

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**In the Matter of the Petition of
PUGET SOUND ENERGY, INC.**

DOCKET UE-132027

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

INITIAL BRIEF ON BEHALF OF COMMISSION STAFF

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Attachment 1:	Updated Staff Exhibit No. EJK-3, PSE and Staff Proposed Allocation of JPUD Sale Proceeds
Attachment 2:	<i>Accounting Standards Codification</i> , ¶ 980-340-25 – <i>Recognition - General</i> , v. 4, page 2377 (Financial Accounting Standards Board (October 31, 2012)).

I. INTRODUCTION

1 This case arises from a petition¹ of Puget Sound Energy, Inc. (PSE or Company), asking
the Commission to determine that PSE is entitled, as a matter of law, to all of the gain on the sale
of part of PSE’s distribution system² to Public Utility District No. 1 of Jefferson County (JPUD).
At stake in this case is whether the Commission may continue to give customers the gain on
the sale of utility assets, or whether the Commission must give shareholders that money.

2 In making its decision, the Commission should apply the “regulatory compact,” as PSE
suggests. However, the Commission should apply that compact correctly, and disregard the
many ancillary arguments that detract from the core issue in this case: whether shareholders are
harmful if they receive back the value of the money they invested in the assets being sold, and
nothing more?

3 As we explain, the answer to that question is No. The “regulatory compact” requires
only that the Commission return to PSE shareholders the unamortized balance of utility plant on
PSE’s books (*i.e.*, the net book value of the assets sold), and nothing more. This treatment is fair
and it does not harm PSE’s owners. Net book value is the foundation of Commission regulation
and investor expectations in this state. That is all that PSE shareholders may reasonably expect.
They have no legal claim to any more than that.

4 Nonetheless, in addition to returning to investors the net book value of the assets (plus
provable transaction costs), Commission Staff proposes that investors receive an additional
amount (\$7,481,394) as an incentive to negotiate favorable sales prices in the future, and as an

¹ *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 132027, Petition for Accounting Order (October 31, 2013) (PSE Petition or Petition).

² The assets PSE sold “are predominantly comprised of distribution facilities,” though “a small amount of 115 kV transmission facilities” were included. Piliaris Direct, Exh. No. JAP-1T at 16:20-21. Therefore, in this brief, we refer to the sold assets as PSE’s distribution system in Jefferson County, or words to that effect.

award for negotiating a favorable sales price in this instance.³ Public Counsel and ICNU take a similar approach.

5 PSE contends that shareholders are legally entitled to 100 percent of the gain. PSE offers customers a portion of that gain (25 percent), but only as a “voluntary sharing of the proceeds of this sale.”⁴ PSE’s case is premised on the assertion that shareholders alone bear the “risk of ownership” in the facilities.⁵ However, that is a false premise. In this state, PSE customers bear the risk of ownership, and remaining customers continue to bear that risk through the rate setting process. This confirms that customers are entitled to receive the gain on sale of the JPUD assets.

6 PSE’s theory of risk/reward heavily relies on a decision of the California commission in *City of Redding II*.⁶ However, like PSE here, *City of Redding II* was based on the assumption that investors bear the risk of ownership. While that may be the situation in California, it is not the situation here. Here, customers bear that risk because the Commission’s rate setting practices place the risk of capital loss on customers. Accordingly, PSE’s customers are entitled to the gain on sale of the JPUD assets.

II. FACTS

7 Jefferson County is a rural, “sparsely populated” county,⁷ located on the Olympic Peninsula. As the Company testified: “The high cost of serving Jefferson County in relation to the number of customers in the service territory limits its revenue potential,” and furthermore,

³ Keating Direct, Exhibit No. EJK-1T at 55:5-12.

⁴ PSE Petition at 18, ¶ 37.

⁵ PSE Petition at 18, ¶ 37; Levin Rebuttal, Exh. No. SLL-1T at 11:14-20.

⁶ *Ratemaking Treatment of Capital Gains from the Sale of a Public Utility Distribution System Serving an Area Annexed by a Municipality or Public Entity*, 104 Pub. Util. Rep. (PUR) 4th 157 (Cal. PUC 1989) (*City of Redding II*).

⁷ Osborne, TR. 48:24 to 49:2.

economic prospects are limited: “There is no expectation of any significant load growth in the [Jefferson County] service territory in the foreseeable future.”⁸

8 PSE formerly provided electric service to customers located in the eastern part of Jefferson County.⁹ In 2008, Jefferson County voters approved a proposition that enabled JPUD to be formed, with the authority to acquire PSE’s distribution system in that county.¹⁰ Under threat of condemnation, JPUD acquired PSE’s distribution system in Jefferson County, for an “all-in” sales price of \$109,273,196.¹¹

9 As a result of the sale, on April 1, 2013, the electric service customers in Jefferson County became JPUD customers; those customers are no longer PSE customers.¹²

III. TABLE SUMMARIZING THE PARTIES’ RECOMMENDATIONS

10 There is no dispute about the key numbers in this case. The following table shows the positions of the parties. As we explained in footnote 11, Staff’s figures change slightly due to a \$100,000 reduction in the total proceeds figure in PSE’s rebuttal testimony (\$109,273,196) compared to the figure used in PSE’s Petition (\$109,373,196). An updated version of Staff’s Exhibit No. EJK-3 is Attachment A to this brief:

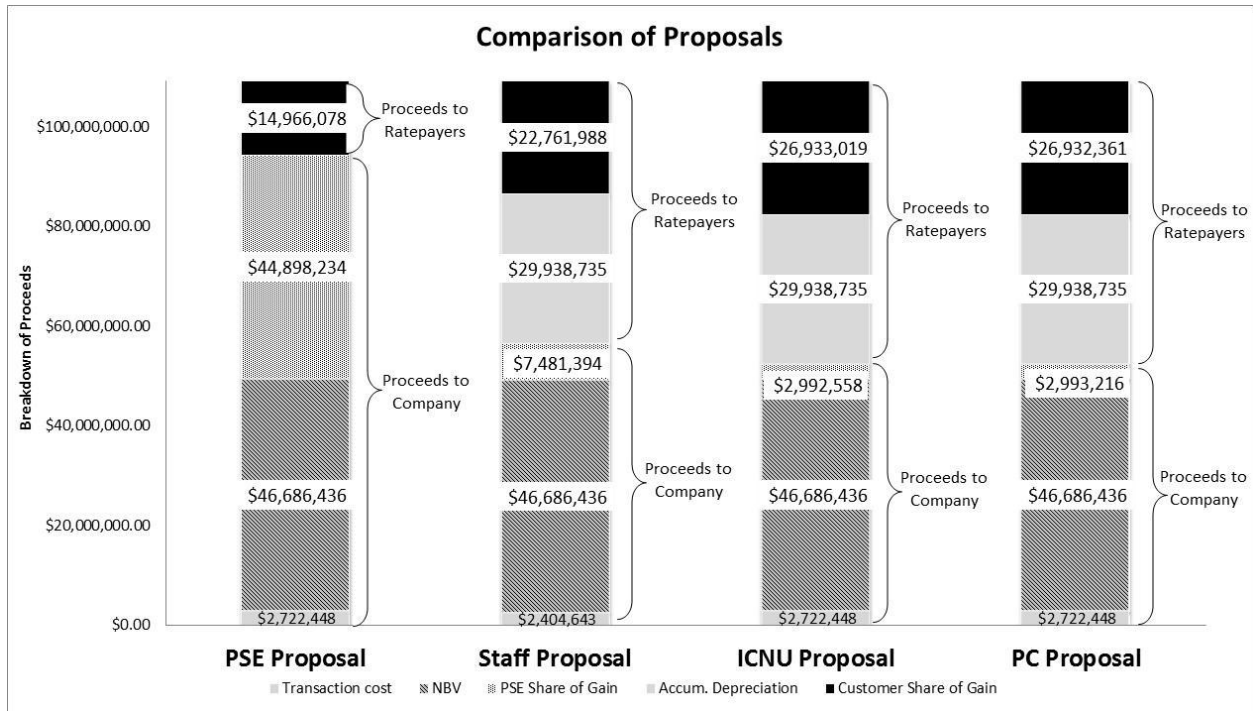
⁸ Osborne, Exh. No. SS0-5 (testimony of Mr. Karzmar, adopted by Mr. Osborne) at 16:12-15.

⁹ Osborne Direct, Exh. No. SSO-1T at 2:12-13.

¹⁰ Osborne Direct, Exh. No. SSO-1T at 2:12-19.

¹¹ Marcelia Rebuttal, Exh. No. MRM-5T at 7:19 to 8:6. This \$109,273,196 amount is \$100,000 less than the \$109,373,196 amount from PSE’s Petition at 15, ¶ 32. This change causes slight, corresponding changes to Staff’s figures in Mr. Keating’s Exhibit No. EJK-3. An updated version of that exhibit as Attachment A to this brief.

¹² PSE Petition at 2, ¶ 4.



11

As the Commission can see from the above chart:¹³

- All parties agree PSE is entitled to the net book value of the JPUD assets (\$46,686,436) plus appropriate transaction costs (bottom section).
- Staff has an issue with the calculation of the transaction costs (bottom section, \$2,404,643 versus \$2,722,448).
- Staff, Public Counsel and ICNU propose that PSE also receive an increment above net book value and transaction costs (Staff: \$7,481,394; Public Counsel: \$2,993,216; ICNU: \$2,992,558)
- Staff, Public Counsel and ICNU propose that ratepayers receive the rest of the proceeds, while PSE wants to keep the rest of the proceeds, except for

¹³ This chart contains updated information to reflect the \$100,000 decrease in total proceeds identified by PSE in its rebuttal case. Also, please note that Public Counsel did not distinguish between “accumulated depreciation” and other proceeds amounts going to customers.

\$14,966,078, which PSE proposes to allocate to ratepayers as a “voluntary sharing of the proceeds of this sale.”¹⁴

12 For the reasons stated in this brief, of the total sales proceeds of \$109,273,196, the Commission should accept Staff’s recommendation, and allocate to ratepayers \$52,700,723 and to PSE \$56,572,473 (*i.e.*, the sum of the net book value (\$46,686,436), provable transaction costs (\$2,404,643) and the incentive amount (\$7,481,394)).

IV. ARGUMENT

A. The Public Interest Standard Applies to the Commission’s Disposition of the Proceeds on the Sale of PSE’s Property to JPUD

13 The Legislature provided the Commission broad authority to “regulate in the public interest, as provided in the public service laws, the rates, service, facilities and practices” of electrical utilities such as PSE. RCW 80.01.040(3). More specifically, the Commission has authority to regulate the reasonableness of PSE’s practices and accounts. RCW 80.28.040 & RCW 80.04.090, respectively. This case arises on a petition by PSE seeking Commission approval of accounting treatment of the proceeds from the JPUD sale. Accordingly, the “public interest” standard applies.

14 Under the public interest standard, the Commission applies the risk/reward principle, even in cases outside the context of the transfer of property statute, RCW 80.12. For example, in Docket UE-070725,¹⁵ at issue was the revenue PSE received from selling Renewable Energy Credits (RECs). The Commission did not decide that case under RCW 80.12, but it did apply the risk/reward principle.¹⁶

¹⁴ PSE Petition at 18, ¶ 37.

¹⁵ *Amended Petition of Puget Sound Energy, Inc. for an Order Authorizing the Use of the Proceeds From the Sale of Renewable Energy Credits and Carbon Financial Instruments*, Docket UE-070725, Order 03, Final Order, 282 Pub. Util. Rep. (PUR) 4th 303 (2010) (*PSE REC Case*).

¹⁶ *Id.* 282 Pub. Util. Rep. (PUR) 4th at 311-13.

15 Notably, in that case, PSE took the position that the Commission should apply the “public interest” standard and the risk/reward principle:¹⁷

The Commission has broad general powers to “[r]egulate in the public interest, as provided by the public service laws, the rates, services, facilities, and practices of all persons engaging within this state in the business of supplying any utility service or commodity to the public for compensation.”¹⁸ ... [W]hen determining the public interest, the Commission equitably balances the interests of ratepayers and shareholders in view of particular circumstances, relying on the broad general principle that “reward should follow risk and benefit should follow burden.”¹⁹

16 The same applies here. Like the *PSE REC Case*, even though this case does not involve RCW 80.12,²⁰ the Commission still is empowered to protect ratepayer interests in the proceeds of that sale by applying the public interest standard and the risk/reward principle.

B. The Commission Previously Has Provided Ratepayers a Share of Proceeds on Sales of Parts of a Utility’s System. *City of Redding II* Does Not State the “General Rule” and it is Not Otherwise Persuasive Authority Here

17 The Commission previously has provided ratepayers a share of the gain on sale of a part of a utility’s system. In Docket UW-031284, involving American Water Resources (American Water), the Commission allocated a share of the gain on the sale of parts of American Water’s water system to a water district and a water and sewer district.²¹ The Commission stated: “the

¹⁷ Exh. No. MRM-10X, Brief of Puget Sound Energy, *PSE REC Case*, Docket UE-070725 at 3, ¶ 6 (the footnotes in the block quote are from PSE’s brief).

¹⁸ RCW 80.01.040(3).

¹⁹ *Application of Avista Corp. for Authority to Sell its Interest in the Coal-Fired Centralia Power Plant*, Docket No. UE-991255, *et al.*, Second Supplemental Order (March 6, 2000) ¶ 84; *Utilities & Transp. Comm’n v. Am. Water Res., Inc.*, Docket No. UW-031284, *et al.*, Order 8 (Nov. 1, 2004) ¶ 60.

²⁰ *See, Petition of Puget Sound Energy, Inc., for a Declaratory Order Regarding the Transfer of Assets to Jefferson County Public Utility District*, Docket U-101217, Final Order Approving and Adopting Settlement Agreement; Granting Petition of Declaratory Judgment (February 1, 2011) at 17, ¶ 42, Conclusion of Law 5. The Commission reasoned that RCW 80.12.020 exempts transfers of property from a Commission-regulated electric company to a “special purpose district as defined in 36.96.010,” and JPUD meets the definition of “special purpose district.” *Id.* at 13, ¶ 23 and at 17, ¶ 40, Conclusion of Law 3.

²¹ *Utilities & Transp. Comm’n v. Am. Water Res.* Docket UW-031284, *et al.*, Order 08, Final Order Dismissing Complaint Against Rates in Part, Ordering Refund of “Docket Account” Set Aside, and Denying Application for Mitigation of Penalties (November 1, 2004)

allocation between shareholders and ratepayers of the gain on sale of in-service utility assets rests essentially on equitable considerations.”²²

18 PSE relies on a decision by the California Public Utilities Commission in *City of Redding II*, for what PSE calls the “rule generally applied” to the allocation of proceeds from the sale of a distribution system by an investor-owned utility to a public entity. According to PSE, this “general rule” is that shareholders receive the gain or loss on sale of part of a utility’s system, so long as remaining customers are not harmed, and they have not contributed capital to the distribution system.²³

19 Obviously, that is not the rule applied in this state, as the *American Water* case attests, but there are many other reasons why the Commission should not consider *City of Redding II* as persuasive precedent. A primary reason is that the California commission based its decision on the notion that shareholders “have assumed the general financial risk of making the investment. Because they have assumed the risk, they should be assigned the rewards,” absent any adverse effect of the sale on customers, or capital contribution by customers.²⁴ As we explain in detail in a later section of this brief, PSE’s shareholders did not bear the risk of ownership related to the assets PSE sold to JPUD. We address many of the other reasons in this section.

²² *Id.*, Order 8, at 22, ¶ 60. PSE fails to acknowledge this precedent in its Petition, though PSE is aware of the *American Water* case; PSE acknowledged that case and quoted the above language from that case in its brief in the *PSE REC Case*, *supra*, Docket UE-132027, 282 Pub. Util. Rep. (PUR) 4th 303 (2010). Exh. No. MRM-10X, *PSE REC Case*, Docket UE-070725, Brief of Puget Sound Energy, Inc. at 12, footnote 45.

²³ PSE Petition at 16, ¶ 35, quoting *City of Redding II*, *supra*, 104 Pub. Util. Rep. (PUR) 4th at 168.

²⁴ *City of Redding II*, *supra*, 104 Pub. Util. Rep. (PUR) 4th at 165.

20 First off, PSE is simply wrong to characterize *City of Redding II* as enunciating a
“general rule,” because in *City of Redding II*, the California PUC itself found that treatment in
other jurisdictions was “not consistent.”²⁵

21 Second, commissions other than Washington allocate to customers the gain on sale when
a regulated utility sells part of its system to a governmental entity. For example, the Wyoming
Public Service Commission gave customers the gain on sale when PacifiCorp sold its electric
distribution system in Cody, Wyoming to the City of Cody.²⁶ These facilities were “in the rate
base and were ‘used and useful’ to Pacific Power’s system and had been paid for by the
ratepayers.”²⁷ The same was true of PSE’s Jefferson County assets.

22 Notably, in the same case, the Wyoming commission gave PacifiCorp the gain on the sale
of transmission facilities to the City of Powell, because unlike the City of Cody, the City of
Powell had paid under a wholesale tariff designed to cover the specific costs of the system
PacifiCorp provided to serve the City of Powell. No such situation applies to PSE and Jefferson
County; PSE charged its Jefferson County customers rates based on total system costs, not
Jefferson County-specific costs. As Staff testified: “... Jefferson County was not a stand-alone
system for ratemaking purposes.”²⁸

23 The Oregon Public Utility Commission, in approving PacifiCorp’s sale of its distribution
system in the City of Hermiston to that city, accepted its Staff recommendation that customers
receive 95 percent of the gain.²⁹

²⁵ *City of Redding II*, *supra*, 104 Pub. Util. Rep. (PUR) 4th at 165.

²⁶ *Application of PacifiCorp*, 68 Pub. Util. Rep. (PUR) 4th 573, 485-86 (Wyo. PSC 1985).

²⁷ *Id.* 68 Pub. Util. Rep. (PUR) 4th at 485.

²⁸ Keating Direct, Exh. No. EJK-1T at 10:14-15.

²⁹ *Application of PacifiCorp*, Docket UP-187, 2001 WL 1335742 (Or. PUC Sept. 26, 2001). The Oregon
commission staff’s recommendation for 95 percent of the gain to ratepayers is at 2001 WL 1335742 at *24. The
Oregon’s acceptance of that recommendation is at 2001 WL 1335742, at *1-2.

24

In its Petition, PSE cites a decision from the Maine Supreme Court, *Maine Water Company v. Public Utilities Commission*.³⁰ In that case, Maine Water Company sold two of its seven divisions to water districts, named “Newport” and “Wilton.” 482 A.2d at 443. In providing the gain on sale solely to shareholders, the court reasoned that remaining customers could have no claim to the gain, because they did not pay rates to cover depreciation or maintenance on the Newport or Wilton service areas:

Maine Water’s present customers have never paid any rates that have reflected any depreciation expense on the water systems in Newport and Wilton. Over the years, the rates of each of those transferred divisions have been separately set to cover its individual cost of service, including the particular depreciation expense associated with its particular assets.

482 A.2d at 449.

25

Unlike the situation in Maine, PSE customers paid rates covering PSE’s costs of the entire system; the Commission has not set rates for Jefferson County separate and apart from the rest of PSE’s service territory. As PSE put it:

The Company’s rates are uniform throughout its service area. As such all customers share in the recovery of PSE’s overall depreciation expense. The amount paid by any given customer or group of customers is not tied to specific assets used to provide service within any particular city or county within PSE’s service area.³¹

26

Logical application of this decision would be to evaluate whether a sale of assets involves a separate system with a separate set of tariff rates for service to customers served by that system. If so, then the remaining customers served by other systems under common corporate ownership are not entitled to the proceeds of the sale. The facts in this case do not support the application of the Maine decision.

³⁰ 482 A.2d 443 (Maine 1984); PSE Petition at 18, footnote 4.

³¹ PSE: Piliaris Direct, Exh. No. JAP-1T at 9:14-17; *Accord*: ICNU: Gorman Direct, Exh. No. MPG-1T at 4:21-23: “it is appropriate to conclude that PSE recovered the JPUD costs from system-wide cost recovery and not only from JPUD customers.” Staff: Keating Direct, Exh. No. EJK-1T at 9:17-18: “The Commission sets rates on a system-wide basis rather than by individual sections of PSE’s service territory.” and at 10:14-15: “... Jefferson County was not a stand-alone system for ratemaking purposes.”

27 In short, the *City of Redding II* case does not dictate the result here. For the above reasons, and all of the other reasons stated in this brief, the Commission is on firm legal ground in granting PSE customers a substantial share of the proceeds of the sale of PSE’s Jefferson County distribution system.

C. The Gain on Sale of PSE’s Jefferson County Distribution System Belongs to Remaining PSE Customers

28 PSE applied the “regulatory compact” to address the key issues in this case.³² Accordingly, Staff uses the regulatory compact as a framework for its analysis in this brief, to demonstrate how proper application of that compact confirms Staff’s recommendation.³³ By contrast, PSE misinterprets and misapplies the regulatory compact.

29 The regulatory compact inheres in the manner in which investor-owned electric utilities are regulated in this country in general, and regulated by the Commission in particular. Like almost every other regulatory commission, the Commission regulates PSE based on the value of its property the Company devotes to public service. Pursuant to the Commission’s valuation statute, RCW 80.04.250, the Commission values PSE’s utility property (rate base) at its original cost less accumulated depreciation, otherwise referred to as “net book value.”

30 As a result, the Commission provides PSE the opportunity to earn a fair return *on and of* rate base, no more and no less. In this case, giving PSE investors back the net book value of their investment is all the regulatory compact requires.

31 Under the regulatory compact, PSE customers are called upon to pay rates that are sufficient to allow the Company to operate successfully, attract capital on reasonable terms and an opportunity to earn a fair return on the property it dedicates to public use. As concluded by

³² *E.g.*, Levin Rebuttal, Exhibit No. SLL-1T.

³³ In effect, Staff witness Mr. Keating’s discussion in Exh. No. EJK-1T regarding Rate Base Rate of Return Regulation is a discussion of the regulatory compact (though he did not use that term).

the federal Circuit Court of Appeals in *Democratic Central Committee v. Washington Metropolitan Transit Area Authority Commission*, 485 F.2d 786, 806 (D.C. Cir. 1973) (*Democratic Central Committee*): "... practice in the utility field has long imposed upon consumers substantial risks of loss and financial burden associated with assets employed in the utility business."

32 We explain more fully below how the regulatory practices in this state more than justify application of the court's conclusion here. Accordingly, PSE customers are entitled to the gain on sale of PSE's Jefferson County distribution system, not shareholders.

33 Put another way, while PSE agrees that "risk should follow reward" and that those who bear the "risk of ownership" are entitled to the gain,³⁴ PSE is simply wrong that shareholders bear that risk. Rather, it is customers who bear that risk and therefore, it is customers who are entitled to the gain on sale.

1. The Regulatory Compact

34 The regulatory compact is described in two landmark decisions by the United States Supreme Court: *Federal Power Commission v. Hope Natural Gas Co.*³⁵ (*Hope*) and *Bluefield Water Works & Improvement Co. v. Public Service Commission*³⁶ (*Bluefield*).

35 In *Bluefield*, the Court recognized that a public utility was not like a competitive venture, and should not be regulated as such. This is consistent with PSE's testimony that "PSE is not a competitive business ... It is a regulated monopoly."³⁷ The *Bluefield* Court also observed that a public utility is entitled to reasonable treatment of its capital, to the end that the utility could be creditworthy and could properly discharge its public duties:

³⁴ Levin Rebuttal, Exh. No. SLL-1T at 14-20.

³⁵ 320 U.S. 591 (1944).

³⁶ 262 U.S. 679 (1923).

³⁷ Marcellia, TR. 102:22 to 103:1.

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding, risks and uncertainties, but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.³⁸

36 Later, in *Hope*, the Court emphasized that regulation needed to “enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate investors for the risks assumed”³⁹

37 Between the Court’s decisions in *Bluefield* (1923) and *Hope* (1944), there was considerable debate about how a regulatory agency lawfully could value the rate base for ratemaking purposes. However, in *Hope*, the Court “cleared the air” by expressly approving original cost less depreciation (*i.e.*, net book value) as an appropriate valuation method for utility property devoted to public use: “By such a procedure [valuing rate base at net book value] the utility is made whole and the integrity of its investment is maintained.”⁴⁰

38 Accordingly, the standard form of regulation in this country is based on valuing utility property on the basis of net book value. As Mr. Goodman describes in his treatise, utility regulation based on the net book value of utility property is used by the Federal Energy Regulatory Commission (and its predecessor, the Federal Power Commission), and all but a “handful of states.” Leonard Saul Goodman, *The Process of Ratemaking* (1998) at 777-782.

³⁸ *Bluefield*, 262 U.S. at 692. The Washington Supreme Court noted its approval of this language as early as 1943, in *Pacific Telephone & Telegraph Co. v. Department of Public Service*, 19 Wn.2d 200, 266, 142 P.2d 498 (1943), and later in *People’s Organization for Washington Energy Resources v. Utilities & Transportation Commission*, 104 Wn.2d 798, 813, 711 P.2d 319 (1985) (*POWER*).

³⁹ *Hope*, 320 U.S. at 605. The Washington Supreme Court noted its approval of this language in *POWER*, *supra* footnote 38, 104 Wn.2d at 811.

⁴⁰ *Hope*, 320 U.S. at 606.

Simply put, net book value is the bedrock of shareholder expectations regarding treatment of the capital they invest in utility property.

39 The federal Circuit Court of Appeals in *Democratic Central Committee* identified one important consequence of this long-standing form of regulation based on net book value of utility property: “it is now clear that the utility is not entitled to have its rate base established at the value which the assets would command on the current market, although that market value exceeds original cost. This can mean only that the investors’ legally protected interest in such assets does not inexorably extend to the increment in value.”⁴¹

a. Consistent with *Hope* and the Regulatory Compact, the Commission Consistently Has Regulated PSE Based on the Net Book Value of its Utility Property

40 Like the vast majority of jurisdictions in this country, the Commission consistently has valued utility property based on net book value, including PSE. In fact, for PSE, the Commission used this method from the very beginning.

41 Cause U-9150 was “the first general rate increase which has been requested by Puget,” and the Commission used net book value as the measure of PSE’s rate base in that case.⁴² It is important to recognize that in its decision, the Commission noted: “Initially, the company had asked the commission to consider reproduction cost new or trended original cost as a basis for determining value. However, as the case progressed, the company withdrew from this position and accepted net original cost as the basis for calculating its rate base.”⁴³ *Id.* The Company’s acceptance of Commission valuation of its assets based on net book value has been long-lasting;

⁴¹ *Democratic Central Committee, supra*, 485 F.2d at 805.

⁴² *Wash. Pub. Service Comm’n v. Puget Sound Power & Light Co.*, Cause U-9150, 33 Pub. Util. Rep. (PUR) 3rd 113, 118 (1960).

⁴³ A table in the Commission’s decision (33 Pub. Util. Rep. (PUR) 3rd at 120) shows the calculation of the rate base using historical cost and subtracting accumulated depreciation.

we searched for each reported PSE general rate case order since 1960, and we found none that used a method other than net book value.

42 Based on this long regulatory tradition, it is apparent that PSE’s investors have provided the capital necessary for the Company to deliver service, expecting that the Commission would value the utility property based on the net book value, no more and no less.

b. Shareholders are Not Harmed if They Receive the Net Book Value of the Utility Property They Devoted to Serve Jefferson County Customers

43 Based on the tradition just described in which this Commission has consistently valued PSE’s utility property based on net book value, it is necessary and appropriate to value PSE’s shareholder interest in the sale of property sold to JPUD using the same measure: Shareholders’ expectation is that in the event of the sale of any asset, including a forced sale under the threat of condemnation, the Commission would honor the regulatory compact and would ensure that the invested capital on PSE’s books, as measured by net book value, would be returned.

44 As ICNU’s witness testified: “By recovering the net book value of the assets, as well as transaction costs, and reinvesting this capital in new assets, PSE bears little risk associated with the JPUD sale and will not be worse off as a result of the sale.”⁴⁴

45 This point was firmly cemented by the court in *Democratic Central Committee*: “Ratepayers bear the expense of depreciation, including obsolescence and depletion, on operation utility assets through expense allowances to the utilities they patronize. It is well settled that utility investors are entitled to recoup from customers the full amount of their investment in depreciable assets devoted to public service...”⁴⁵

⁴⁴ Gorman Direct, Exh. No. MPG-1T at 2:5-8.

⁴⁵ *Democratic Central Committee, supra*, 485 F.2d at 808 (footnotes omitted).

46 Simply put, shareholders have no reasonable expectation of receiving any more for their investment than net book value. Staff proposes to provide that compensation to the Company. Any more is excessive compensation, absent a substantial policy reason, such as providing an incentive or reward for negotiating a favorable price, as Staff has proposed.

c. PSE’s Customers Have Compensated PSE’s Shareholders for the Risks they have Undertaken; PSE Shareholders were Keenly Aware of the Specific Risks Associated with the JPUD Sale

47 Under the regulatory compact, shareholders are entitled to a return that “compensate[s] investors for the risks assumed” *Hope*, 320 U.S. at 605. As Staff explained:

[Rate Base Rate of Return Regulation] provide[s] a company the *opportunity* to earn a fair rate of “return on” its assets used to provide service. The Commission does this by determining an appropriate level of shareholder compensation through a rate of return applied to the [net book value] of utility assets, or rate base. Any risk associated with ownership of utility assets (such as future income) is included in the return on equity component of the overall cost of capital.⁴⁶

ICNU’s witness testified similarly:

The return on equity reflects the level of compensation the market demands for assuming the level of risk in PSE. Thus, that return would include the known and long-standing risk that a public utility district such as JPUD may condemn a portion of PSE’s territory. ... As such, to the extent customers pay rates which provide the utility an opportunity to earn a fair rate of return, PSE is fairly rewarded its investment risk.⁴⁷

48 As PSE conceded, “information found is considered [by investors] in determining a stock price.”⁴⁸ There is no doubt that PSE shareholders were fully informed of the specific facts and risks associated with the JPUD sale, including the risk that customers could receive a substantial amount of the proceeds in the event of a sale under threat of condemnation.

49 For example, in 2008, during the time period leading up to the vote on public purchase of PSE’s Jefferson County distribution system, PSE shareholders were clearly on notice of the

⁴⁶ Keating Direct, Exh. No. EJK-1T at 15-21.

⁴⁷ Gorman Direct, Exh. No. MPG-1T at 9:10-12 and at 9:17-29.

⁴⁸ Bellemare, TR. 164:9-11.

potential for a public takeover in Jefferson County, due to the considerable media coverage and “vigorous debate” on the issue.⁴⁹ More specifically, PSE’s current shareholders, led by the Macquarie group, were attempting to buy PSE at that same time, and they were well aware of these ballot measures.⁵⁰

50 After the Macquarie group bought PSE in late 2008, it became crystal clear that PSE shareholders knew the magnitude of what was at risk. In PSE’s petition in Docket U-101217, filed in July 2010, PSE sought “to determine that the Commission is satisfied that PSE’s customers are not entitled to claim proceeds ... in an amount *in excess of* \$103 million.”⁵¹ This is cogent evidence PSE shareholders knew customers might well be entitled to much more than the small amount PSE offers in this case, *i.e.*, only to a “voluntary [share] of the proceeds” PSE now offers.⁵²

51 PSE Shareholders were certainly aware of the legal system in this state, which PSE suggests makes the Company “more risky” because it permits a PUD to condemn an investor-owned utility’s property.⁵³ Shareholders were also aware of PSE’s disclosure in its SEC Form 10-K regarding the risk of “loss of significant customers” and “condemnation of PSE’s facilities as a result of municipalization.”⁵⁴

52 The bottom line is that shareholders were fully aware of the risks PSE faced specific to the JPUD sale, as they should have been. During this time frame, PSE had a general rate case, Dockets UE-111048 & UG-111049. In its Final Order in those dockets, the Commission

⁴⁹ Osborne, TR. 51:21-22 & TR 52:2-3; Exh. Nos. SSO-11CX & 12CX (news articles).

⁵⁰ Osborne, TR. 19-25.

⁵¹ Osborne, Exh. No. SSO-10CX at 6, n. 7 (emphasis in the original). Mr. Osborne confirmed this. TR. 63:19 to 65:8.

⁵² PSE Petition at 18, ¶ 37.

⁵³ Levin, TR. 140:14-20.

⁵⁴ Keating Direct, Exh. No. EJK-1T, quoting PSE’s Annual Report (Form 10-K at 5 (December 31, 2012)).

described in detail the cost of capital presentations of each party, including PSE.⁵⁵ There is no mention of PSE advocating that the return on equity needed to be any higher to reflect the foregoing risks of the JPUD sale.

d. Shareholders are Not Entitled to Additional Compensation for the Loss of a Revenue Stream from Jefferson County Customers

53 PSE argues that because it has permanently lost the revenues from its (former) Jefferson County customers, shareholders are entitled to the gain on sale as compensation.⁵⁶ PSE's argument lacks both factual and legal support.

54 PSE's argument lacks factual support in two ways. First, as we just explained, PSE's shareholders have been compensated for this risk.

55 Second, PSE ignores the fact that it can reinvest the sale proceeds (*i.e.*, the cash representing the net book value of the assets sold) in the utility business. In fact, PSE intends to do just that.⁵⁷ Reinvesting this money into the business restores the "lost" revenue stream. Alternatively, PSE could return the money to its shareholders, and they could invest the money in an investment of their choosing, and enjoy the benefits of that investment.⁵⁸ As Staff concluded: "Both of these are acceptable outcomes that mitigate PSE's perceived risk of losing future revenue. Shareholders are still afforded an opportunity to earn future revenue."⁵⁹

56 It is wrong to assume, as PSE implicitly does, that PSE's share of proceeds under Staff's proposal has no value to shareholders other than when it was invested in PSE's Jefferson County distribution system. In fact, PSE *currently* is enjoying the benefits of the over \$109 million in JPUD sales proceeds the Company received from JPUD. As PSE explained, that cash has "gone

⁵⁵ *Utilities & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049, Order 08, 297 Pub. Util. Rep. (PUR) 4th 1, 21-27 (2012).

⁵⁶ *E.g.*, Marcella Direct, Exh. No. MRM-1T at 7:11 to 9:9.

⁵⁷ PSE Petition at 20, ¶ 42.

⁵⁸ Keating Direct, Exh. No. EJK-1T at 17:5-9.

⁵⁹ Keating Direct, Exh. No. EJK-1T at 17:9-11.

through the whole cash management process and it's been used.”⁶⁰ PSE has not accounted for that substantial shareholder benefit either in its analysis or in its proposed allocation of proceeds.

57 PSE's argument lacks legal support because it rests on the proposition that shareholders are entitled to a guaranteed revenue stream in the first place, allegedly upwards of \$75.7 million.⁶¹ Staff has found no legal authority to support that proposition. As Staff testified: “Rate Base Rate of Return Regulation does not guarantee future income on assets that are no longer used to provide service.”⁶² Moreover, “[a]ny risk associated with ownership of utility assets (such as future income) is included in the return on equity component of the overall cost of capital,” and therefore, shareholders are compensated for this risk.⁶³ Because of this, “[t]he return on equity authorized by the Commission and earned on the Jefferson County assets has compensated investors for the risk of condemnation and any lost revenue that may result.”⁶⁴

58 The Commission should reject the Company's argument because it falsely assumes that shareholders are guaranteed that revenue stream. As we have just demonstrated, the regulatory compact only provides PSE an opportunity to earn a return on and of its invested capital, as valued by the Commission. It is simply false to assume that once the rate base is returned to shareholders they continue to be harmed by a lost revenue stream.

i. In Any Event, PSE's Calculation of Lost Earnings is Based on a Flawed Assumption

59 PSE's claim of a \$75.7 million harm is flawed for other reasons, as well.

⁶⁰ Marcelia, TR. 115:19-21.

⁶¹ Bellemare Rebuttal, Exh. No. RCB-1T at 7-10.

⁶² Keating Direct, Exh. No. EJK-1T at 11:14-15.

⁶³ Keating Direct, Exh. No. EJK-1T at 19-22.

⁶⁴ Keating Direct, Exh. No. EJK-1T at 18:18-20.

60 For example, PSE’s earnings analysis applies a robust, four percent earnings growth rate,⁶⁵ yet the facts show that rate either should be negative or minuscule, because, as the Company conceded, “[t]he high cost of serving Jefferson County in relation to the number of customers in the service territory limits its revenue potential,” and furthermore, “[t]here is no expectation of any significant load growth in the [Jefferson County] service territory in the foreseeable future.”⁶⁶ This testimony refutes the growth rate assumed in PSE’s lost earnings analysis.

2. A Risk/Reward Analysis Confirms Customers are Entitled to the Gain on the JPUD Sale

61 Each party to this docket conducted a “risk/reward” analysis to support their proposals to the Commission. In PSE’s analysis, the Company makes a distinction between the “risk of doing business” and the “risk associated with ownership of the assets.”⁶⁷ According to PSE: “Customers have not borne the risk of owning the assets; therefore, they have no claim to the proceeds.”⁶⁸

62 In fact, PSE’s customers bear substantial risks associated with PSE’s ownership of those assets, as PSE correctly acknowledged in the *Centralia Case*, and as confirmed by long-standing regulatory practices in this state.

⁶⁵ Bellemare Rebuttal, Exh. No. RCB-1T at 8:5-12.

⁶⁶ Osborne, Exh. No. SS0-5 (Direct Testimony of Mr. Karzmar, adopted by Mr. Osborne) at 16:12-15.

⁶⁷ Levin Direct, Exh. No. SLL-1T at 9:16-19/

⁶⁸ Levin Rebuttal, Exh. No. SLL-1T at 11:19-20. Although Dr. Levin’s prepared testimony here is unequivocal that risk of owning assets determines who gets the gain on the sale of those assets, he testified at hearing that “it’s hard to generalize,” and “there are always possible other issues” that “might have an effect on who was going to cover the loss or who was ... going to share in the gain.”

a. PSE Customers Bear Risks Associated With Utility Asset Ownership, as PSE Testified in the *Centralia Case*

63 PSE insists customers bear no ownership risk at all, because “only the cost” passes to customers.⁶⁹ Semantics aside, what PSE now is telling the Commission directly contradicts what PSE told the Commission in the *Centralia Case*. In fact, when PSE wanted the Commission to approve the Company’s proposed sale of its share of the Centralia coal plant, the Company convincingly argued that customers bore risks associated with PSE’s continued ownership of that plant.

64 For example, PSE’s witness in that case, Mr. Gaines, warned about the need to install “expensive new environmental controls on the plant, including scrubbers,” and that “[a]bsent a sale, these costs *and liabilities* likely would fall on PSE’s customers.”⁷⁰ He also testified that “[t]he risks [of early closure of the plant] are significant; selling the facility eliminates those risks for customers,”⁷¹ and that “the proposed sale greatly reduces risks for customers.”⁷²

65 PSE’s brief to the Commission in the *Centralia Case* strongly urged the Commission to accept the fact that customers bore the risk of ownership. For example, PSE argued that the sale of the plant would place the risk of “potentially enormous environmental costs” and the cost of extending the plant’s life “on the new owners, instead of [PSE] customers....”⁷³ PSE concluded that keeping the plant would “*force customers to continue bearing the risks of ownership of the Centralia facilities.*”⁷⁴

66 It is hard to imagine a more explicit Company concession that ownership risks are borne by PSE customers.

⁶⁹ Marcelia Rebuttal, Exh. No. MRM-5T at 29:3.

⁷⁰ Marcelia, Exh. No. MRM-8X at 3:2-4 (emphasis added).

⁷¹ Marcelia, Exh. No. MRM-7X at 1:22-23.

⁷² *Id.* at 7:22.

⁷³ Marcelia, Exh. No. MRM-9CX at 1:9-24, Puget Sound Energy’s Post Hearing Brief, *Centralia Case*, Docket UE-991409, *et al.*, (January 28, 2000).

⁷⁴ *Id.* at 1:19-20 (emphasis added).

b. Experience in this State Proves the Pervasive Shift of Ownership Risk to PSE Customers

67 In this case, PSE defines “ownership risk” in a particular way, but the result is the same: customers bear ownership risk as PSE uses that term. As PSE explained in its prepared testimony, “the risk of ownership associated with assets” means: “The value of the assets may change in unforeseen ways. This might be due to market conditions, including technology. This risk of ownership falls on investors, and any gain or loss accrues to them.”⁷⁵

68 There is no legal or factual basis for this testimony. First, the court in *Democratic Central Committee* concluded the exact opposite of what PSE now claims: “practice in the utility field has long imposed on consumers substantial risks of loss and financial burden associated with the assets employed in the utility’s business.”⁷⁶

69 Second, as we just explained, PSE’s position in this case contradicts its position in the *Centralia Case*, where the foundation of PSE’s presentation was that customers bore ownership risk.

70 Third, PSE’s current position is refuted by the nature of regulation in this state. Below we offer a series of specific examples, each of which prove why, in this state, customers bear the risk of ownership as PSE defines that risk, *i.e.*, the risk of asset value change. The primary example is the \$709 million of regulatory assets currently on PSE books, but there are several other examples.

Example 1: \$709 Million in Regulatory Assets

71 PSE has \$709,000,000 in regulatory assets on its books.⁷⁷ “Regulatory asset” is the term

⁷⁵ Levin Rebuttal, Exh. No. SLL-1T at 11:14-16.

⁷⁶ *Democratic Central Committee*, *supra*, 485 F.2d at 806.

⁷⁷ Marcelia, TR. 109:1-3.

given to a cost that would have to be expensed, or an expenditure for an asset that is impaired,⁷⁸ but the item instead is capitalized because the regulator has determined that the expenditures will be recovered from ratepayers.

72 The accounting rules for regulatory assets⁷⁹ make it crystal clear that it is only because customers are responsible to cover the cost that PSE may recognize that asset on its financial statements. The accounting rules (ASC 980-340-25) state in pertinent part (bold emphasis in the original):⁸⁰

➤ Effects of Regulation

➤ Recognition of Regulatory Assets

An entity shall **capitalize** all or part of an **incurred cost** that would otherwise be charged to expense that would be charged if both of the following criteria are met:

- a. It is probable ... that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in **allowable costs** for rate-making purposes.
- b. Based on the available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. ...

73 Only regulated companies like PSE may enjoy this benefit; non-regulated businesses are not entitled to recognize regulatory assets on their books.⁸¹ PSE has enjoyed this benefit to the fullest. In fact, under this accounting standard as implemented in this state, PSE customers are responsible for \$709 million in deferred costs, including carrying costs. PSE bears little or no risk that it will not recover these costs, and therefore, PSE bears little or no risk that these assets may decline in value. Under PSE's definition of "ownership risk," *i.e.*, the risk of capital loss or

⁷⁸ "Impairment" arises from many factors that may affect the value of an asset: *e.g.* obsolescence, damage, technology, *etc.*

⁷⁹ The accounting rules for regulatory assets were previously covered under "FAS 71," published by the Financial Accounting Standards Board. It is now contained as ASC 980-340-25. "ASC" refers to the Accounting Standards Codification of the Financial Accounting Standards Board. *See* Marcellia, TR. 106:19 to 107:8.

⁸⁰ *Accounting Standards Codification*, ¶ 980-340-25 – *Recognition - General*, v. 4, page 2377 (Financial Accounting Standards Board (October 31, 2012)). A complete version of ASC 980-340-25 is attached as Attachment B to this brief.

⁸¹ Marcellia, TR. 107:9-12.

loss in the value of utility property, PSE's customers bear ownership risk; in this instance, to the tune of \$709 million in regulatory assets. Notably, the Jefferson County customers no longer can be called upon to pay even one penny of that amount; a harm no party addressed in their presentations in this case.

74 Put another way, if PSE is correct that shareholders truly bear the risk of ownership, then they can have no reasonable expectation of future recovery of any of the \$709 million in regulatory assets currently on PSE's books, and must bear any decline in the value of any of those assets. The Commission would be justified in reopening each of those deferral dockets, and reconsider the decision to place ownership risk on customers.

Example 2: Obsolete plant

75 Another way utility property may change in value is due to technological changes. Consistent with PSE's theory, if technology adversely affects the value of a utility asset before it is fully depreciated, the utility would absorb the loss and remove the obsolete property would be removed from rate base. However, that does not happen. Instead, customers bear this form of "ownership risk." As the court concluded in *Democratic Central Committee*: "The risk of loss from premature retirement of assets because of obsolescence, as a general rule, also falls on consumers."⁸²

76 The record provides the accounting basis for this general rule. As Public Counsel's witness testified, when obsolete property is retired before it is fully depreciated, the "cost of removal, salvage realized, as well as the net ... 'under' recovered original cost plant are all recorded within the Accumulated Depreciation Reserve Account."⁸³ "In sum, in the vast

⁸² *Democratic Central Committee, supra*, 485 F.2d at 807.

⁸³ Dittmer Direct, Exh. No. JRD-1T at 5:15-17. In the circumstance when plant is retired after it has been fully depreciated, the same accounting applies. *Id.*

majority of instances, customers effectively bear any losses and enjoy any implicit gains arising when plant is removed from utility service.”⁸⁴

77 As ICNU’s witness summarized: “asset cost recovery risk is transferred to customers in the event of early plant retirement ... PSE has failed to acknowledge that the ratemaking constructs, and accounting mechanisms, shift significant asset recovery risk to customer in these circumstances.”⁸⁵

78 In sum, as a regulated utility PSE transfers to customers the “risk of ownership” (*i.e.*, loss of asset value) due to obsolescence.

Example 3: Extraordinary Storm Damage Losses

79 The value of PSE’s assets can also change when a severe storm reduces the value of PSE’s distribution plant or other property by rendering that property unusable. Storm damage costs are among the \$709 million in regulatory assets on PSE’s books, and for which customers alone are responsible. PSE is allowed to defer all storm damage expenses above the \$8 million dollars of storm damage included in the normal rate setting process. This creates a regulatory asset that assures full recovery of that extraordinary amount.⁸⁶ PSE also capitalizes the cost associated with any assets that are installed as a result of a storm, which increases the rate base and thus, increases PSE’s dollar return on investment.⁸⁷

80 In other words, it is ratepayers who bear the risk of capital loss associated with extraordinary events such as severe storms and other similar extraordinary events.

⁸⁴ Dittmer Direct, Exh. No. JRD-1T at 6:17-19.

⁸⁵ Gorman Direct, Exh. No. MPG-1T at 7:14-18.

⁸⁶ Marcelia Rebuttal, Exh. No. MRM-5T at 23:1-6.

⁸⁷ *Id.* at 23:5-6.

Example 4: Abandoned Project Capital Losses

81 When a utility abandons a major project before it is completed, there is a total loss in the value of that property (after salvage). In these circumstances, the Commission has required customers to cover most of PSE's loss, enabling the Company to record a regulatory asset and recover those costs from ratepayers. Two examples are the Pebble Springs project and the Skagit/Hanford project.⁸⁸ For Pebble Springs, PSE recovered \$47.5 million from customers, over a 10-year period.⁸⁹ Customers paid an additional \$81.5 million for the Skagit/Hanford project, also over 10 years.⁹⁰ Neither project provided customers even a single kilowatt hour of electrical energy.⁹¹ Under PSE's theory in this case, if shareholders bore the risk of loss, investors should have absorbed these costs. They did not.

82 A more current example is PSE's request that customers bear the loss associated with the Company's proposed sale of the Electron Hydroelectric Project (Electron plant), in PSE Docket UE-131099. If PSE were consistent in its position that shareholders alone bear the "risk of ownership," *i.e.*, the risk of loss in the value of utility assets, then PSE would be advocating that shareholders absorb the loss on the sale of the Electron plant. Instead, PSE asked that customers be held responsible for the Company's \$11 million loss associated with its sale of that project,⁹² by asking customers to pay for that loss over a six-year period, plus a return on the unamortized

⁸⁸ *Utilities & Transp. Comm'n v. Puget Sound Power & Light Co.*, Cause U-82-38, 3rd Supplemental Order, 54 Pub. Util. Rep. (PUR) 4th 480, 494-97 (1983), *aff'd*, *People's Org. for Wash. Energy Res. v. Utilities & Transp. Comm'n*, 104 Wn.2d 798 711 P.2d 319 (1985).

⁸⁹ 104 Wn.2d at 803.

⁹⁰ *Utilities & Transp. Comm'n v. Puget Sound Power & Light Co.*, Cause U-83-54, 4th Supplemental Order, 62 Pub. Util. Rep. (PUR) 4th 557, 587 (1984).

⁹¹ The Commission explained its decisions in the Pebble Springs and Skagit/Hanford cases on the basis that customers needed to share responsibility for the loss to enable PSE to continue to finance its utility business on an ongoing basis. However, in a PacifiCorp rate order, the Commission required customers to pay for the cost of abandoned projects in the amount of \$715,579, without the need for PacifiCorp to demonstrate its inability to finance its operations. *Utilities & Transp. Comm'n v. Pacific Power & Light Co.*, Docket U-84-65, 4th Supplemental Order, 68 Pub. Util. Rep. (PUR) 4th 396, 404-05 (1984).

⁹² *Application of Puget Sound Energy, Inc. for an Order Authorizing the Sale of the Water Rights and Associated Assets of the Electron Hydroelectric Project*, Docket UE-131099, Order 02, Final Order (October 23, 2013) (*PSE Electron Case*).

balance.⁹³ The Commission approved PSE's application, provided there were no material changes to the terms of the asset purchase agreement for the Electron plant.⁹⁴

83 PSE attempted to counter the Electron example, first by stating that the Commission applied the "no harm" test that does not apply here, and then by arguing that customers did not bear the risk of a premature retirement of the Electron plant.⁹⁵ PSE is wrong on both counts. First, the Commission applied the "public interest" test, which is the test that applies here.⁹⁶ Moreover, as we explained earlier, customers most assuredly bear the risk of plant obsolescence. PSE's contrary position is simply flat wrong.

84 PSE goes on to suggest that the *PSE Electron Case* is different because no customers would be lost as a result of the sale of the Electron plant, and because "the risk of a condemnation proceeding cannot be passed along to the remaining customers as it is a risk of owning assets and is not a component of the cost of service regulatory model."⁹⁷

85 PSE is wrong again. First, as explained in Part IV.C.1.c above, PSE fully disclosed to shareholders the risk of condemnation in its SEC Form 10-K, and PSE shareholders were specifically aware of the risk of the JPUD condemnation through PSE's accounting petition in Docket U-101217, where PSE sought to mitigate the risk that customers might be entitled to more than \$103 million in this case. Shareholders were fully aware of the risks here.

86 Second, for all the reasons stated in this brief, the fact that PSE lost customers in the JPUD sale is a distinction that does not justify disparate treatment of the gain. As we summarized earlier, PSE agrees that "risk should follow reward" and that those who bear the

⁹³ PSE petition in Docket UE-131099, at 13, ¶47 and Keating Direct, Exh. No. ELK-1T at 16:15-18.

⁹⁴ *PSE Electron Case, supra*, Order 02, at 19, ¶ 63 (October 23, 2013).

⁹⁵ Marcelia Rebuttal, Exh. No. MRM-5T at 37:17 to 38:6.

⁹⁶ *PSE Electron Case, supra*, Order 02 at 9, ¶ 25 (October 23, 2013): "The Commission finds the sale of the Electron plant to Electron Hydro LLC is in the public interest provided there are no material changes to the Asset Purchase Agreement as filed." A word search of PSE's petition and the Commission's Order 2 in that docket disclosed no use of the term "no harm" or "harm."

⁹⁷ Marcelia Rebuttal, Exh. No. MRM-5T at 38:8-16.

“risk of ownership” are entitled to the gain.⁹⁸ PSE is simply wrong that shareholders bear ownership risk. It is customers who have borne the “ownership risk,” and it is customers who are entitled to the gain on sale.

Example 5: Environmental Remediation

87 When utility property requires environmental cleanup, the value of that capital asset is diminished significantly. Statutes such as the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)⁹⁹ and the State Model Toxic Control Act,¹⁰⁰ help assure environmentally damaged property is remediated, and thus its value is restored.¹⁰¹

88 PSE does not bear the risk of loss due to environmental damage; customers do. For example, in its order in Docket UE-911476,¹⁰² the Commission granted PSE’s request to defer such environmental cleanup costs related to PSE’s utility property, including the site of the Electron plant and PSE’s program for testing, removing and replacing PSE’s underground storage tanks.¹⁰³ According to the Commission’s order: “Unless the costs incurred by the Company in connection with its [environmental remediation program] are shown to be imprudent in subsequent rate proceedings, such costs would be recoverable in [PSE’s] retail rates.”¹⁰⁴

⁹⁸ Levin Rebuttal, Exh. No. SLL-1T at 14-20.

⁹⁹ 49 U.S.C. § 9601 *et. seq.*

¹⁰⁰ RCW 70.105D.

¹⁰¹ Obviously, property contaminated by a hazardous substance is worth substantially less than similar, non-contaminated property. Moreover, these statutes confirm that environmental damage to property reduces the value of that property. For example, in RCW 70.105D.055, the state may place a lien on property for remedial action costs it incurs. Obviously, the existence of such a lien further reduces the value of the property.

¹⁰² *Petition of Puget Sound Power & Light Company for an Order Regarding the Accounting Treatment for Costs of its Environmental Remediation Program*, Docket UE-911476, Order Authorizing Accounting Treatment (April 1, 1992).

¹⁰³ The order also allowed PSE to defer costs associated with property PSE did not own, but for which PSE was designated as a “potentially responsible party” under CERCLA. See Order Authorizing Accounting Treatment, Docket UE-911476, at 3, Finding of Fact 2 and at 4, Ordering ¶ 1.

¹⁰⁴ Order Authorizing Accounting Treatment, Docket UE-911476, *supra*, at 4, Finding of Fact 3.

89 This is simply another example where ratepayers were required to bear the risk of ownership, this time to pay, dollar for dollar, to restore the value of PSE's property that was impaired by environmental damage.

c. Conclusion: Customers Bear the Risk of Ownership Related to PSE's Utility Property, so They are Entitled to the Gain on the Sale of PSE's Jefferson County Distribution System

90 As the above examples and analysis demonstrate, time after time, PSE's customers have been asked to bear the risk of loss (or diminution in value) related to PSE's utility assets, and they have done so. From the amortization to rates of \$709 million in regulatory assets, including extraordinary adverse weather events and environmental cleanup, to paying higher rates through regulatory treatment of obsolete property, and for abandoned plants that never provided electricity, PSE customers (other than PSE's former Jefferson County customers) remain "on the hook." and shareholders' risk of capital loss is minimized.

91 PSE's contrary suggestion, that investors alone have borne the risk of loss of value in utility property, is simply not credible.

92 It is important to note that the primary proponent of PSE's theory in this case is Company witness Dr. Levin, who supported PSE's theory by testifying that when he was at the Illinois Commerce Commission, "we always gave all the proceeds to the – to the owners of the company."¹⁰⁵ But, that is not consistent with this Commission's precedent, including the *American Water Resources* case¹⁰⁶ and the six other Commission cases Staff cited¹⁰⁷ where the Commission gave all or substantially all of the gain on sale of utility assets to customers. Importantly, while Dr. Levin agreed he would advise investors to read that Commission precedent, he failed to do so himself:

¹⁰⁵ Levin, TR. 156:6-8.

¹⁰⁶ *Supra*, note 21.

¹⁰⁷ See Keating Direct, Exh. No. ELK-1T at 19:12 to 20:12.

Q: Wouldn't you [Dr. Levin] advise the potential investor to read those cases as precedent about how the Commission has allocated gains in the past?

A. Yes, I probably would. I don't know the circumstances in those cases ...¹⁰⁸

93 Washington is not Illinois. Legitimate shareholder expectations can differ, because the precedent and regulatory practices between the two jurisdictions apparently differ. As demonstrated above, this Commission's case precedent and accounting practices confirm PSE is wrong to contend that ratepayers bear no "ownership risk;" they emphatically do, and therefore, because customers have borne and continue to bear that risk, customers are entitled to the reward: the gain on the sale of the Jefferson County distribution system.

3. Giving Customers the Gain on Sale is Also Appropriate Because the Transaction Harms Customers

94 Even under PSE's theory in this case, PSE shareholders do not receive the gain on sale if there is harm to customers. As PSE explained: "Customers need to be compensated if there is customer harm."¹⁰⁹ The record contains ample proof of customer harm.

95 As Staff demonstrated, there are three ways in which PSE's sale to JPUD harms remaining customers: 1) the "immediate and substantial" harm in the amount of \$39 million over the first five years, caused by the reduction in contribution to fixed costs by former PSE customers;¹¹⁰ 2) Harm of \$1,142,941 annually through the end of 2017 due to the fact that the ERF did not take into account the impact of fewer customers;¹¹¹ and 3) Harm of \$8,356,230 annually through 2017, because the decoupling baseline was set at a higher level than if the

¹⁰⁸ Levin, TR. 155:12-18.

¹⁰⁹ Levin, TR. 132:1-2.

¹¹⁰ Keating Direct, Exh. No. EJK-1T at 25:23 to 28:17.

¹¹¹ Keating Direct, Exh. No. EJK-1T at 28:21 to 30:13, and Piliaris, Exh. No. JAP-3, page 2, "Scenario 2," column B, line 57.

JPUD sale had not been consummated.¹¹² As shown on Staff Exhibit No. EJK-6, the total harm to ratepayers is \$52,993,000. Public Counsel performed a similar analysis.¹¹³

96 There was no need for Staff to go beyond these calculations, because the evidence is clear that there is near term harm to customers due to the lost contribution of the former customers. The cost responsibility of PSE's former customers has been transferred to PSE's remaining customers, which includes not only the fixed costs of PSE's system, but also the plentiful deferred (regulatory) assets on PSE's books.

a. PSE's Contention that Jefferson County Ratepayers Paid their Cost of Service is Contradicted by the Fact that the Commission Sets Uniform Rates, and Jefferson County was a "High Cost" Area

97 PSE contends there can be no harm to remaining customers because its former Jefferson County ratepayers allegedly "covered their cost of service."¹¹⁴ This is not true because, as PSE admitted:

The Company's rates are uniform throughout its service area. As such, all customers share in the recovery of PSE's overall depreciation expense. The amount paid by any given customer or group of customers is not tied to specific assets used to provide service within any particular city or county within PSE's service area.¹¹⁵

98 This PSE admission is important. For example, as we discussed earlier, the Wyoming Public Service Commission distinguished between the sale of distribution plant that was part of the rate base and used to set general rates, versus transmission plant whose costs were assigned to and recovered from a specific ratepayer; the City of Powell. Because the distribution assets were "in the rate base and were 'used and useful' to Pacific Power's system and had been paid

¹¹² Keating Direct, Exh. No. EJK-1T at 30:14 to 31:19.

¹¹³ Dittmer Direct, Exh. No. JRD-1T at 29:16 to 30:6.

¹¹⁴ PSE Petition at 12, ¶ 24.

¹¹⁵ Piliaris Direct, Exh. No. JAP-1T at 2:7-8.

for by the ratepayers,”¹¹⁶ PacifiCorp’s remaining ratepayers were entitled to the gain, just as PSE’s remaining ratepayers are entitled to the gain on the JPUD property.

99 Conversely, the gain on sale of the PacifiCorp transmission assets went to shareholders, because the City of Powell paid under a wholesale tariff designed to cover the specific costs PacifiCorp incurred to serve Powell. That is not the situation here.

b. PSE’s Critique of Staff’s Harm to Customers Analysis Once Again Contradicts PSE’s Testimony in the *Centralia Case*

100 PSE chose to critique Staff’s “harm” analysis, primarily because Staff (as well as Public Counsel and ICNU) focused on the early years post-sale, rather than use the full 20 years of the Company’s forecast. PSE chose to call Staff’s decision to focus on the impact during the early years “arbitrary” and having “no basis in relevant regulatory precedent.”¹¹⁷ PSE then used the full 20 year forecast to claim a customer “benefit” of \$83 million (direct case) and \$102.6 million (rebuttal case).¹¹⁸

101 PSE chose the exact opposite approach in the *Centralia Case*, where PSE strongly urged the Commission to give little weight to long-term forecasts when considering whether to approve PSE’s sale of its share of the Centralia coal plant, arguing: “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.”¹¹⁹ In that case, PSE repeatedly characterized as “speculative” the “out years” of the sort of long term forecasts PSE now embraces *in toto*.¹²⁰

¹¹⁶ *Application of PacifiCorp, supra*, 68 Pub. Util. Rep. (PUR) 4th at 485.

¹¹⁷ Piliaris Rebuttal, Exh. No. JAP-9T at 14:4-5.

¹¹⁸ Piliaris, TR. 72:23 to 73:23.

¹¹⁹ Marcelia, Exh. No. MRM-9CX at 11:1-3, Puget Sound Energy’s Post-Hearing Brief, *Centralia Case*, Docket UE-991409, *et al.*

¹²⁰ *Id., e.g.*, at 11:7: “The out-year ‘benefits’ are based on highly speculative long term forecasts;” and at 11:18: “it makes little sense to use the speculative out-year benefits”

102 PSE was correct in the *Centralia Case*; the out years of a 20 year forecast are indeed speculative. Just as PSE was justified in focusing on the near term part of the forecast in the *Centralia Case*, Staff, Public Counsel and ICNU were justified in doing the same in this case.

103 It is also noteworthy (to say the least) that PSE is not proposing to create a regulatory liability representing the customer benefits PSE calculates, as a way of assuring customers the benefits PSE now assures the Commission will come to customers over the next 20 years.¹²¹

104 The Commission should disregard PSE's customer benefit analysis in this case as a non-credible, self-serving analysis that directly contradicts the approach the Company assured the Commission was the correct one in the *Centralia Case*. PSE was correct in the *Centralia Case* to limit the use of the forecasts out years in the analysis. PSE is wrong to spurn that approach now.

D. Allocation of Sales Proceeds Between Shareholders and Customers

105 As demonstrated above, a proper evaluation and application of the regulatory compact and risk/reward principle requires that PSE shareholders are entitled only to the net book value of the distribution assets PSE sold to JPUD (\$46,686,436), plus provable transaction costs. As we discuss below, the provable transaction costs are \$2,404,643. The Commission should also add an incentive payment to PSE of \$7,481,394.

106 In total, the Commission should adopt Staff's recommendation that PSE shareholders receive \$56,572,473 of the \$109,273,196 total proceeds, fully 52 percent of the total proceeds of sale; ratepayers should receive \$52,700,723.

¹²¹ Piliaris, TR. 73:24 to 74:3.

1. Proven Transaction Costs are \$2,404,643

107 The Company computed transaction costs of \$2,722,448.¹²² However, Staff discovered that \$317,805 of this amount “duplicated costs that are already included in rates from the ERF and [the] most recent PCORC.”¹²³ Accordingly, Staff removed that amount. On rebuttal, while PSE insisted there was no duplication,¹²⁴ the Company had the burden to prove that the labor costs actually contained in the PCORC and ERF cases contained no labor costs related to the JPUD sale. This the Company did not demonstrate. Therefore, the Commission should allow \$2,404,643 in transaction costs, and no more.

2. Using the Allocation Formula From the *Centralia Case*, Staff Ascribed to Ratepayers \$29,983,735, Which is Equal to the Accumulated Depreciation of the Sold Assets

108 Staff’s analysis in this case demonstrates that based on the regulatory compact and a risk/reward analysis, ratepayers are entitled to the sales proceeds in excess of \$56,572,473 (*i.e.*, total proceeds less (net book value + provable transaction costs)).

109 Nonetheless, Staff recognized that in the Commission’s order in the *Centralia Case*, the Commission, after allocating to shareholders an amount equal to net book value, allocated to ratepayers an amount equal to accumulated depreciation, and then addressed the remaining amount of proceeds, which the Commission termed “appreciation.”¹²⁵

110 Accordingly, Staff ascribed to ratepayers the accumulated depreciation amount of \$29,938,735.¹²⁶ As Staff explained: “Accumulated depreciation equals the sum of all prior years’ depreciation expense recovered through rates. Therefore, when the asset is sold, 100

¹²² Keating Direct, Exh. No. EJK-1T at 36:5-6.

¹²³ *Id.*, at 36:15-17.

¹²⁴ Marcelia, Rebuttal, Exh. No. MRM-5T at 36:1-14.

¹²⁵ Keating Direct, Exh. No. EJK-1T at 15-23.

¹²⁶ Keating, Exh. No. EJK-3, “Staff Proposal” column, fifth to last line: “Accum. Depreciation - \$29,938,735.”

percent of the accumulated depreciation should be returned to ratepayers...”¹²⁷ ICNU took the same approach.¹²⁸

111 The Company contends that ratepayers have not paid for all of PSE’s depreciation expense and therefore should not be allocated an amount equivalent to accumulated depreciation. The Company points to its 2013 SEC Form 10K, page 33, where PSE notes that actual depreciation expense exceeded the amount “allowed in rates” by \$36.4 million in 2013 and \$38.2 million in 2012. From this, PSE concludes that “customers have not paid for all of PSE’s depreciation expense or accumulated depreciation.”¹²⁹

112 PSE’s statement regarding its recovery of depreciation expense is inaccurate and the underlying analysis to calculate the alleged under-recovery of depreciation expense is flawed. The Company’s analysis presumes that there is a static, fixed amount authorized for recovery of depreciation expense. In fact, the Commission has never accepted any ratemaking methodology that specifically authorizes a fixed level of depreciation expense for ratemaking purposes.

113 The Commission determines rates based upon historical costs and the relationship between revenue, expenses and rate base. As rate base grows, depreciation expense grows proportionately. Therefore, it is axiomatic that depreciation expense is higher in 2012 and 2013 compared to the 2011 test year the Commission used in the 2011 rate case. However, that is beside the point, because it is the relationship of all revenues and costs that is relevant, not the myopic consideration of one single element of utility costs.

114 Simply put, the Commission does not engage in single issue ratemaking, therefore, any allegations of under-recovery of depreciation expense based on financial statements are irrelevant.

¹²⁷ Keating Direct, Exh. No. EJK-1T at 8:8-11.

¹²⁸ Staff: Keating Direct, Exh. No. EJK-1T at 8:8-11; ICNU: Gorman Direct, Exh. No. MPG-1T at 2:16-22.

¹²⁹ Marcella Rebuttal, Exh. No. MRM-5T at 13:5-8.

115 Furthermore, depreciation expense is the return of capital. It is a non-cash item and therefore it is fully recovered in expense the moment PSE records it on the income statement. All other cash flow benefits accrue to PSE due to the nature of the expense. Moreover, for tax purposes, PSE is allowed accelerated depreciation expense. Again, all the benefits of depreciation expense accrue to shareholders because it is a non-cash item the minute it is recognized for income tax purposes.

116 In conclusion, the Commission should disregard PSE’s analysis and statements regarding under-recovery of depreciation, because the Commission does not engage in single issue ratemaking, and depreciation expense is a non-cash item that returns the investment in utility plant to investors.

3. PSE Should be Allocated an Incentive Amount of \$7,481,394

117 As explained in this brief, investors are entitled to 100 percent of net book value plus certain transaction costs, and ratepayers are entitled to the rest of the proceeds. However, Staff considered whether PSE should be awarded an incentive amount, and determined the amount of \$7,481,394 was appropriate.

118 As we just explained, Staff followed the allocation process the Commission used in the *Centralia* Case, and after allocating an amount equal to accumulated depreciation to ratepayers. “the only issue ... should be the sharing percentage between ratepayers and shareholders of the appreciation on the assets sold to JPUD.”¹³⁰

119 Accordingly, Staff’s allocation of 25 percent of the appreciation to shareholders was strictly an incentive mechanism resulting from PSE obtaining a very good sales price for the assets. As Staff explained:

¹³⁰ Keating Direct, Exh. No. EJK-1T at 21:5-7. In Staff Exhibit No. EJK-2, Staff defines “appreciation” as proceeds less original cost and other costs, or put another way, the amount in excess of original cost, less certain transaction costs.

PSE's negotiating plan ultimately resulted in a sales price that included significant appreciation above NBV and the accumulated depreciation of the assets in Jefferson County. Such prowess should not be overlooked as the Company represented ratepayer's interests fairly throughout the settlement negotiations.

Staff's proposal to provide shareholders 25 percent of the appreciation from the JPUD Sale rewards that prowess and provides an incentive to PSE to pursue a vigorous negotiating plan in any other condemnation proceedings or asset sales.¹³¹

120 In previous orders involving the sale of utility assets, the Commission has allocated as little as zero percent of the appreciation to shareholders and as much as 50 percent of appreciation to shareholders.¹³² Staff's proposal of 25 percent falls in the middle of that range. Staff also supported the 25 percent of appreciation as comparable to a brokerage fee:

Furthermore, 25 percent is approximately \$7.5 million or about 7 percent of the gross proceeds from the JPUD Sale. This approximates the standard fee applied by brokerage firms in negotiating real property transactions between two parties. It is reasonable to use a similar benchmark for PSE in this case.¹³³

121 Staff's mid-range allocation of 25 percent of the appreciation resulting in a dollar amount equivalent to a brokerage fee is based on informed judgment and is reasonable. Allocating additional amounts of appreciation to shareholders would be overly generous.

E. Tariff Mechanics for Distributing Sales Proceeds to Customers

122 For distribution to ratepayers of any sales proceeds the Commission decides is appropriate, the Commission should use a rate credit similar to PSE Tariff Schedule 95a. The proceeds would be returned to ratepayers over a four-year period, and the account would accrue interest at the Company's after-tax rate of return, grossed up for taxes.¹³⁴ PSE agrees with this mechanism.¹³⁵

¹³¹ Keating Direct, Exh. No. EJK-1T at 35:5-12.

¹³² See Keating Direct, Exh. No. EJK-1T at 19 and 20.

¹³³ *Id.* at 35:13-16.

¹³⁴ Mickelson Direct, Exh. No. CTM-1T at 8:10-15.

¹³⁵ Piliaris Rebuttal, Exh. No. JAP-9T at 35:1-2.

123 Staff's mechanism is based on a general plant allocator.¹³⁶ While PSE accepts this allocator because the Staff/Company differences on this issue are "minor,"¹³⁷ the Company explains that "the general plant allocation factor used by Staff is largely driven by labor expense, which includes a large component that is production related. Production assets were not included among the plant that was sold in Jefferson County."¹³⁸

124 Staff agrees the differences on this issue are minor, and the Commission does need to "get into the weeds" on this issue. However, by way of explanation, Staff believes that, because PSE sold general plant, then the same general plant allocation factors that the Company used for low- and high-voltage distribution should be used, based on PSE's last general rate case. To Staff, it did not matter whether production related labor expense was a component of the allocator because production assets are being used by the remaining customers on the system for which general plant is being allocated. Therefore, Staff believes its approach treats all remaining customers equally.

1. Special Contract Customers Should be Included

125 Staff initially had proposed to exclude special contract customers from any distribution of proceeds.¹³⁹ However, after considering PSE's rebuttal testimony objecting to this treatment,¹⁴⁰ Staff verified that in the last PSE general rate case, special contact customers received an increase equal to the class revenue deficiency. Accordingly, Staff now agrees that special contract customers should be entitled to share in the amount of proceeds the Commission determines should go to customers in this case. Within Staff Exhibit No. CTM-2, the

¹³⁶ Mickelson, Exh. No. CTM-2 at 1:2-6.

¹³⁷ Piliaris Rebuttal, Exh. No. JAP-9T at 34:21 to 35:2.

¹³⁸ Piliaris Rebuttal, Exh. No. JAP-9T at 34:14-17.

¹³⁹ Mickelson, Exh. No. CTM-2 at 1:40.

¹⁴⁰ Piliaris Rebuttal, Exh. No. JAP-9T at 32:1 to 34:5.

Commission should use line 34 for allocation of proceeds to customers, because this line includes special contract customers.

V. CONCLUSION

126 Under the system of regulation in this state, there is no question that time after time, ratepayers have been called upon to shoulder the burdens of ownership of utility property, and every time, ratepayers have answered the call. This is one occasion where ratepayers get to enjoy the benefits.

127 For the reasons stated in this brief, of the \$109,273,196 proceeds PSE received from the sale of its distribution system in Jefferson County, the Commission should allocate \$56,572,473 to PSE and \$52,700,723 to ratepayers. This result reflects a correct application of the “regulatory compact,” and the risk/reward principle.

DATED this 10th day of June 2014.

Respectfully submitted,

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