Approving the Allocation of Proceeds of the Sale of Certain Assets to Public Utility District No. 1 of Jefferson County (Petition) at ¶ 33-37. PSE emphasizes that the sale was involuntary from

Commission to adopt a ruling from California (*Redding II*) that allocates 100 percent of the gain to shareholders.⁵⁰ However, the Commission should reject the argument, as PSE has not produced convincing evidence that the principles set forth in *Democratic Central* are irrelevant to this case. PSE has not demonstrated that a new rule is required to address the situation presented in this case. Rather, the Commission's own strong precedent allocating gain from sale of utility assets is appropriate to determine the allocation in this case.⁵¹ Indeed, *Redding II* is inconsistent with the policy decisions made in Commission's precedent and *Democratic Central*.

22. Unlike the UTC's precedent, the California PUC focused on the risks taken by ratepayers and shareholders only at the time the investment is made in *Redding II*.⁵² In particular, the California PUC focused on the source of the dollars used to make the initial investment. However, Washington precedent provides that while the source of dollars in the initial acquisition of an asset may be from shareholders, the ratepayer is required to bear the costs of ownership, including the risk of loss and the financial burdens of the cost of money and maintenance, once the asset is included in rates.⁵³

23. Other cases cited by PSE in its Petition also fail to align with UTC precedent and *Democratic Central*. A number of cases rely on the reasoning that ratepayers are not owners and

its perspective. See Osborne, Exhibit SSO-1T at 3:11-13; Marcellia, Exhibit MRM-1T at 7:16-20, 8:7-12; Marcellia, Exhibit MRM-5T at 5:22.

⁵⁰ Petition at ¶¶ 35-36, citing *Re Ratemaking Treatment of Capital Gains Derived from the Sale of a Public Utility Distribution System Serving an Area by a Municipality or Public Entity (Redding II)*, CA PUC, Decision 89-07-016, R. 88-11-041 (July 6, 1989). The California PUC declined to give weight to whether a sale was voluntary or involuntary. See § 8.

⁵¹ See, *In re Sale of Centralia Steam Plant*, Second Supplemental Order (Order Approving Sale with Conditions); *In re Sale of Centralia Steam Plant*, Dockets UE-991255 (Avista), 991262 (PacifiCorp), 991409 (PSE), Third Supplemental Order (Order Serving Dissent Regarding Allocation of Gain) at ¶ 205 (March 14, 2000); *In re PSE REC Petition*, Docket UE-070725, Order 03 (May 20, 2010); *WUTC v. American Water Resources*, Docket UW-031284, Order 08 (November 1, 2004).

⁵² *Redding II* at §§ 2, 6, 7, 8.

⁵³ *In re PSE REC Petition*, Docket UE-070725, Order 03 at n.40 (ratepayers bear the full burden of cost responsibility); See also *Democratic Central*, 485 F.2d at 806.

are thus not entitled to share in gain. For example, in allocating gain to shareholders, the court in *Maine Water Company* reasoned that the utility property was owned by the company, not the ratepayers. Ratepayers, the court said, only pay for service and not the property used to render it.⁵⁴ In another case, a commission reasoned that ratepayers only have an expectation of service as they do not have an interest in utility property.⁵⁵ However, the foundation for this approach – that property, though dedicated to the public use, remained the sole property of the owners – does not hold true.⁵⁶

24. Nevertheless, PSE argues here that ratepayers are not owners, and thus not entitled to the gain.⁵⁷ PSE made this argument in a prior docket, and the Commission properly rejected it. In Docket UE-070725, PSE argued that it was entitled to certain REC sales proceeds akin to gain from sale based on the ownership concept. The UTC rejected the “straw man” argument, stating it was not relevant to determining how proceeds should be allocated.⁵⁸ Moreover, the Commission dismissed the precedent relied upon by PSE as “inapt” because rates include operating expenses, depreciation, and a return on investment, and it was “indisputably the case that ratepayers bear the full burden of cost responsibility” for the utility assets at issue in that case.⁵⁹ The Commission confirmed that the proper consideration in allocating proceeds was the principle that reward follows risk and benefit follows burden.⁶⁰

⁵⁴ *Maine Water Company v. Public Utilities Commission*, 482 A.2d 433, 447-448 (1984). The Court also noted that it would be equitable for ratepayers who paid the depreciation and maintenance on the property to be entitled to the gain. In that case, the water systems sold had separately set rates, so remaining customers did not bear any costs associated with the assets and did not bear the risk of loss. This is distinguishable from the case at hand because PSE has uniform, system-wide rates, and all customers are at risk of loss for all of PSE’s assets.

⁵⁵ *Public Service Commission of the State of Missouri*, 29 Mo. P.S.C. (N.S.) 178 (1987).

⁵⁶ *Democratic Central*, 485 F.2d at 800; *In re PSE REC Petition*, Docket UE-070725, Order 03 at n.40.

⁵⁷ *Marcelia*, Exhibit MRM-5T at 13:9, 27:7 to 28:16.

⁵⁸ *In re PSE REC Petition*, Docket UE-070725, Order 03 at ¶ 39.

⁵⁹ *In re PSE REC Petition*, Docket UE-070725, Order 03 at n.40.

⁶⁰ *In re PSE REC Petition*, Docket UE-070725, Order 03 at ¶¶ 40-41, 46-47.

25. Furthermore, PSE undermines its ownership argument by conceding that if this sale was not a municipalization sale, it would propose a different allocation between ratepayers and shareholders.⁶¹ PSE emphasizes that the “involuntary” nature of the sale changes the analysis. However, even the California decision PSE relies upon acknowledges that the threat of condemnation and the involuntary or voluntary nature of a sale does not factor in to the analysis of whether an allocation should be made to ratepayers.⁶²

26. Ultimately, the municipalization aspect of the current case does not alter how the Commission should analyze the allocation of proceeds.

B. Applying the Principles that Reward Follows Risk and Benefit Follows Burden to the JPUD Gain, the Equities Tip in Favor of the Ratepayers.

27. PSE and Public Counsel differ on what is the case-determining risk. The Company points to the risk of customer loss and municipalization and characterizes this risk as unusual and extraordinary. Public Counsel points to the risks ratepayers are asked to bear and the effects the sale will have on remaining customers.

1. The equitable considerations fall in favor of ratepayers because the risks they bore with regard to the assets were much greater than the risks borne by PSE’s shareholders.

28. Through regulation, shareholders are shielded from the risks they take or are compensated for taking them. For example, PSE argues that shareholders carry the risk of municipalization and customer loss and characterizes the risk as extraordinary and unusual. However, the risk is well-established for utilities offering services in Washington: customers have had the ability to municipalize since the 1930s, utilities do not have exclusive service

⁶¹ Marcelia, TR at 119:3-19.

⁶² *Redding II* at § 8.

territories, and industrial customers can opt for self-generation.⁶³ The risk is evidenced by the significant amount of public power in Washington compared with the percentage of customers served by public power nationally.⁶⁴ Moreover, PSE's shareholders acquired the Company during a time when there was a significant movement to municipalize multiple portions of its service territory. The investor consortium specifically knew of the risk and of the successful Jefferson County vote prior to completing the transaction that transferred ownership.

29. The risk of customer loss and municipalization is in line with other ordinary risks borne by the shareholders, such as the risk of prudent management and legislative risk. More importantly, the utility's rate of return compensates it for these normal risks.⁶⁵ As stated in *Democratic Central*, "[A]n investor can hardly muster any equitable support for a claim to appreciation in asset value where he has been shielded against the risk of loss on his investment, or has already been rewarded for taking on that risk."⁶⁶

30. PSE attempts to make a distinction between "business risk" and "ownership risk" to substantiate shareholder risk, but this is a distinction without a difference in the regulatory context. Dr. Levin testified that various costs included in customer rates were simply the price of doing business, or "business risk."⁶⁷ Dr. Levin asserts that ratepayers do not assume the risk of ownership,⁶⁸ which he defines as the "risk that comes with owning the assets that you may have to sell it for more or less than it's worth, or that you think it's worth."⁶⁹ Given that ratepayers are called upon to bear the risk of loss, while investors often retain their right to recoupment, the

⁶³ *In re Sale of Centralia Steam Plant*, Third Supplemental Order (Dissent) at ¶¶ 203-207.

⁶⁴ Levin, TR. at 156:9-16.

⁶⁵ *In re Sale of Centralia Steam Plant*, Third Supplemental Order (Dissent) at ¶ 221.

⁶⁶ *Democratic Central*, 485 F.2d at 806.

⁶⁷ Levin, Exhibit SLL-1T at 10:13 to 11:5.

⁶⁸ Levin, Exhibit SLL-1T at 11:3-4, 11:15-16.

⁶⁹ Levin, TR at 137:25 to 138:2. Dr. Levin continues by stating that in a competitive market, the owner would take this risk into account in setting rates. PSE, of course, is not a competitive business.

distinction between business risk and ownership risk is illusory. This is particularly true in Washington, where ratepayers have been asked to pay the costs of ownership, losses on assets, and cost deferrals with a return.

31. In terms of ratepayer risk, Washington is not unusual. Regulation has long imposed on customers the substantial risk of loss and the financial burdens associated with the utility's assets.⁷⁰ As Commissioner Hemstad noted in his partial dissent from the Centralia Order, so long as a utility shows an investment to be prudent, the costs associated with that investment will be passed to the ratepayers.⁷¹ Costs borne by ratepayers cover operational and ownership risks, including operating expenses, depreciation, return of and on investment, the cost of money to acquire the assets, and maintenance. Importantly, because PSE uses a single, system-wide rate, all of PSE's ratepayers pay for all of PSE's assets.⁷² Likewise, all of PSE's customers are at risk of loss for all of PSE's assets.⁷³ Therefore, the remaining ratepayers in this case bore the risks associated with the Jefferson County assets to the same extent as the ratepayers who are now being served by JPUD, and the remaining ratepayers bore substantially more risk than PSE's shareholders.

2. In addition to risk, ratepayers will also experience harm from the sale of assets.

32. The equitable considerations are in ratepayers' favor due to the harm customers face as a result of the sale to JPUD. Those harms include stranded costs, effects on power costs, and effects on non-power costs.

⁷⁰ *Democratic Central*, 485 F.2d at 806; *In re PSE REC Petition*, Order 03 at n.40.

⁷¹ *In re Sale of Centralia Steam Plant*, Third Supplemental Order (Order Serving Dissent Regarding Allocation of Gain) at ¶¶ 205.

⁷² Piliaris, Exhibit JAP-1T at 14:13.

⁷³ Dittmer, TR. at 226:2-6.

33. Stranded costs were considered but not quantified by the valuation experts retained by PSE and JPUD to prepare feasibility reports in 2008.⁷⁴ The experts disagreed about whether stranded costs would occur, with the expert hired by JPUD opining that stranded costs would not likely occur. The expert hired by PSE stated that stranded costs would likely occur, but did not require quantifying due to the preliminary nature of the report, his conclusion that the transaction would be too expensive to be feasible, and that the stranded costs would not be known until after extensive litigation was completed.⁷⁵

34. The contemplated stranded costs are occurring, or will occur, with respect to PSE's power supply and non-power supply costs to the disadvantage of ratepayers.⁷⁶ With respect to non-power supply costs, the remaining PSE customers will be called upon to absorb fixed costs that were spread across a larger customer base prior to the sale. That PSE's customer base may grow to equal what it was prior to the sale does not reduce the impact on remaining customers, because that growth would have been additive to the number of Jefferson County customers. This would result in the costs being spread across an even larger group of customers. Consequently, remaining PSE customers will not have the benefit of any contributions that would have been made by the Jefferson County customers, which is estimated to be as high as \$3.2 million.⁷⁷

35. With respect to power costs, PSE's own study shows fairly significant early-year cost penalty to the remaining ratepayers.⁷⁸ As Mr. Dittmer testifies, information in the early years of a long-term forecast is more likely to be reliable because the inputs used to calculate the early

⁷⁴ Dittmer, Exhibit JRD-1T at 21:13 to 24:11; Bellemare, Cross Exhibit RCB-5CX (Hittle Report), p. 18-19; Bellemare, Cross Exhibit RCB-6CX (UtiliPoint Reprt), p. 20 – 22.

⁷⁵ Bellemare, Cross Exhibit RCB-6CX (UtiliPoint Report), p. 11, 20-22.

⁷⁶ Dittmer, Exhibit JRD-1T at 24:13-16.

⁷⁷ Dittmer, Exhibit JRD-1T at 24:20 to 28:11; Piliaris, Exhibit JAP-3 at 2.

⁷⁸ Piliaris, Exhibit JAP-7; Piliaris, Exhibit JAP-13.

years' results are simply more knowable.⁷⁹ Thus, it is likely that ratepayers will experience the cost penalties in the early years, and the value of PSE's predicted long-term benefits are much more uncertain. Additionally, lower-than-projected load growth may delay the need for additional generation resources. This could cause the early cost penalties to continue for a longer period as the "savings" predicted by the Company's study are delayed.⁸⁰

36. The harms faced by the remaining ratepayers further support allocating the majority of the gain to customers.

3. An equitable allocation in this case would provide the majority of the gain to ratepayers and a small portion of the gain to shareholders.

37. In weighing the equities of a case, the Commission considers the particular circumstances of the sale that produced the gain.⁸¹ The current case arose as the result of a 2008 vote by Jefferson County customers to authorize JPUD to take steps to acquire facilities so it could provide electric service. The vote was successful due to concerns about ownership of the utility, rate increase requests, and customer service short-comings. In negotiating the sale, PSE was able to achieve a high purchase price, which benefits both ratepayers and shareholders.

38. The Commission has acknowledged that it is in the public interest to encourage utilities to pursue strategies that benefit both ratepayers and shareholders. To encourage utilities to pursue such strategies, the Commission has exercised its discretion to allow PSE retain monies

⁷⁹ Dittmer, Exhibit JRD-1T at 30:22 to 31:3. An example of expenses being more knowable in the early years is PSE's use of a three-month average of the forward price marks for natural gas in conjunction with the Wood Mackenzie Long Term forecasts. The forward price marks for natural gas are typically available for about five years ahead. Piliaris, Cross Exhibit JAP-16CX, p. 5.

⁸⁰ Dittmer, Exhibit JRD-1T at 28:15 to 36:9.

⁸¹ *In re Sale of Centralia Steam Plant*, Second Supplemental Order (Order Approving Sale with Conditions) at ¶ 86; *In re PSE REC Petition*, Docket UE-070725, Order 03 at ¶ 41; See also, *WUTC v. American Water Resources*, Docket UW-031284, Order 08 ("We agree with Staff that the allocation between the shareholder and customers of the gain on sale of in-service utility assets rest essentially on equitable considerations. The allocation process necessitates a sensitive balancing of the interest of the shareholder and ratepayers in view of the particular circumstances of the case."); Dittmer, Exhibit JRD-1T at 14:6 to 15:2.

that would otherwise be allocated to ratepayers.⁸² Applied to this case, the Commission could exercise its discretion to allocate a small portion of the gain to shareholders. Because the balance of risks and equities shows that shareholders are largely insulated from risk and substantial risk of ownership is placed on ratepayers, the balance tips in favor of ratepayers. Therefore, the majority of the gain should be allocated to ratepayers.⁸³ It is with these considerations in mind that Public Counsel submits a recommendation that equitably balances the interests of shareholders and ratepayers and divides the gain five percent to shareholders and 95 percent to ratepayers.⁸⁴

V. ISSUES RAISED BY PSE

39. In this section, Public Counsel responds to select arguments made by PSE. First, the use of PSE's PSM III model to calculate the potential power cost savings does not provide the Commission with a reliable calculation. Second, PSE's comparison of the loss of the Jefferson County load with its conservation programs is inapposite. Third, PSE mischaracterizes the effect of allocating to ratepayers an amount equal to the accumulated depreciation collected through rates on the Jefferson County assets. Fourth, PSE describes the sale of the Jefferson County assets as a liquidation of a utility when, in fact, the sale was not a liquidation.

⁸² *In re PSE REC Petition*, Docket UE-070725, Order 03 at ¶ 47 and n.56.

⁸³ This is also consistent with *In re Sale of Centralia Steam Plant*, Second Supplemental Order (Order Approving Sale with Conditions). Even though the Commission split the appreciation 50/50 between the ratepayers and shareholders, ratepayers received between 86.7 percent to 92.9 percent of the overall gain for each of the three utilities. See Dittmer, Exhibit JRD-1T at 11:4-5 (Table 1).

⁸⁴ The Oregon PUC has also recognized the policy of allocating a portion of the gain on sale to the utility when it has contributed significantly to the value in the sale. PacifiCorp sold facilities to the City of Hermiston after aggressively defending its service territory and maximizing the proceeds received. The remaining ratepayers were not only unharmed by the transaction, but benefitted from a lower cost of service after the sale. The Oregon PUC approved a settlement that allocated 95 percent of the gain to ratepayers and five percent to shareholders. *In re the Application of PacifiCorp for Approval of the Sale and Transfer of Electric Properties and Transfer of Service Territory to the City of Hermiston*, OPUC Docket UP 187, Order No. 01-830 (September 26, 2001). Public Counsel views the treatment of the gain on sale in the Hermiston case as being consistent with *Democratic Central*. While the Oregon order is not controlling, it provides the Commission with an example of how proceeds similar to the proceeds at issue in the instant docket has been treated in a neighboring jurisdiction.

A. PSE's Use of the PSM III Model to Calculate the Potential Power Cost Savings does not Provide the Commission with a Reliable Calculation of the Actual Impact the Sale may have on Power Costs.

40. PSE argues that the sale will result in potential power cost savings that will offset any harm that might occur to customers in the years immediately following the sale. To quantify the potential savings, PSE used its PSM III model.⁸⁵ PSE points out that the Commission routinely relies upon PSM III and long-term cost projections, “to support its decisions to approve rate recovery of PSE’s resource acquisitions.”⁸⁶ However, the Commission has not previously used the PSM III model to project with certainty the value of potential outcomes. There are several reasons the Commission should not do so in this case.

41. First, while the PSM III model is used for integrated resource planning (IRP) and resource acquisition decisions, numerous scenarios and sensitivities are analyzed, allowing analysis of numerous possible futures.⁸⁷ For example, in its most recent IRP, PSE ran ten scenarios.⁸⁸ If an acquisition or portfolio is common across multiple possible futures, that indicates the resource or portfolio is the least-cost option across a wide range of possibilities.⁸⁹ PSE recognizes the limitation of using only one scenario, as indicated by a PSE witness in testimony in a previous docket discussing the evaluation of a resource acquisition.⁹⁰ Despite this recognition, PSE only presents one possible future in its PSM III analysis of future power costs after the sale of Jefferson County assets in the instant case.⁹¹

⁸⁵ Piliaris, TR. at 84:24 to 85:8.

⁸⁶ Piliaris, Exhibit JAP-9T, p. 3:1-3.

⁸⁷ Piliaris, TR. at 87:19-25, 88:22 to 89:18.

⁸⁸ Piliaris, Cross Exhibit JAP-18CX, p. 2. In addition to the PSM III scenarios, PSE also uses additional quantitative analysis to evaluate potential portfolios. Piliaris, Cross Exhibit JAP-16CX.

⁸⁹ Piliaris, Cross Exhibit JAP-17CX, p. 4.

⁹⁰ Piliaris, Cross Exhibit JAP-17CX, p. 9.

⁹¹ Piliaris, TR. at 88:14-21.

42. But, even if PSE had presented multiple scenarios in this case, the PSM III model would not be able to accurately forecast the potential savings or costs. While PSM III develops portfolio cost estimates for each possible future, neither the Commission nor parties rely on the PSM III cost estimates to develop PSE's revenue requirement. Rather, the actual cost of the resource, along with other factors, determine PSE's revenue requirement.⁹² Thus, the PSM III model is used to characterize whether a decision is prudent or reasonable, but not to determine the price associated with that decision.

43. Second, as discussed by Public Counsel witness Mr. Dittmer, studies based on long term forecasts are inherently imprecise.⁹³ Small changes to input assumptions significantly impact long-term study results, in part because small changes become magnified when compounded over multiple years.⁹⁴ Further, the range of inputs in any long-term analysis will vary significantly between scenarios, and from year to year, as demonstrated in Exhibit JAP-16CX.⁹⁵ The inputs used to calculate the early years' results are simply more knowable and are more influenced by the current investment and expense levels being incurred to serve the current customer base.⁹⁶ Thus, as noted by Mr. Dittmer and discussed above, information in the early years of a long-term forecast is more likely to be reliable.⁹⁷ Even PSE has acknowledged that the

⁹² Piliaris, TR. 89:19 to 90:2.

⁹³ Dittmer, Exhibit JRD-1T at 29:12 to 30:2.

⁹⁴ Dittmer, Exhibit JRD-1T at 30:10-17.

⁹⁵ Piliaris, Cross Exhibit JAP-16CX, p. 13-21.

⁹⁶ Dittmer, Exhibit JRD-1T at 30:22 to 31:3. An example of expenses being more knowable in the early years is PSE's use of a three-month average of the forward price marks for natural gas in conjunction with the Wood Mackenzie Long Term forecasts. The forward price marks for natural gas are typically available for about five years ahead. Piliaris, Cross Exhibit JAP-16CX, p. 5.

⁹⁷ Dittmer, Exhibit JRD-1T at 30:18 to 31:3.

earlier years of a long-term study are more reliable and that results from the out years are more speculative.⁹⁸

44. Third, the load forecast used in PSE's analysis is outdated. Changes in a utility's load impacts when it would be required to add a new resource. A lower load forecast would allow the utility to defer acquiring a new resource to later years, which would delay the costs of that resource acquisition.⁹⁹ In this case, PSE used the same load forecast to develop the potential power cost benefit as it used in its 2013 IRP.¹⁰⁰

45. In its acknowledgement letter for the 2013 IRP, the Commission stated, "The load growth projections from 2017 and beyond are mostly driven by the inputs to the econometric model and are themselves projections of the level of economic growth."¹⁰¹ The Commission found that there was little in the way of explanation for how and which underlying inputs change in 2017 to create a higher rate of load growth beyond 2017. PSE has informed stakeholders that the load forecast for the 2015 IRP will be lower than the previous IRP.¹⁰²

46. The analysis PSE presents in this case is uncertain at best. PSE's analysis does not provide an adequate basis for the Commission to conclude with any probability that ratepayers will experience a net power cost benefit that will offset stranded costs and increases in power costs for remaining customers that will occur during the first five years after the sale.

⁹⁸ *In re Sale of Centralia Steam Plant*, Second Supplemental Order (Order Approving Sale with Conditions) at ¶ 19. PSE argued strongly that the Commission should discount the results from the out-years of long term forecasts presented in the *Centralia* case. On brief, PSE characterized the out year benefits as "based on highly speculative long term forecasts" and argued that it made "little sense to use the speculative out year benefits" to justify rejection of the sale. Marcella, Cross Exhibit MRM-9X at 11:7, 11:17-20.

⁹⁹ Dittmer, Exhibit JRD-1T at 28:15 to 36:9.

¹⁰⁰ Piliaris, Cross Exhibit JAP-18CX.

¹⁰¹ Piliaris, Cross Exhibit JAP-19CX, p. 4.

¹⁰² Dittmer, TR. 222:17 to 223:15.

B. The Loss of Jefferson County Load is not similar to the Loss of Load due to PSE's Conservation Program.

47. In his rebuttal testimony, Mr. Piliaris compared the load reduction caused by the loss of Jefferson County service territory to PSE's conservation programs. He argued that this comparison further justified PSE's reliance on the results of the PSM III model.¹⁰³ However, using the PSM III model to determine the level of conservation acquisition PSE will pursue is very different from creating a specific dollar value to apply as a customer benefit from the loss of a portion of PSE's service territory. Mr. Piliaris confirmed on cross examination that PSE does not model loss of service territory as a conservation strategy in its IRP, and PSE has not presented an option of removing another part the Company's service territory as a conservation method.¹⁰⁴ The comparison has no merit.

C. PSE Mischaracterizes the Effect of Allocating Gain to Ratepayers in Amounts that Equal the Accumulated Depreciation Collected Through Rates with Respect to the Assets Sold.

48. Both Staff and ICNU advocate that the Commission should allocate the gain in this case using the methodology the Commission used in the *Centralia* case. That methodology allocates the asset's net book value to the company, the amount equivalent to the accumulated depreciation to the ratepayers, and determines the appropriate split of any remaining gain based on equitable principles.¹⁰⁵ PSE has responded that allocating any amount equivalent to the accumulated depreciation would be confiscatory. PSE also argues that the proposed allocations

¹⁰³ Piliaris, Exhibit JAP-9T at 10:1-14.

¹⁰⁴ Piliaris, TR. 90:6 to 91:8.

¹⁰⁵ Public Counsel does not oppose the recommendations made by Staff and ICNU and believes that the *Centralia* methodology provides a reasonable and equitable method of splitting gain. Public Counsel chose to focus primarily on the equitable considerations in allocating gain in its analysis. Public Counsel presents its recommendation as allocating the net gain between shareholders and ratepayers without focusing on the accumulated depreciation in particular.

by the non-company parties would prevent PSE's shareholders from realizing the accumulated depreciation, and that only the Jefferson County customers paid the accumulated depreciation.

49. Confiscation is a particular legal concept that is rooted in constitutional law.¹⁰⁶ In response to questioning, Dr. Levin stated that he was not using the term "confiscation" in the legal sense, but rather meant simply that "one group was getting money that belonged to somebody else."¹⁰⁷ An allocation of a portion of the gain in this case does not result in a confiscation, either in the constitutional sense or the "dictionary" sense because neither ratepayers nor shareholders are automatically entitled to the gain.¹⁰⁸

50. Dr. Levin also argues on behalf of PSE that "allocating an amount equal to the accumulated depreciation to ratepayers denies the investors recovery of their investment."¹⁰⁹ This argument is nonsensical in that no party is advocating that investors return revenues collected through rates during the time the Jefferson County assets were included in rate base. According to PSE's calculation, the amount of accumulated depreciation is \$29.9 million, or 39 percent of the Jefferson County investment.¹¹⁰ This is money PSE has already collected from customers to provide investors with a return of their investment. Investors will be made whole when they receive the remaining amount of their investment from the sales proceeds, as no party disagrees with the net book value being returned to PSE.

¹⁰⁶ The Fifth Amendment of the United States Constitution provides that private property shall not be taken for public use without just compensation. *Armstrong v. United States*, 364 U.S. 40, 49 (1960). While it confirms the State's authority to confiscate private property, the text of the Fifth Amendment imposes two conditions on the exercise of such authority: the taking must be for a "public use" and "just compensation" must be paid to the owner. *Brown v. Legal Found of Washington*, 538 U.S. 216, 231-32 (2003).

¹⁰⁷ Levin, TR. 144:20 to 145:24.

¹⁰⁸ *Democratic Central*, 485 F.2d at 805.

¹⁰⁹ Levin, Exhibit SLL-1T at 8:11-13.

¹¹⁰ Marcellia, Exhibit MRM-6 shows that original cost is approximately \$76.6 million and accumulated depreciation is approximately \$29.9 million. \$29.9 million is approximately 39 percent of the original cost.

51. Lastly, PSE argues that the accumulated depreciation was paid for by Jefferson County customers, who are now being served by JPUD. However, as Mr. Piliaris and Mr. Marcellia testify, one cannot calculate with certainty which ratepayers paid which costs.¹¹¹ As noted above, PSE uses a uniform, system-wide rate, resulting in all customers paying for all assets and all customers bearing the risk of loss for all PSE assets.¹¹² The remaining ratepayers paid the accumulated depreciation associated with the Jefferson County assets to the same extent as the Jefferson County customers.

52. PSE's arguments regarding accumulated depreciation do not prevent the Commission from weighing the equities in favor of ratepayers in this case and allocating a significant portion of the gain on sale to customers.

D. The Sale of Jefferson County Assets did not result in a Liquidation of a Utility.

53. PSE argues that the sale of Jefferson County assets and the resulting loss of customers was a "partial liquidation." This is an argument that the California PUC adopted in the *Redding II* case to justify allocating 100 percent of the sales proceeds and gain on sale to shareholders. The concept is that if shareholders receive 100 percent of the proceeds in a complete liquidation, they should also receive 100 percent of the proceeds in a partial liquidation.¹¹³ This argument is flawed.

54. In a complete liquidation, the utility sells its entire operations to another entity. In such cases, the purchaser often pays a premium. PSE argues that the shareholders always receive that

¹¹¹ Piliaris, Exhibit JAP-1T at 14:13-17, 14:21-22; Marcellia, Exhibit MRM-5T at 16:17-19.

¹¹² Piliaris, Exhibit JAP-1T at 14:13-14.

¹¹³ *Redding II*, Policy Overview.

premium.¹¹⁴ If that purchaser is another investor, the Commission would retain jurisdiction over the utility, and the premium would not be passed to ratepayers through rates.¹¹⁵

55. The sale in this case was not a liquidation. Although the sale resulted in a reduction of service territory and customers, PSE continues to operate as the same entity it operated as prior to the sale. Additionally, PSE still has customers who bore the risk of the assets that were sold, and PSE concedes that if the sale had been “voluntary,” it would seek a different distribution of the gain than it advocates in this case.¹¹⁶ It defies logic that the same sale would be treated differently when the purchaser is a municipality versus a private investor. The Commission has the authority to allocate the gain in a manner that is consistent with the public interest after evaluating the risks borne by each group and the equities of the specific case before it. The risks and equities in this case overwhelmingly favor ratepayers.

VI. CONCLUSION

56. As Mr. Dittmer observed, it logically follows that a utility should not experience an extraordinary windfall upon disposition of property, just as the utility is not required to bear the loss from premature disposition of property formerly used to provide service.¹¹⁷ The Commission has the tools necessary to allocate the gain PSE achieved in the sale of assets to JPUD. The Commission should consider the risks borne by ratepayers and shareholders, and weight the equities of this particular case. In doing so, Public Counsel recommends that the

¹¹⁴ Marcellia, Exhibit MRM-5T at 30:12-15.

¹¹⁵ *In re: the Joint Application of Puget Holdings LLC and Puget Sound Energy, Inc. for an Order Authorizing Proposed Transaction*, Docket U-072375, Order 08 at ¶ 91 (December 30, 2008) (“Commitment 21 protects PSE’s customers by providing that the Joint Applicants will not seek recovery of the acquisition premium in PSE’s rates.”). Additionally, Commission approval would be required before the transaction could occur.

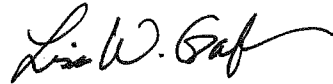
¹¹⁶ See Marcellia, TR at 119:3-19.

¹¹⁷ Dittmer, Exhibit JRD-1T at 8:13-18.

Commission allocate 95 percent of the gain (\$56,871,097) to ratepayers and five percent of the gain (\$2,993,216) to the utility. The result is fair and fits squarely in the regulatory compact.

DATED this 10th day of June, 2014.

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