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**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Application of  
AVISTA CORPORATION for  
Authority to Sell its Interest in the  
Coal-Fired Centralia Power Plant

Docket No. UE-991255

In the Matter of the Application of  
PACIFICORP for an Order  
Approving the Sale of its Interest in  
(1) the Centralia Steam Electric  
Generating Plant, (2) the Rate Based  
Portion of the Centralia Coal Mine,  
and (3) Related Facilities; for a  
Determination of the Amount of and  
the Proper Rate Making Treatment  
of the Gain Associated with the Sale,  
and for an EWG Determination

Docket No. UE-991262

In the Matter of the Application of  
PUGET SOUND ENERGY, INC.  
for (1) Approval of the Proposed  
Sale of PSE's Share of the Centralia  
Power Plant and Associated  
Transmission Facilities, and (2)  
Authorization to Amortize Gain over  
a Five Year Period,

Docket No. UE-991409

**RESPONSE OF PUBLIC COUNSEL  
TO PETITIONS FOR  
RECONSIDERATION AND  
CLARIFICATION OF AVISTA,  
PACIFICORP, PUGET SOUND  
ENERGY, AND COMMISSION STAFF**

**I. INTRODUCTION**

On March 6, 2000 the Commission issued the Second Supplemental Order Approving Sale with  
Conditions in the Centralia case. All of the applicants, as well as Commission Staff and Public  
Counsel, filed petitions for reconsideration and clarification on March 15 or 16, 2000. The

1  
2 Commission called for responses by the parties on March 30, 2000.  
3

4 Public Counsel will address issues raised by the other parties, including treatment of transaction  
5 costs, and tax treatment which apply to all of the applicants, as well as Puget Sound Energy's  
6 argument that it not be required to accrue interest and Pacificorp's argument about limiting  
7 environmental liability.  
8

## 9 **II. ARGUMENT**

### 10 **Treatment of Transaction Costs**

11 Transaction costs are fundamentally related to the selling of the plant, and should therefore be  
12 treated as a cost of the sale. They should be deducted from the net proceeds of the sale, since  
13 there would be no net proceeds but for the costs of closing the transaction. This deduction has  
14 the effect of reducing any gain before it is apportioned between ratepayers and shareholders, and  
15 is consistent with the principle articulated by the Commission in the Second Supplemental Order  
16 of sharing the burdens and benefits from the sale.  
17

18 The treatment of selling costs as a deduction from the gross proceeds, prior to calculation of  
19 gain, is a well-established principle. For example, Internal Revenue Service Form 4797, a copy  
20 of which is attached, provides for the calculation of the gain on sale by subtracting the sum of  
21 depreciation expense (column e), cost basis, and the expense of sale (column f) from the gross  
22 sales price (column d).  
23

24  
25 We explicitly oppose the proposal articulated by Puget Sound Energy to treat the  
26 transaction costs as part of the gain to be split according to the relative share of the total amount

1  
2 of money provided to shareholders and ratepayers. [Puget Sound Energy at p2, also Attachment  
3 1] Puget's methodology would have the Commission take the position that transaction costs  
4 should be assigned in some fashion proportionate to allocation of the proceeds, when in fact  
5 these costs are directly related to the sale of the entire plant, not the accounting treatment for the  
6 transaction.  
7

8 Public Counsel recommends the Commission clarify that transaction costs for all three  
9 applicants will be deducted from the selling price as part of the calculation of net appreciation  
10 (sale price less depreciated book value, costs of the sale, and accumulated depreciation).  
11

### 12 **Treatment of State Income Taxes**

13 All of the applicants raise concerns about the proper tax rate to be applied to the sale of  
14 Centralia. Public Counsel believes the appropriate tax rate, identified by the Commission in its  
15 order in table 5, is the federal income tax rate.  
16

17 Because Washington has no state income tax, ratepayers in Washington should not be liable for  
18 any income taxes due by the applicants in any other state jurisdiction. Income taxes in Idaho,  
19 Oregon and other states are paid for the benefit of taxpaying citizens in those jurisdictions and  
20 not for the benefit of ratepayers of the operating utilities. If the applicant utilities operated only  
21 in Washington, Washington ratepayers would be liable for only the federal taxes due. The fact  
22 that Avista and PacifiCorp operate in other states should not cause an increase in tax liability for  
23 Washington ratepayers. The income taxes due in other states provide a net benefit to those states  
24 (in the form of additional income to state government). Washington ratepayers should be liable  
25 for no more than the amount that would be due if the utility were a single-state entity. Puget  
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2 Sound Energy asserts an effective tax rate of 42% without any justification in the record or  
3 explanation in its petition. Since Puget is a single-state utility and Washington has no income  
4 tax, there is no justification for anything but the federal rate of 35%. Puget's proposed  
5 calculation should be rejected. It appears that this calculation is developed to deny Washington  
6 ratepayers the benefit of accrued deferred income taxes previously paid by ratepayers, but never  
7 remitted by Puget because of the tax benefits to the Company of accelerated depreciation. This  
8 tax benefit of amounts previously paid by ratepayers should be recaptured as a part of the  
9 distribution of sale proceeds.  
10

11  
12 Pacificorp and Avista both include a higher tax rate based on the assignment of other state  
13 taxes to Washington consumers. Avista is arguing that the Commission should first determine  
14 the net of tax gain including the Idaho income tax, and then assign a percentage of that gain to  
15 Washington. (Avista Corp. Consolidated Motion for Reconsideration and Correction of Order,  
16 pages 4-6). This effectively burdens Washington consumers with an Idaho tax. Similarly,  
17 Pacificorp argues that more gain is allocated from the sale than exists, based on its premise that  
18 state taxes should be apportioned across its service territory rather than to the jurisdiction that  
19 imposes them. (Pacificorp Petition for Reconsideration, pages 9-11).  
20

21 The Commission should reject the income tax treatment proposed by all three applicants,  
22 and clarify that Washington ratepayers will be held harmless from taxes imposed in any other  
23 state jurisdiction in which an applicant operates. The Commission should affirm that the  
24 methodology for calculating taxes is first to assign a percentage of the sale proceeds to the  
25 Washington jurisdiction (for both Avista and Pacificorp this can be done in the pending rate  
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1  
2 cases), then allocate those proceeds between shareholders, ratepayers, and federal tax liability.

3  
4 **Puget Sound Energy’s Proposal To Avoid Accruing Interest Harms Consumers, Is  
5 Inconsistent With The Commission’s Order, And Should Be Rejected.**

6 In its petition for reconsideration, Puget Sound Energy asks to be relieved of its obligation to  
7 accrue interest on the ratepayer portion of the sale proceeds. (PSE Petition at 4-6). The  
8 Company’s arguments should be rejected, and the Commission should affirm that it expects  
9 ratepayers to receive the full value of their share of the proceeds, including interest.

10 Puget Sound Energy argues that it has made substantial investments and not sought their  
11 inclusion in rate base. The Commission should reject this reasoning, which is merely a red  
12 herring. The company fully expects to recover prudent investments at the time of its next rate  
13 case, and benefits from regulatory lag when it makes cost saving decisions.

14 Puget Sound Energy then attempts to separate the accounting treatment from the sale itself. In  
15 so doing, the company fails to recognize that the sale is only in the public interest in the eyes of  
16 the Commission if the Commission’s ordered accounting treatment is followed. An equitable  
17 treatment of the ratepayers share of the proceeds cannot be divorced from the Commission’s  
18 decision to allow the sale. The Commission observed in its decision that this was part of its task,  
19 stating: “...we can now determine whether the proposed sale, *taken together with the accounting*  
20 *treatment we have directed*, is in the public interest.” Second Supp. Order, para. 95 (emphasis  
21 added).  
22

23  
24 Depriving ratepayers of interest on their share of the appreciation and gain during the lag  
25 before these amounts are reflected in rates devalues the ultimate benefit received by ratepayers,  
26 due to the time value of money (which, in turn, is the basis for the rate of return and discount rate

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2 used by the Commission.) Public Counsel suggests the company accrue interest at the 7.16  
3 percent rate until its next rate case, or alternatively, make an immediate refund to all customers  
4 of their share of the proceeds from the sale. Either of these options gives ratepayers the  
5 functional equivalent of what shareholders will enjoy: the present value of the return of capital  
6 and gain as of the date of closing of the transaction.  
7

8 Finally, the company asserts that it should not have to pay interest because it will face higher  
9 power costs as a result of the transaction, but cannot pass these along due to the rate plan. Public  
10 Counsel is wholly unsympathetic to this plight, which is entirely one of Puget's making. It  
11 accepted the rate plan as a condition of the merger. It chose to offer its share of Centralia for  
12 sale, at a time when the expected replacement power cost was lower than the cost of Centralia.  
13 In the rebuttal phase of the proceeding, it first asserted that replacement costs would be higher. If  
14 Puget is belatedly concerned with exposing itself and its customers to higher market prices, it  
15 should choose not to sell the plant. That choice is still available to the Company.  
16  
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18 **Pacificorp's Argument That It Will Not Indemnify Mine Reclamation Risk Undermines A**  
19 **Crucial Element Of The Commission's Public Interest Determination, And Argues For**  
20 **The Sale To Be Disallowed.**

21 Pacificorp argues that its offer to indemnify ratepayers from environmental remediation costs  
22 beyond those booked against contingent liability if its proposed allocation of the sale proceeds  
23 was adopted (Pacificorp Petition at pp. 1-7) was not clearly understood by the Commission,  
24 which instead chose to require the Pacificorp to indemnify the mine reclamation risks in its  
25 decision. (Second Supp. Order, para 60-62). Public Counsel interprets Pacificorp's petition for  
26 reconsideration as a representation that Pacificorp never intended to indemnify ratepayers and

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2 other owners from mine reclamation risk, and will not indemnify these parties from  
3 environmental remediation exposure as the Commission has chosen a different accounting  
4 treatment for the sale.

5  
6 The Commission now needs to consider how strongly it ascribes value to what it understood to  
7 be the mine reclamation indemnity. In its decision, the Commission concluded that:

8  
9 *[T]he benefit of removing mine reclamation and responsibilities and liability,*  
10 *along with improving the likelihood that timely capital investments will be made*  
11 *to extend the life of the plant and improve its environmental characteristics, more*  
*than balance the uncertain risk of higher costs” (Second Supp. Order, para. 63,*  
*emphasis added).*

12 Irrespective of whether the Commission intended to secure protection against  
13 environmental remediation or mine reclamation risk, if Pacificorp’s position is accepted  
14 consumers will no longer benefit from either risk mitigation for environmental remediation or  
15 mine reclamation, the Commission can no longer rely on those benefits to “balance” against the  
16 risk (now, the virtual certainty; see (3) above, discussing Puget’s assertions) of higher costs.  
17

18 Public Counsel has consistently argued that the quantitative risk of the transaction is  
19 more than enough to disallow it, we will not repeat our arguments here. Pacificorp proposes the  
20 removal of the qualitative benefits with perhaps the most value to consumers; this should give  
21 the Commission considerable pause. The Commission should reject Pacificorp’s request for  
22 release from the indemnification requirement, as this is an essential part of the Commission’s  
23 decision that the otherwise uneconomic sale is consistent with the public interest. If this risk is  
24 unacceptable to Pacificorp (which has operated the plant and had control over environmental  
25 impacts of that operation), the Commission should recognize that this risk is even more  
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1  
2 unacceptable to ratepayers, who are being denied the benefit of the low-cost years of the plant  
3 life if it is sold, in exchange for only partial remuneration of the increased power costs to which  
4 they are exposed.]  
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8 **III. CONCLUSION**  
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10 For the foregoing reasons, Public Counsel requests that the Commission resolves the  
11 treatment of transaction costs, state income tax, interest accrual, and mine reclamation  
12 indemnification in a manner consistent with Public Counsel's recommendations.

13 DATED THIS \_\_\_\_\_ day of February, 2000  
14

15 Christine O. Gregoire  
16 Attorney General

17 \_\_\_\_\_  
18 Simon ffitch  
19 Assistant Attorney General  
20 Public Counsel  
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