

**BEFORE THE**  
**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petition of	)	
	)	
PUGET SOUND ENERGY, INC.	)	
	)	
For an Accounting Order Approving the	)	DOCKET NO. UE-132027
Allocation of Proceeds of the Sale of	)	
Certain Assets to Public Utility District #1	)	
of Jefferson County.	)	
_____	)	

Opening Brief of the Industrial Customers of Northwest Utilities

June 10, 2014

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## I. INTRODUCTION

There is a fundamental disagreement in this case between Puget Sound Energy, Inc. (“PSE” or the “Company”) on the one hand, and the Industrial Customers of Northwest Utilities (“ICNU”), the Washington Utilities and Transportation Commission (“Commission”) Staff, and Public Counsel on the other. Through its testimony and Accounting Petition, PSE has argued that the circumstances of this case – a sale under threat of condemnation of part of its service territory to the Jefferson County Public Utility District (“JPUD”) – warrant special treatment with regard to the allocation of proceeds from that sale. ICNU, Staff, and Public Counsel argue that this case is subject to the same legal and equitable allocation principles as any other disposition of in-service utility property.

PSE states that, under the allegedly unique circumstances of this case, the Commission “must recognize the right of the utility to the net capital gain resulting from the sale.”<sup>1/</sup> Yet, the voluntary nature of a transaction does not impact the legal interest PSE has in the sold assets. Whether a utility’s sale of a portion of its service territory under threat of condemnation is unusual or not, the assets sold in this case – mainly distribution assets – are as ordinary as they come. PSE is legally entitled to nothing more than its capital investment in the JPUD assets, and its authorized return on plant that remains used and useful for service. No party to this case disputes PSE’s right to this. It is up to the Commission to determine whether PSE “deserves” more.

The Commission has an established framework for allocating proceeds from a property sale that is sufficiently flexible to address the issues in the case. The rules regarding who bears the risks and burdens upon the sale of such assets are the same in this case as they are

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<sup>1/</sup> PSE Ex. No. \_\_\_ (MRM-5T) at 5:17-18.

in any other – they do not change depending on the voluntary nature of the transaction. When PSE sells in-service assets for a loss, it has consistently asked customers to cover the remaining net book value, even though those assets are no longer used and useful for service. Given that customers bear the risk and burden of property sales that result in a loss, they are the ones who should receive the proceeds from a property sale that results in a gain.

While the Commission may wish to consider other equitable factors specific to the facts at issue in any particular case, here, where PSE has not demonstrated that it will be harmed as a consequence of the JPUD transaction, the fact that customers bore the risks and burdens of supporting the distribution assets sold to JPUD warrants allocating the gain to them.

## II. BACKGROUND

In 2008, voters in Jefferson County acquired enough signatures to place a measure on the ballot (“Proposition 1”) that would provide JPUD with authority to condemn all of PSE’s distribution and related assets in the county (the “Assets”) and take power from the Bonneville Power Administration (“BPA”).<sup>2/</sup> Supporters of the measure voiced concern about the pending acquisition of PSE by an international group of investors, the Company’s lack of a local presence, and its high rates, as well as other issues.<sup>3/</sup> Although PSE resisted this measure, it passed in the 2008 general election.<sup>4/</sup>

After the measure passed, PSE informed JPUD that it was an “unwilling seller” and refused to negotiate the sale of the Assets.<sup>5/</sup> Accordingly, on June 3, 2009, the JPUD Commissioners voted to grant the district condemnation authority and also authorized JPUD’s

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<sup>2/</sup> PSE Pet. ¶ 9.

<sup>3/</sup> ICNU Ex. No. \_\_\_ (SSO-9CX).

<sup>4/</sup> PSE Pet. ¶ 10.

<sup>5/</sup> Id.



general manager to negotiate a purchase price with PSE.<sup>6/</sup> Facing condemnation, PSE eventually negotiated a purchase price of \$103 million for the Assets.<sup>7/</sup> The original cost of the Assets was \$71,034,862.<sup>8/</sup> Thus, PSE realized a net gain upon their sale.

To arrive at the \$103 million purchase price, both PSE and JPUD evaluated a number of valuation methodologies. PSE's methodologies produced a low of \$22.6 million based on the assessed value of the Assets, and a high of \$136 million, though PSE acknowledged that this high number included a number of speculative elements.<sup>9/</sup> The highest value JPUD placed on the assets was \$83 million.<sup>10/</sup>

The terms of the deal required PSE to obtain an order from the Commission confirming that “the amount of the Purchase Price is an amount that is sufficient to fully compensate PSE customers for the sale of the Assets” and that Commission approval was not required for PSE to transfer the Assets to JPUD.<sup>11/</sup> Consistent with this requirement, PSE filed a Petition for Declaratory Order at the Commission seeking the necessary findings.<sup>12/</sup> The Commission did so in Order 03 in the Declaratory Ruling Proceeding, which approved a settlement of all issues.<sup>13/</sup> With regard to its approval of the amount of the purchase price, the Commission:

Emphasize[d] that the Stipulation asks the Commission to determine *only* that the \$103 million purchase price sets a financial ceiling for subsequent ratemaking purposes. Thus, while we determine that the purchase price of \$103 million is an appropriate one and sufficient to fully compensate PSE for the sale of the assets, our determination does not affect the subsequent accounting

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<sup>6/</sup> Id. ¶ 11.

<sup>7/</sup> Id. ¶ 13.

<sup>8/</sup> PSE Ex. No. \_\_\_ (MRM-3) (row 2). With improvements made after June 11, 2010, the original cost of the Assets ultimately sold to JPUD was \$76,625,171.

<sup>9/</sup> PSE Ex. No. \_\_\_ (SSO-5) at 10:2, 17:19-18:3.

<sup>10/</sup> Id. at 16:9.

<sup>11/</sup> PSE Ex. No. \_\_\_ (SSO-3) at 10 (definition of “WUTC Confirmations”).

<sup>12/</sup> Docket No. U-101217 (“Declaratory Ruling Proceeding”).

<sup>13/</sup> Docket No. U-101217, Order 03 (Feb. 1, 2011).

treatment of the sale proceeds and does not affect an allocation of the sale proceeds as between PSE’s customers and shareholders.<sup>14/</sup>

To determine the ultimate allocation of the proceeds from the JPUD transaction, PSE, on October 31, 2013, filed the Petition for an Accounting Order (“Petition”) at issue here. In its Petition, PSE argued that this case was “unique” from other property sales.<sup>15/</sup> Specifically, PSE argued that the “unusual and extraordinary circumstances presented in this case are the unique and harsh circumstances of the liquidation of the entire business enterprise in a given locality.”<sup>16/</sup>

To support its claim that the “unique” nature of the transaction dictated that its investors were entitled to the full amount of the proceeds, PSE relied primarily on a California Public Utilities Commission (“CPUC”) rulemaking, Redding II,<sup>17</sup> which found that, absent harm to remaining customers, a utility’s investors are entitled to all proceeds from a utility’s sale of a distribution system to a municipality or other public entity when such sale constitutes the entire operating system within a given area, is part of rate base, and is concurrent with the public entity assuming the utility obligations for the customers in that area.<sup>18/</sup> The CPUC also determined that, while under normal accounting rules any loss associated with such a sale would flow through to customers, an exception to this rule should be made such that investors would also bear the loss since they were entitled to the gain.<sup>19/</sup>

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<sup>14/</sup> Id. at 14 (emphasis in original).

<sup>15/</sup> PSE Pet. ¶ 6.

<sup>16/</sup> Id. ¶ 35.

<sup>17/</sup> In re Ratemaking Treatment of Capital Gains from the Sale of a Public Utility Distribution System Serving an Area Annexed by a Municipality or Public Entity, Cal. Pub. Util. Comm’n, Dec. No. 89-07-016, 104 P.U.R.4th 157 (July 6, 1989) (“Redding II”).

<sup>18/</sup> Id. at \*1-\*2.

<sup>19/</sup> Id. at \*16-\*17.

PSE proposed to share 25 percent of the net gain with customers.<sup>20/</sup> PSE calculated the net gain by subtracting the total proceeds from the net book value of the assets and transaction costs.<sup>21/</sup>

PSE also stated that the JPUD Transaction would not “affect the quality or reliability of service to PSE’s remaining customers.”<sup>22/</sup> Through its witness, Jon Piliaris, the Company attempted to allocate all of the costs of supporting the Assets to its former Jefferson County customers.<sup>23/</sup> Mr. Piliaris performed a similar allocation with regard to the accumulated depreciation of the Assets.<sup>24/</sup> He also stated, however, that it “is unrealistic to think that you can arbitrarily determine the cost of serving any portion of the Company’s service area, at any given time, and find a perfect match with the revenues derived from that area.”<sup>25/</sup> This is because the “Company’s rates are uniform throughout its service area .... 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.”<sup>26/</sup> Mr. Piliaris also projected that, over a 20-year period, PSE’s remaining customers would receive power cost benefits as a consequence of the transaction.<sup>27/</sup> His analysis, however, also showed that customers were likely to see increased costs in the first five years following the JPUD transaction.<sup>28/</sup>

ICNU, Commission Staff, and Public Counsel all filed testimony responding to the Company’s Petition.<sup>29/</sup> While the parties differed somewhat in their calculations, each

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<sup>20/</sup> PSE Pet. ¶ 37.

<sup>21/</sup> Id. ¶ 32.

<sup>22/</sup> Id. ¶ 43.

<sup>23/</sup> PSE Ex. No. \_\_\_ (JAP-1T) at 4:4-10:20.

<sup>24/</sup> Id. at 13:16-15:12.

<sup>25/</sup> Id. at 8:20-9:1.

<sup>26/</sup> Id. at 14:13-17.

<sup>27/</sup> Id. at 11:1-13:14.

<sup>28/</sup> PSE Ex. No. \_\_\_ (JAP-7).

<sup>29/</sup> ICNU Ex. No. \_\_\_ (MPG-1T); Staff Ex. Nos. \_\_\_ (EJK-1T) and (CTM-1T); Pub. Counsel Ex. No. \_\_\_ (JRD-1T).

argued that the majority of the gain should go to customers.<sup>30/</sup> ICNU recommended that the Company be reimbursed for the net book value of the Assets and transaction costs; that customers be allocated a portion of the proceeds equal to the amount they paid in accumulated depreciation for the Assets; and that the remaining gain be split with 90 percent going to customers and 10 percent to the Company.<sup>31/</sup> ICNU's witness, Michael Gorman, testified that, under the Commission's standard framework for evaluating the proper distribution of proceeds from a property sale, which looks at the risks and rewards, and benefits and burdens arising from the transaction, customers should receive the gain because they are the ones that shoulder the cost risks when utility assets are sold for a loss.<sup>32/</sup> Staff witness, Edward Keating, testified that, under traditional "Rate Base Rate of Return Regulation," a utility is provided "the opportunity to earn a fair rate of return on and a return of its investment, and nothing more. Therefore, Rate Base Rate of Return Regulation does not entitle shareholders to any appreciation on the sale of an asset."<sup>33/</sup> Public Counsel witness, James Dittmer, testified that "utilities typically should not expect to experience or enjoy an extraordinary windfall or gain upon disposition of property, just as they should not expect to experience or bear a loss from premature or earlier-than-anticipated disposition of a utility asset."<sup>34/</sup> Mr. Dittmer also noted that "the recording of typical retirements of depreciable plant components, as prescribed within the FERC Uniform System of Accounts, ensures that the utilities will neither profit nor be financially harmed upon removing plant from service."<sup>35/</sup>

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<sup>30/</sup> ICNU Ex. No. \_\_\_ (MPG-1T) at 5; Staff Ex. No. \_\_\_ (EJK-1T) at 4; Pub. Counsel Ex. No. \_\_\_ (JRD-1T) at 38.

<sup>31/</sup> ICNU Ex. No. \_\_\_ (MPG-1T) at 5.

<sup>32/</sup> Id. at 14:2-3.

<sup>33/</sup> Staff Ex. No. \_\_\_ (EJK-1T) at 13:4-7.

<sup>34/</sup> Pub. Counsel Ex. No. \_\_\_ (JRD-1T) at 8:14-18.

<sup>35/</sup> Id. at 8:18-21.

Both Mr. Keating and Mr. Gorman also argued that PSE had not properly defined the net gain. Mr. Gorman noted that customers paid nearly \$30 million in depreciation expense associated with the assets, and thus, “the original investment funding of the JPUD assets has been shared between PSE and its customers.”<sup>36/</sup> Mr. Keating testified that returning accumulated depreciation to customers was consistent with standard “Rate Base Rate of Return Regulation” because it “equals the sum of all prior years’ depreciation expense already recovered through rates.”<sup>37/</sup> Accordingly, both ICNU and Staff argued that the proper way of determining the net gain available for distribution between customers and the Company was to return to PSE its transaction costs and the remaining net book value of the Assets, which makes the Company whole, and provide accumulated depreciation to customers.<sup>38/</sup> The remaining amount constitutes the appreciated value of the Assets.<sup>39/</sup>

In PSE’s rebuttal testimony, it attempted a different tactic, arguing simply that, because it owned the Assets, it was entitled to the gain.<sup>40/</sup> Indeed, according to PSE, allocating any proceeds to customers would be confiscatory and would “contravene the regulatory compact.”<sup>41/</sup> This represents a far cry from where PSE was when it began the transaction process with JPUD. In the Declaratory Ruling Proceeding, the Company asked solely for an order that provided the Company certainty that customers would not be entitled to *more* than the purchase price.<sup>42/</sup> Today, Dr. Levin’s equivocations at the hearing notwithstanding,<sup>43/</sup> it apparently

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<sup>36/</sup> ICNU Ex. No. \_\_\_ (MPG-1T) at 3:16-17.

<sup>37/</sup> Staff Ex. No. \_\_\_ (EJK-1T) at 8:8-11.

<sup>38/</sup> ICNU Ex. No. \_\_\_ (MPG-1T) at 3:22-23; Staff Ex. No. \_\_\_ (EJK-1T) at 4:7-11.

<sup>39/</sup> Id.

<sup>40/</sup> PSE Ex. No. \_\_\_ (SLL-1T) at 4:5-12.

<sup>41/</sup> Id. at 4:9-12.

<sup>42/</sup> ICNU Ex. No. \_\_\_ (SSO-10CX) at 6 n. 7.

<sup>43/</sup> Under questioning from Commissioner Jones, Dr. Levin testified that he did not “attach any legal meaning to” his use of the word “confiscate.” Tr. 145:6-7. If this is the case, it is not clear to ICNU what Dr. Levin means when he states that, “[i]f the allocation confiscated proceeds belonging to stockholders ... it would contravene the regulatory compact.” PSE Ex. No. \_\_\_ (SLL-1T) at 4:9-12.

believes that customers are legally prohibited from receiving any of the proceeds unless the Company voluntarily agrees to share them.

### III. ARGUMENT

#### A. Response to Bench Requests

At the hearing in this case, Commissioner Goltz requested that the parties address two issues in their briefs: (1) what an appropriate incentive payment to PSE would be for having negotiated the sales price with JPUD; and (2) whether there is a difference between the risks associated with doing business and the risks associated with ownership of assets.<sup>44/</sup> ICNU addresses these requests first, and in particular the question of whether there is a difference between business risk and ownership risk, because an examination of this question gets to the heart of why it is appropriate to give customers the vast majority of the proceeds in this case.

##### 1. The risk of doing business is concurrent with the risk of owning assets, and customers compensate PSE for this risk.

In Dr. Levin's Rebuttal Testimony, he argues that, "[i]n order to understand the risk associated with the ownership of PSE's assets ... it is necessary to separate risk into two components: 1) risk associated with doing business, and 2) risk associated with the ownership of the assets."<sup>45/</sup> Dr. Levin argues that all businesses incur risks for which they attempt to compensate themselves by building the costs of those risks into their prices.<sup>46/</sup> According to Dr. Levin, regulators do the same for utilities.<sup>47/</sup> Thus, Dr. Levin asserts, by covering, for instance, the costs associated with losses from natural disasters or early retired plant, customers are simply

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<sup>44/</sup> Tr. 259:13-24. A third request, related to whether it was PSE's position that it wished to take the loss when it sold property for less than net book value, was directed solely to the Company. Tr. 259:25-260:11.

<sup>45/</sup> PSE Ex. No. \_\_\_ (SLL-1T) at 9:16-19.

<sup>46/</sup> Id. at 10:2-12.

<sup>47/</sup> Id. at 10:14-22.

paying for the normal costs of doing business.<sup>48/</sup> And “customers do and should pay for this cost of business.”<sup>49/</sup> This is different, Dr. Levin states, from the risk of owning assets, which relates to the fact that the “value of assets may change in unforeseen ways. This might be due to various market conditions, including technology. The risk of ownership falls onto the investors ....”<sup>50/</sup>

The validity of the distinction Dr. Levin makes between the risk of doing business and the risk of owning assets is not apparent to ICNU. Owning assets, particularly in the capital-intensive utility industry, is part of doing business. To supply electricity to its customers, PSE must own generation, transmission, distribution, and an assortment of related assets, all of which play an integral role in the Company’s business. If, as Dr. Levin argues, customers pay for the costs of business risks, either through anticipated costs embedded in rates or as they occur, then customers are necessarily compensating PSE for its risks of owning assets.<sup>51/</sup> Whether one describes these risks as business risks or ownership risks, at the end of the day, according to Dr. Levin, it is customers who are paying the costs associated with those risks.

Nevertheless, Dr. Levin’s testimony appears to indicate that there is a difference between cost and risk. Mr. Marcelia, in fact, makes a similar point when he states that, in “the ordinary course of business, PSE faces all of the capital risk. That cost associated with that risk can only pass to customers (the risk does not pass, only the cost does) ....”<sup>52/</sup> Thus, for both Dr. Levin and Mr. Marcelia, cost and risk are not the same.

ICNU does not see it this way. Indeed, Dr. Levin’s entire argument regarding business risk is that companies attempt to pass the costs associated with those risks on to their

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<sup>48/</sup> Id. at 11:1-5.

<sup>49/</sup> Id. at 10:21-22.

<sup>50/</sup> Id. at 11:14-16.

<sup>51/</sup> For instance, if a mudslide destroys part of a hydroelectric facility PSE owns, should this be considered a business risk or an ownership risk?

<sup>52/</sup> PSE Ex. No. \_\_ (MRM-5T) at 29:3-5.

customers so that they will be “compensated for this risk,” and that this practice is entirely appropriate.<sup>53/</sup> If PSE is compensated for its risk (whether one describes it as business or ownership risks), as both Dr. Levin and Mr. Marcellia appear to admit is the case, then there is no need to compensate the Company further. It has already been made whole. Whether the Company at this point continues to bear the “risk” of ownership becomes irrelevant. Dr. Levin’s argument supports ICNU’s position, analyzed below, that customers have borne the risks (whether defined as “cost” or “risk”) and burdens associated with the Assets, and therefore, should receive the benefit from their sale.

**2. An appropriate incentive payment for PSE is at or near its authorized return on equity.**

ICNU recommends that, as Mr. Gorman testified at the hearing in this case, an appropriate incentive payment for PSE is at or near the Company’s authorized return on equity. PSE’s return on equity represents the Commission’s determination of the amount the Company’s investors should expect to receive in the current market. It is sensible to use a similar percentage as an amount PSE could expect to receive for negotiating the purchase price with JPUD.

PSE currently has an authorized return on equity of 9.8%. Thus, ICNU’s recommendation to give ten percent of the net gain to PSE (after net book value, transaction costs, and accumulated depreciation), reflects this proposal. Further, because PSE will reinvest the remaining net book value of the Assets in new plant used to provide service to its customers, it will continue to earn a return on this investment, just in different assets.<sup>54/</sup> Accordingly, this ten percent allocation to PSE is pure gain to the Company to which it is not otherwise entitled. It, therefore, provides an adequate incentive payment to PSE.

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<sup>53/</sup> PSE Ex. No. \_\_\_ (SLL-1T) at 10:5.

<sup>54/</sup> ICNU Ex. No. \_\_\_ (MPG-3) at 11.



**B. The proper allocation of proceeds from the JPUD Transaction falls squarely within judicial and Commission precedent.**

That PSE has been compensated for any risk associated with the Assets, as discussed above, is consistent with judicial and Commission precedent. PSE’s arguments notwithstanding, the law is clear that investors have an “ownership” interest – in the sense of a legally protectable interest – in their investment in utility property, not in the property itself. Accordingly, case law and Commission decisions have recognized that customers bear the risks and burdens associated with in-service utility plant for which they bear the costs. The voluntary or involuntary nature of a transaction does not change the balance of these risks and burdens.

**1. Under cost-of-service ratemaking, PSE is entitled to no more than the net book value of the Assets.**

The Commission is charged with fixing “just, reasonable, or sufficient” rates for PSE and other utilities.<sup>55/</sup> Under this statute, as interpreted by the courts, PSE is subject to cost-of-service rate regulation that has its foundation in a long line of precedent going back at least to Fed. Power Comm’n v. Hope Nat. Gas.<sup>56/</sup> Under the framework established in Hope, there is “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’ .... By such a procedure the utility is made whole and the integrity of its investment maintained. No more is required.”<sup>57/</sup> The Washington Supreme Court has turned to Hope and its progeny in holding that “rates, no matter how they are determined, need only ‘enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed ....’”<sup>58/</sup>

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<sup>55/</sup> RCW § 80.28.020.

<sup>56/</sup> 320 U.S. 591 (1944).

<sup>57/</sup> Id. at 606.

<sup>58/</sup> People’s Org. for Wash. Energy Res. v. Wash. Utils. & Transp. Comm’n, 104 Wn.2d 798, 811 (1985) (quoting Hope, 320 U.S. at 605).

Picking up on the Supreme Court’s decision in Hope, the United States Court of Appeals for the District of Columbia Circuit has found “no impediment, constitutional or otherwise, to recognition of a ratemaking principle enabling ratepayers to benefit from appreciations in value of utility properties accruing while in service.”<sup>59/</sup> Indeed, according to the Democratic Central Court, the application of two principles – that “the right to capital gains on utility assets is tied to the risk of capital losses,” and that “he who bears the financial burden ... should also reap the benefit” – “weighs the scale heavily in favor of consumers” in terms of who is entitled to gains on the sale of utility assets.<sup>60/</sup> This is because “the investor’s legally protected interest resides in the capital he invests rather than in the items of property which that capital purchases for provision of utility service.”<sup>61/</sup> Thus, because investors’ right to their capital investment is protected, “loss or damage from acts of nature and man, and risks of such casualties are usually passed on to consumers. The risk of loss from premature retirement of assets because of obsolescence, as a general rule, also falls on consumers.”<sup>62/</sup> Additionally, “[r]atepayers bear the expense of depreciation, including obsolescence and depletion, on operating utility assets through expense allowances to the utilities they patronize. It is well settled that utility investors are entitled to recoup from consumers the full amount of their investment in depreciable assets devoted to public service.”<sup>63/</sup> From these determinations, the D.C. Circuit reasoned:

Investors who are afforded the opportunity of a fair return on a secure investment in utility assets are hardly in position to complain that they do not receive their just due from the traveling public. On the other hand, it is eminently just that consumers,

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<sup>59/</sup> Dem. Cent. Comm. v. Wash. Area Met. Transp. Comm’n, 485 F.2d 786, 800 (D.C. Cir. 1973) (“Democratic Central”).

<sup>60/</sup> Id. at 806.

<sup>61/</sup> Id. at 801.

<sup>62/</sup> Id. at 807.

<sup>63/</sup> Id. at 808.

whose payments for service reimburse investors for the ravages of wear and waste occurring in service should benefit in instances where gain eventuates – to the full extent of the gain.<sup>64/</sup>

Judicial precedent belies PSE's claim that it is entitled to the proceeds from the JPUD transaction simply because it was the owner of the assets.<sup>65/</sup> The fallacy in PSE's argument has already been made apparent through an examination of Dr. Levin's fictional distinction between business risk and ownership risk. It is perhaps even clearer by probing PSE's homeowner analogy. In both Mr. Marcellia's and Dr. Levin's rebuttal testimony, PSE argues that it is similar to a homeowner, with its customers as renters, because a homeowner is entitled to all net gain from the sale of the house; renters have no claim to the proceeds.<sup>66/</sup> PSE does not, however, describe what happens when the owner sells the house for less than he or she owes the bank. In that situation the owner cannot turn to the renter to make him or her whole, yet that is precisely what PSE does when it sells property for a loss – it asks its customers to make it whole.<sup>67/</sup> This is the fundamental difference between a regulated utility and a competitive enterprise. It is a distinction Hope and Democratic Central have recognized for decades and for which they fashioned corresponding legal requirements. These legal requirements do not entitle PSE to gain on the sale of in-service utility property.<sup>68/</sup>

Furthermore, beyond various generalities offered by Dr. Levin,<sup>69/</sup> PSE has provided no evidence to suggest that, if it is not provided with the proceeds from the JPUD transaction above the Assets' remaining net book value, its credit rating will diminish or it will have a reduced access to capital. Indeed, it is difficult to understand how the failure to obtain

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<sup>64/</sup> Id. at 811.

<sup>65/</sup> PSE Ex. No. \_\_\_ (SLL-1T) at 4:5-12.

<sup>66/</sup> PSE Ex. No. \_\_\_ (MRM-5T) at 27:2-28:4; PSE Ex. No. \_\_\_ (SLL-1T) at 12:2-13:5.

<sup>67/</sup> See infra at 20-21 for examples of this.

<sup>68/</sup> Hope, 320 U.S. at 606.

<sup>69/</sup> PSE Ex. No. \_\_\_ (SLL-1T) at 4:13-5:2.

pure profit could financially harm the Company, which is still entitled to a return of and on its remaining plant in service. Thus, to comply with its constitutional and statutory duties, the Commission need only ensure that PSE is provided with its full investment in the Assets. No party disputes that this is appropriate – all have argued that PSE is entitled to its remaining net book value and transaction costs.<sup>70/</sup> Any amount above this is pure gain to the Company and is neither required nor contemplated by the ratemaking regime under which PSE operates.

**2. The Commission has a long and consistent precedent for evaluating how to allocate the proceeds from a utility property sale.**

Although PSE is entitled to no more than the return of its capital investment in the Assets, the Commission has found that the specific circumstances of a property sale may warrant an equitable sharing of the proceeds between a utility and its customers. Since at least 1986, the Commission has followed Democratic Central with regard to the allocation of proceeds from a utility property sale.<sup>71/</sup> In WUTC v. Puget Sound Power & Light Co., the Commission found, following Democratic Central, that “once acquired, all costs and risks of ownership [of utility property] – such as taxes, insurance, maintenance, the costs of the money for the acquisition, etc. – are borne by the ratepayers and risk of loss at sale appears to be borne by ratepayers. The arguments are persuasive that, because the ratepayers have shouldered the risks of ownership, they should share in the benefit at sale.”<sup>72/</sup>

In In re Avista Corp. for Authority to Sell its Interest in the Coal-Fired Centralia Power Plant, the Commission again articulated the Democratic Central principle that reward should follow risk and benefit should follow burden.<sup>73/</sup> The Commission found that “ratepayers

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<sup>70/</sup> ICNU Ex. No. \_\_\_ (MPG-1T) at 5; Staff Ex. No. \_\_\_ (EJK-1T) at 4; Pub. Counsel Ex. No. \_\_\_ (JRD-1T) at 38. 485 F.2d at 806-07.

<sup>71/</sup> Cause No. U-85-53, 2d Supp. Order, 74 P.U.R.4th 536 at \*62 (May 16, 1986).

<sup>72/</sup> Docket Nos. UE-991255, UE-991262, UE-991409, 2d Supp. Order, 200 Wash. UTC LEXIS 252 at \*62 (Mar. 6, 2000) (“Centralia II”).

have supported the Centralia facilities through a return *of* the investment; they have paid based on straight-line depreciation. The ratepayers have also supported the Centralia facilities through rates that include a return *on* the investment; they have paid a fair rate of return on the undepreciated balance of the facilities.”<sup>74/</sup> Based on this analysis and a finding that the assets at issue had appreciated in value, the Commission gave net book value to the utilities, the equivalent of accumulated depreciation to ratepayers, and split the remaining gain equally between the utilities and their customers based on a finding that the utilities’ investors bore certain legislative and market risks.<sup>75/</sup> Commissioner Hemstad dissented, noting that the risks that the majority found investors bore were the same risks they had always borne: “Since the 1930s, customers have had the ability to municipalize through formation of a public utility district. In the absence of exclusive service territories, utilities have always faced the risk of loss of customers on the fringes of their service areas.”<sup>76/</sup> Commissioner Hemstad noted that customers bear the risks of maintaining utility assets and that, consequently, the better-reasoned decisions allocating proceeds from the sale of utility property “have limited gain-sharing to unusual or extraordinary circumstances, or based the sharing on the notion that a small share of the gain can serve the role of encouraging the utility to maximize the sale proceeds, akin to a brokerage commission.”<sup>77/</sup>

More recently, the Commission has applied these same principles to PSE’s and PacifiCorp’s sale of renewable energy credits (“RECs”). In In re Amended Pet. of PSE for an Order Authorizing the Use of the Proceeds from the Sale of Renewable Energy Credits and Carbon Financial Instruments, the Commission found that the principal that reward should

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<sup>74/</sup> Id. at \*61 (emphasis in original).

<sup>75/</sup> Id. at \*62-\*64.

<sup>76/</sup> Id. at \*112.

<sup>77/</sup> Id. at \*100-\*101.

follow risk and benefit should follow burden “offers useful guidance” in determining the allocation of proceeds from the sale of RECs because RECs are derived from customer-supported generation assets.<sup>78/</sup> In responding to PSE’s statement that it was “absurd” to argue that customers have an ownership interest in utility property, the Commission stated that, “[w]hether or not it might be ‘absurd’ to do so, no one argues that PSE customers are entitled to the REC Proceeds because they have an *ownership interest* in the generation assets from which the RECs are derived.”<sup>79/</sup> “PSE’s customers’ rates do include operating expenses, depreciation ... and return on the capital invested in the renewable resources from which the RECs are derived. Thus, while no one argues PSE’s customers own these resources, it is indisputably the case that the ratepayers bear the full burden of cost responsibility for the resources that generate the RECs ....”<sup>80/</sup> Similarly, in WUTC v. PacifiCorp d/b/a Pac. Power & Light Co., the Commission found that “RECs are comparable to utility property, and the sale of such property results in proceeds that, absent unusual circumstances, must be distributed in total to ratepayers.”<sup>81/</sup>

**3. An exception to the Commission’s precedent is unnecessary and unwarranted in this case.**

In attempting to avoid this long and consistent line of precedent, PSE argues that the Commission should establish a narrow exception in cases where part of a utility’s service territory is sold under threat of condemnation.<sup>82/</sup> The reason an exception is appropriate here, PSE asserts, is that forced sales are fundamentally different from voluntary sales.<sup>83/</sup> ICNU notes that, while PSE did negotiate the JPUD Transaction under threat of condemnation, the

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<sup>78/</sup> Docket No. UE-070725, Order 03 ¶ 41 (May 20, 2010) (“PSE REC Order”).

<sup>79/</sup> Id. (emphasis in original).

<sup>80/</sup> Id. ¶ 39 n. 40.

<sup>81/</sup> Docket No. UE-100749, Order 10 ¶ 23 (Aug. 23, 2012).

<sup>82/</sup> PSE Ex. No. \_\_\_ (MRM-5T) at 4:1-8.

<sup>83/</sup> Id. at 4:1-5:18.

Company's decision accept JPUD's \$103 million purchase price was entirely voluntary, as was its negotiation of the asset purchase agreement with JPUD. Nevertheless, under these circumstances, PSE argues, the Commission "must recognize the right of the utility to the net capital gain resulting from the sale."<sup>84/</sup> PSE argues that the JPUD transaction represents a partial liquidation of its service territory and that, under the CPUC's analysis in Redding II, all of the gain in such a situation rightfully belongs to investors.<sup>85/</sup> PSE is correct that the factual pattern of this case closely aligns with Redding II. The question for the Commission, however, is whether it should *follow* Redding II.

In Redding II, the CPUC noted that, "[u]nder normal circumstances the Uniform System of Accounts would require that the gain or loss on sale of depreciable assets would be charged to a depreciation reserve account and thus *would flow through to ratepayers* .... In the circumstances of this rulemaking net gains or losses on sale ... *should be assigned to shareholders* by transferring the plant accounts and related depreciation reserve accounts to non-utility plant at the time of sale."<sup>86/</sup> Thus, for the particular type of transaction at issue, the CPUC created an exception to the normal rule that would pass losses to customers by holding that, in such cases, the utility's investors get all the gain or all the loss. The CPUC's justification for doing so – that customers did not contribute capital to the sold assets – however, is hardly persuasive. Customers rarely contribute initial capital to utility assets. Nevertheless, as the Democratic Central Court found, and as the Commission has recognized over and over again, customers are the ones who bear the risk if those assets are sold at a loss.<sup>87/</sup>

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<sup>84/</sup> Id. at 5:14-18.

<sup>85/</sup> Id.

<sup>86/</sup> Redding II at \*16-\*17 (emphasis added).

<sup>87/</sup> See supra at 14-16. Indeed, the CPUC also, at least implicitly, recognized this in Redding II by explicitly modifying the normal accounting treatment for such sales. Redding II at \*16-\*17.

Indeed, when one looks at the relative risks investors and customers bear with regard to the types of assets sold to JPUD, the exception the CPUC made in Redding II makes even less sense. The CPUC specifically found that “[d]istribution systems seem to be among the least risky individual investments by electric utilities, due to their relatively small scale, conventional technology and natural monopoly characteristics.”<sup>88/</sup> Yet, despite the minimal risks investors face with regard to distribution assets, the CPUC does not suggest that customers face diminished cost assumption risks. Furthermore, as Chairman Danner noted during the hearing in this case, the chances that a utility will sell, under threat of condemnation, part of its service territory to a municipality for a loss are minimal.<sup>89/</sup> This is because the utility is entitled to fair market value for the assets.<sup>90/</sup>

Thus, even though customers normally bear the risk of loss, in Redding II the CPUC created a narrow rule that gave investors all of the gain (and theoretically all of the loss) in situations where (1) the utility is selling assets that carry minimal risk for investors and (2) the utility will almost inevitably realize a gain. The equities underlying such a policy elude ICNU.

In addition to relying on a flawed CPUC order, PSE makes an erroneous distinction when it claims that the involuntary nature of this transaction somehow separates it from the Commission’s traditional analysis regarding the allocation of gains from a property sale.<sup>91/</sup> Neither Democratic Central nor any Commission order ICNU is aware of makes such a distinction. Rather, if there is a distinction to be made, it likely would be between in-service utility assets and other utility property. The former falls squarely within Democratic Central’s

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<sup>88/</sup> Redding II at \*21.

<sup>89/</sup> Tr. 195:23-196:2.

<sup>90/</sup> RCW § 54.16.020; Ham, Yearsley & Ryrie v. Northern Pac. R.R. Co., 107 Wash. 378, 384 (1919).

<sup>91/</sup> PSE Ex. No. \_\_\_ (MRM-5T) at 2:9-6:22.



holding that customers bear the risks and burdens associated with such property, and these are the types of assets PSE sold to JPUD in the transaction at issue here.<sup>92/</sup>

The Commission has been consistent in the framework it uses for evaluating how to distribute the proceeds from a utility property sale. This consistency, however, does not imply rigidity. While the underlying principle for allocating the gain – that reward should follow risk and benefit should follow burden – is a constant, the Commission has also recognized “the important point that Commission decisions concerning the allocation of proceeds from the sale of utility assets are to some extent contextual.”<sup>93/</sup> That is, while reward should follow risk and benefit should follow burden in any allocation of gain from a property sale, what the risks and burdens are in any given transaction will necessarily vary and must be evaluated on a case-by-case basis. The Commission’s established framework is sufficiently flexible to accommodate this case. Although PSE argues that its sale of the Assets to JPUD is “unique,” “unusual,” and “extraordinary,”<sup>94/</sup> that does not justify creating a special rule for this transaction, particularly when the risks and burdens of supporting the sold Assets are no different than those related to any other depreciable rate base property.

**C. Customers bear the risks and burdens associated with PSE’s property sales, including the Company’s sale of the Assets to JPUD.**

The Commission should recognize that the portion of the proceeds available for sharing in this case is the amount above the net book value, transaction costs, and accumulated depreciation. Mr. Piliaris’ fictionalized allocations notwithstanding, PSE’s remaining customers have shouldered the vast majority of cost responsibility for the Assets. Because these customers have overpaid such depreciation, they are entitled to an equivalent amount of the proceeds prior

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<sup>92/</sup> Democratic Central, 485 F.2d at 811.

<sup>93/</sup> PSE REC Order ¶ 41.

<sup>94/</sup> PSE Pet. ¶¶ 34-35.

to any equitable sharing considerations. Furthermore, because customers bear the cost recovery risk of sold assets, including the JPUD Assets, they should be entitled to the remaining gain, less an amount appropriate to incentivize PSE to negotiate a favorable sales price.

**1. Customers bear cost recovery risk.**

In this case, PSE has sold property with a remaining net book value. There is no reason to think, based on prior similar circumstances, that PSE would not have turned to its customers to make it whole had it sold the Assets for less than that net book value. As ICNU's witness, Mr. Gorman, testified in this case, "[u]tility customers typically assume significant amounts of utility plant investment risk" which includes "the cost recovery risk of plant that is retired early."<sup>95/</sup> In a number of prior cases, discussed above, the Commission has also made this determination.<sup>96/</sup> Cost recovery risk of early retired plant is borne by customers when that plant is sold at a loss, i.e., less than net book value, because PSE asks customers to make it whole.

Examples of this as relates to PSE are not difficult to come by, and include: (1) the White River Hydroelectric Plant;<sup>97/</sup> (2) the Issaquah Operating Base;<sup>98/</sup> (3) the Seaway Property;<sup>99/</sup> and (4) the Electron Hydroelectric Project.<sup>100/</sup> With regard to the White River Hydroelectric Plant, PSE elected to cease its operation and sell it to a third party as a consequence of Federal Energy Regulatory Commission re-licensing requirements. PSE sought, and was granted, an accounting order that allowed for a return of and return on the Company's unrecovered plant costs.<sup>101/</sup> The loss associated with the Issaquah Operating Base occurred as a result of the consolidation of operations at PSE's Redmond facility. The Company sought

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<sup>95/</sup> ICNU Ex. No. \_\_ (MPG-1T) at 11:14-23.

<sup>96/</sup> WUTC v. Puget Sound Power & Light Co., Cause No. U-85-53, 74 P.U.R.4th 536, 2d Supp. Order at \*62; Centralia II at \*61; PSE REC Order ¶ 39; Docket No. UE-100749, Order 10 ¶ 23.

<sup>97/</sup> ICNU Ex. No. \_\_ (MPG-3) at 7-8.

<sup>98/</sup> ICNU Ex. No. \_\_ (MPG-3) at 8-9.

<sup>99/</sup> ICNU Ex. No. \_\_ (MPG-3) at 9; Docket No. UE-051437, Order 01 (Nov. 30, 2005).

<sup>100/</sup> Docket No. UE-131099, Order 02 (Oct. 23, 2013).

<sup>101/</sup> Docket No. UG-040640/UE-040641, Order 06 ¶¶ 252-53 (Feb. 18, 2005).

approval to transfer this property to a subsidiary. PSE was allowed to defer the loss associated with this transfer, and was subsequently granted recovery of this deferral in its 2006 general rate case.<sup>102/</sup> PSE's Seaway Property was sold at a loss for reasons similar to its Issaquah Operating Base. Again, PSE sought, and was granted, deferral of the loss for later recovery and amortization.<sup>103/</sup> Finally, as discussed in Mr. Keating's rebuttal testimony, PSE sought, and was granted authority to recover from customers the loss associated with its sale of the Electron Hydroelectric Project, which also included a return on the remaining net book value of the plant.<sup>104/</sup>

All of these assets were disposed of for a significant loss, and in all of them the Company turned to its customers for cost recovery. It is simply inequitable to suggest that PSE is entitled to the gain from a property sale when it does not bear the risk of loss associated with the same type of property sale.

**2. The Commission should not adopt PSE's speculative and indefinite allocations and forecasts.**

In an attempt to avoid a finding that PSE's customers bore the risks and burdens associated with the sold Assets, PSE's witness, Jon Piliaris, engages in extensive and elaborate allocation exercises to attempt to show that PSE's former Jefferson County customers covered all costs associated with the Assets.<sup>105/</sup> He also forecasts the cost consequences of the sale for the Company and its customers.<sup>106/</sup> After an initial five-year period of harm to customers, he forecasts an ultimate benefit to customers based on a 20-year net present value.<sup>107/</sup>

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<sup>102/</sup> Docket No. UE-040921, Order 01 (Jan. 12, 2005); ICNU Ex. No. \_\_\_ (MPG-3) at 9.

<sup>103/</sup> Docket No. UE-051437, Order 01 (Nov. 30, 2005); ICNU Ex. No. \_\_\_ (MPG-3) at 9.

<sup>104/</sup> Docket No. UE-131099, Order 02 ¶ 25 (Oct. 23, 2013); Staff Ex. No. \_\_\_ (EJK-1T) at 16:14-22.

<sup>105/</sup> PSE Ex. No. \_\_\_ (JAP-1T) at 4:4-10:20, 13:16-15:12.

<sup>106/</sup> Id. at 11:1-13:14.

<sup>107/</sup> PSE Ex. No. \_\_\_ (JAP-7).

a. *PSE's allocations do not reflect how the Company recovers its costs of service.*

With respect to the allocation of costs to PSE's former Jefferson County customers, Mr. Piliaris' allocation exercise creates the illusion that these customers actually paid for the full cost of the distribution assets used to serve them when, of course, they did no such thing. Rates are set system-wide.<sup>108/</sup> Thus, all customers pay for the entire system, not a portion of it. Indeed, if PSE's Jefferson County customers truly paid for the costs of only the assets used to serve them, PSE would have faced far more significant cost recovery risk in this area of its service territory. As Mr. Gorman testified, "[c]ost recovery risk is impacted by weather, the economy, natural events, outages, and other factors which can limit PSE's ability to collect its revenue requirement from specific groups of customers. A broader and more diverse customer base mitigates this ... cost recovery risk."<sup>109/</sup>

Through Mr. Piliaris' allocations, it appears that PSE is attempting to approximate a situation similar to that in Maine Water Co. v. Pub. Utils. Comm'n.<sup>110/</sup> A brief examination of that case, however, demonstrates the inappropriateness of PSE's efforts. In Maine Water, the Maine Supreme Court overruled a Maine Public Utilities Commission ruling that allocated the gains from the sale of two of the Main Water Company's divisions ("Newport" and "Wilton") to its remaining customers.<sup>111/</sup> The court noted that, in a prior case, it had found "that when a utility sells [depreciable] property for a *loss* it is generally allowed to amortize such loss as an expense to be recovered from its ratepayers."<sup>112/</sup> Thus, under its prior precedent, "it is only equitable that the ratepayers who bear the cost of depreciation and maintenance on the property and the burden

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<sup>108/</sup> PSE Ex. No. \_\_\_ (JAP-1T) at 14:13.

<sup>109/</sup> ICNU Ex. No. \_\_\_ (MPG-1T) at 4:17-21.

<sup>110/</sup> 482 A.2d 443 (Me. 1984).

<sup>111/</sup> Id. at 451.

<sup>112/</sup> Id. at 448 (citing Casco Bay Lines v. Pub. Utils. Comm'n., 390 A.2d 483, 490 (Me. 1978)) (emphasis in original).

of sale at a loss, should be entitled to benefits from the sale of such property at a gain.”<sup>113/</sup> The current case was distinguishable, the Maine Water court held, however, because the utility’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.”<sup>114/</sup> This was because each division of the utility was a “complete and geographically independent water system;” there was no “common source of water supply or any other physical interconnection;” and each division paid separate rates that were separately determined and set.<sup>115/</sup>

There are obvious distinctions between the situation in Maine Water and what PSE is trying to do here. Despite its imputations of cost assumption and recovery, the fact is that PSE’s rates are, and always have been, set system-wide. Its customers paid for the cost of *all* of its system, and thus assumed the costs and risks associated with each and every part of that system, including the Assets.

*b. PSE’s forecasts of harm are speculative and should not be relied upon in this case.*

While Mr. Piliaris’ allocation of costs to PSE’s former Jefferson County customers is misleading in how it portrays how costs are recovered from customers, his projections of costs to be borne by remaining customers and the Company are purely speculative. While Mr. Piliaris points out that no party has suggested that PSE’s projections are biased,<sup>116/</sup> one need not question the mathematical accuracy of his calculations to understand that he cannot predict the future.

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<sup>113/</sup> Id. at 448.

<sup>114/</sup> Id. at 449.

<sup>115/</sup> Id. at 446.

<sup>116/</sup> PSE Ex. No. \_\_\_ (JAP-1T) at 9:11-12.

There is a difference here between Mr. Piliaris’ 20-year projections of harm based on the JPUD Transaction and such projections used for planning purposes. Long-term projections may be a necessary part of predicting future resource needs or for other long-range planning.<sup>117/</sup> They are not necessary, however, to determine the equities of this case, which, as already discussed, relate to who bears the risks and burdens associated with in-service utility assets. Even integrated resource plans are updated every two years to reflect the impact of actual changes on long-term projections.<sup>118/</sup> Thus, Mr. Piliaris’ statement the effects of the loss of load from this transaction “will be felt through the entire 20-year horizon used in PSE’s analysis” is not necessarily true – unexpected events may occur between now and then that render his projections obsolete.<sup>119/</sup> A request that the Commission base its decision on such speculative projections is a request that it issue an order based on pure guesswork.<sup>120/</sup>

For these reasons, if the Commission determines to base its decision at all on projections of harm to the Company and its customers as a consequence of this transaction, it should place far more weight on near-term projections. PSE itself has recognized the “speculative” nature of long-term forecasts and has emphasized the higher reliability of near-term results.<sup>121/</sup> Here, PSE’s own analysis shows that its remaining customers will need to absorb additional costs for the first five years as a result of the JPUD Transaction.<sup>122/</sup> To the extent the Commission should take into account any projections of harm to PSE and its

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<sup>117/</sup> PSE Ex. No. \_\_\_ (JAP-1T) at 12:7-8.

<sup>118/</sup> WAC § 480-100-238(4).

<sup>119/</sup> PSE Ex. No. \_\_\_ (JAP-9T) at 7:18-19. Even if it were appropriate to project the long-term effects from the JPUD Transaction, one wonders why Mr. Piliaris stopped at 20 years. Why not project the effects of the JPUD Transaction out to 50 years?

<sup>120/</sup> ICNU notes that the Commission in Centralia II did not rely on power cost projections resulting from the asset sale at issue there: “When all is said and done, the power cost analyses present us with a useful, but not definitive, view of the future .... These analyses do not ... take into account technological change which, over the span of 26 years, could cause market rates to be lower than forecast .... Therefore, we do not believe that these analyses are persuasive evidence that ratepayers or the broader public will, on balance, suffer harm from increased rates attributable to the sale.” Centralia II at \*46-\*47.

<sup>121/</sup> Staff Ex. No. \_\_\_ (MRM-9CX) at 11.

<sup>122/</sup> PSE Ex. No. \_\_\_ (JAP-7).

customers, it should look to these near-term projections, which are likely to be more reliable than speculative 20-year forecasts.

**3. Customers are entitled to a portion of the proceeds that represents the amount they have paid in accumulated depreciation to support the Assets.**

In his rebuttal testimony, PSE's witness, Mr. Marcellia, discusses at length why it would be inappropriate to allocate to the Company's remaining customers a portion of the proceeds equivalent to the amount of accumulated depreciation they have paid to support the assets.<sup>123/</sup> The heart of Mr. Marcellia's position is that accumulated depreciation represents the portion of the Assets that has been "worn away," and thus, it is not part of the transaction price.<sup>124/</sup> Mr. Marcellia faults ICNU and Staff for allegedly confusing allocation and valuation. That is, "the presence of a gain in a condemnation setting is not necessarily indicative of excess depreciation .... Depreciation is capturing the wear and tear, not necessarily the change in value."<sup>125/</sup>

Yet, while Mr. Marcellia's testimony refers to accounting definitions,<sup>126/</sup> for purposes of determining who is entitled to the gain from the JPUD transaction, Mr. Marcellia is making a distinction without a difference. The issue is who bore the risks and burdens associated with the Assets. During the time PSE owned the Assets, customers paid the Company rates that included a return of the invested capital in those Assets, allegedly to reflect the depreciating value of the Assets as they were used up in service. These depreciation payments transfer the risk of loss to customers by returning to the Company its invested capital.<sup>127/</sup> If the

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<sup>123/</sup> PSE Ex. No. \_\_\_ (MRM-5T) at 10:1-18:9.

<sup>124/</sup> Id. at 13:17.

<sup>125/</sup> Id. at 12:16-17.

<sup>126/</sup> Id. at 10:9-24.

<sup>127/</sup> Democratic Central, 485 F.2d at 808; AT&T Info. Sys., Inc. v. FCC, 854 F.2d 1442, 1444 (D.C. Cir. 1988) ("ratepayers generally assume the risk of loss on depreciable assets used in a utility's operations because

value of the Assets did not in fact depreciate, customers were burdened with higher than necessary rates.

This was the Commission’s ruling in Centralia II in which it found that customers should be allocated the amount of the proceeds equivalent to accumulated depreciation because the plant in question was sold for greater than its original cost, and customers had, therefore, “overpaid necessary depreciation.”<sup>128/</sup> The same scenario is present here. The original cost of the Assets was approximately \$76.6 million,<sup>129/</sup> yet JPUD was willing to pay over \$30 million more for them. In both scenarios, customers paid an amount that represented the anticipated reduced value of the assets as they were used in service (i.e., depreciation). Because, based on the sale price, the Assets actually appreciated in value, however, customers paid unnecessary depreciation expense and should be compensated accordingly.

PSE also attempts to show that its former Jefferson County customers paid the full amount of accumulated depreciation related to the Assets through another allocation exercise performed by Mr. Piliaris.<sup>130/</sup> As with his other allocations, however, the apportionment of accumulated depreciation to Jefferson County does not reflect how depreciation expense is actually borne by the Company’s customers, which is set system-wide: “all customers share in the recovery of PSE’s overall depreciation expense.”<sup>131/</sup> While ICNU does not dispute Mr. Marcellia’s statement that “it must certainly be true that the departing JPUD customers paid for some portion of [the Assets’] accumulated depreciation,”<sup>132/</sup> it is far more sensible to assume that JPUD paid for a portion of such accumulated depreciation consistent with its share of PSE’s

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the investors are protected against loss by the depreciation expenses incorporated in the rates charged by the utility”).

<sup>128/</sup> Centralia II at \*61.

<sup>129/</sup> PSE Ex. No. \_\_\_ (MRM-3) (row 2).

<sup>130/</sup> PSE Ex. No. \_\_\_ (JAP-1T) at 13:16-15:12.

<sup>131/</sup> Id. at 14:13-14.

<sup>132/</sup> PSE Ex. No. (MRM-5T) at 16:1-2.



overall system. Mr. Marcellia testified that Jefferson County constituted 1.8 percent of its customers and service territory.<sup>133/</sup>

Even with regard to this 1.8 percent, PSE provides no persuasive indication as to why this portion of the accumulated depreciation should flow back to PSE rather than its remaining customers. PSE argues that giving customers the equivalent of what they have paid in accumulated depreciation related to the Assets would actually take money from the Company.<sup>134/</sup> This is simply false. Nothing demonstrates this more clearly than the fact that no one is suggesting that PSE pay to customers money those customers already paid it in rates. All parties advocate returning to PSE its full invested capital, plus transaction costs, plus some amount of the gain.<sup>135/</sup> PSE has already received approximately \$30 million in depreciation payments from customers that it will retain going forward.<sup>136/</sup> The fact that departed customers paid for some portion of the accumulated depreciation of the Assets does not mean that PSE is somehow losing this money. Far from taking money from the Company, every proposal before the Commission in this case results in PSE receiving income it would not otherwise have had as a consequence of the JPUD transaction. There is no risk or burden to PSE associated with the accumulated depreciation customers have already paid, whether it came from current or former customers.

PSE also argues that it has not recovered the full amount of its depreciation expense, citing its 2013 10-K.<sup>137/</sup> According to this 10-K, the primary reason for this under-recovery was “additional electric expenditures placed into service.”<sup>138/</sup> This is the same refrain the Commission has heard from PSE for years now – that capital expenditures have resulted in

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<sup>133/</sup> PSE Ex. No. \_\_\_ (MRM-5T) at 37:15-16.

<sup>134/</sup> PSE Ex. No. \_\_\_ (MRM-5T) at 25:1-18; PSE Ex. No. \_\_\_ (SLL-1T) at 8:9-13.

<sup>135/</sup> ICNU Ex. No. \_\_\_ (MPG-1T) at 5; Staff Ex. No. \_\_\_ (EJK-1T) at 4; Pub. Counsel Ex. No. \_\_\_ (JRD-1T) at 38.

<sup>136/</sup> PSE Ex. No. \_\_\_ (MRM-3) (row 3).

<sup>137/</sup> PSE Ex. No. \_\_\_ (MRM-5T) at 13:5-7.

<sup>138/</sup> PSE Resp. to Commission Bench Request 1, Attach. A.

chronic under-earning.<sup>139/</sup> To specifically address this problem, the Commission, in 2012, granted PSE a rate increase based on an expedited rate filing, which also included a decoupling mechanism and an automatic rate escalation plan.<sup>140/</sup> All three mechanisms were approved essentially as filed.<sup>141/</sup> If PSE is still experiencing earnings attrition due to capital investments, ICNU submits that it is time for the Company to look elsewhere besides its customers and the Commission.

**D. PSE has not suffered risks or burdens from the JPUD Transaction.**

ICNU has already established that customers bear the risk of loss upon the sale of in-service utility property, including the Assets sold to JPUD. Furthermore, with respect to this transaction, PSE's own analysis projects significant near-term harm to customers as a consequence of its sale of Assets to JPUD.<sup>142/</sup> Conversely, PSE does not bear any risks associated with this transaction that it is not already compensated for through its rate of return. Further, the Company will be made whole following the outcome of this proceeding.

ICNU does not dispute that it is certainly possible for a utility to be harmed as a consequence of the sale of a portion of its service territory under threat of condemnation. PSE's primary assertion of harm, for example, is going concern damages – the lost ability to continue to earn revenue from its former Jefferson County service territory.<sup>143/</sup> There may be instances where such damages exist that would warrant the Commission providing a portion of the gain to a utility as part of its analysis of the risks and burdens of a transaction. But going concern damages have not been established in this case. In fact, PSE's testimony in this case that it has

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<sup>139/</sup> See, e.g., Docket Nos. UE-111048/UG-111049, Order 08 ¶ 494 (May 7, 2012); Docket Nos. UE-121697/UG-121705 and UE-130137/UG-130138, Order 07 ¶ 22 (June 25, 2013).

<sup>140/</sup> Docket Nos. UE-121697/UG-121705 and UE-130137/UG-130138, Order 07 (June 25, 2013).

<sup>141/</sup> *Id.* ¶¶ 244-45.

<sup>142/</sup> PSE Ex. No. \_\_\_ (JAP-7).

<sup>143/</sup> PSE Ex. No. \_\_\_ (MRM-1T) at 8:13-9:3.

suffered going concern damages is directly contradicted by its own prior testimony in the Declaratory Ruling Proceeding. In this case, Mr. Marcelia states that “PSE has ... suffered a loss of customers today. Its earnings base is smaller and its investment opportunity has diminished .... Whatever growth is to be had in the remaining customer base is unchanged and unaffected by the transaction.”<sup>144/</sup> Yet, in the Declaratory Ruling Proceeding, PSE’s witness, Karl Karzmar, testified that:

The high cost of serving Jefferson County in relation to the number of customers in the Service Territory limits its revenue potential. There is no expectation of any significant load growth in the Service Territory within the foreseeable future .... [A]s acquisition costs (and other costs of service) increase, the ability to credibly assert going concern value diminishes .... JPUD argued that some or all of these going concern damages were offset by the benefits of selling a high cost service area to JPUD together with the ‘savings’ ... PSE would realize by shedding the existing Jefferson County load. JPUD was prepared to argue that, rather than incurring ‘going concern’ damages, PSE would realize a net financial benefit by releasing the Service Territory to JPUD ....<sup>145/</sup>

PSE’s witness, Samuel Osborne, indicated at the hearing that Mr. Karzmar’s testimony continues to be accurate today.<sup>146/</sup> Accordingly, it is just as likely that, far from suffering going concern damages as a result of this transaction, PSE will be better off from having sold a high cost, low growth service territory to JPUD.

Furthermore, PSE will receive a full return of its capital investment in the Assets. No party disputes PSE’s right to recover the remaining net book value of the Assets.<sup>147/</sup> PSE’s customers have also already paid the Company approximately \$30 million in accumulated

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<sup>144/</sup> PSE Ex. No. \_\_\_ (MRM-5T) at 32:13-19.

<sup>145/</sup> PSE Ex. No. \_\_\_ (SSO-5) at 16:12-17:5.

<sup>146/</sup> Tr. 67:7-11.

<sup>147/</sup> ICNU Ex. No. \_\_\_ (MPG-1T) at 5 (Table 1); Staff Ex. No. \_\_\_ (EJK-1T) at 4:15-23; Pub. Counsel Ex. No. \_\_\_ (JRD-1T) at 3:30-32.

depreciation related to the Assets<sup>148/</sup> as well as a fair return when the Assets were in service. Moreover, PSE will continue to earn a return of and return on its capital investment in the Assets, it will just come from a different place. The Company specifically stated that, for tax purposes, it intends to take the remaining net book value and put it into “investments PSE would otherwise be required to make in order to serve its remaining customers.”<sup>149/</sup> Thus, the value of the Company’s rate base on which it earns a return will not be permanently diminished by the JPUD Transaction.

Finally, PSE makes much of the forced nature of this transaction.<sup>150/</sup> Again, as noted above, PSE voluntarily accepted JPUD’s final payment offer and negotiated the terms of the asset purchase agreement.<sup>151/</sup> Furthermore, the fact that this transaction occurred under threat of condemnation does not in any way alter the balance of risks and burdens associated with this property sale as opposed to any other. Customers have borne the risks and burdens associated with the depreciable rate base Assets sold here, just as they do with other similar assets. And, as Commissioner Hemstad recognized in his Centralia II dissent, the risk of condemnation is a risk Washington utilities have faced for years.<sup>152/</sup> It is simply one of the known risks the Company faces for which it is reasonable to assume it is compensated in its return on equity.<sup>153/</sup> It is also a risk that only the Company has any ability to avoid by, among other things, pricing its service competitively and providing good customer service.<sup>154/</sup> During the campaign over Proposition 1, PSE’s own chief executive officer at the time acknowledged the Company’s failures in this

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<sup>148/</sup> PSE Ex. No. \_\_ (MRM-3) (row 3).

<sup>149/</sup> ICNU Ex. No. \_\_ (MPG-3) at 11.

<sup>150/</sup> PSE Ex. No. \_\_ (MRM-1T) at 8:7-9:3.

<sup>151/</sup> Pet. ¶¶ 13-14.

<sup>152/</sup> Centralia II at \*112.

<sup>153/</sup> ICNU Ex. No. \_\_ (MPG-1T) at 10:1-10. Indeed, the Commission approved PSE’s Declaratory Ruling Petition before setting the Company’s current return on equity in its 2011 general rate case, so it was aware of the pending sale of the Assets at that time. Docket Nos. UE-111048/UG-111049, Order 08 (May 7, 2012).

<sup>154/</sup> ICNU Ex. No. \_\_ (MPG-1T) at 10:11-11:2.

regard.<sup>155/</sup> Indeed, as Mr. Piliaris' near-term power cost forecasts indicate, customers bear at least as much risk from a municipalization as the Company does, yet customers are powerless to avoid one. PSE has not demonstrated that municipalization is a risk that justifies it receiving a portion of the proceeds.

#### **IV. CONCLUSION**

For the foregoing reasons, the Commission should reject PSE's proposed allocation of the proceeds from the sale of assets to the Jefferson County Public Utility District and should enter an order that allocates the proceeds by giving net book value and transaction costs to the Company, the equivalent of accumulated depreciation to customers, and splits the remaining gain with 90 percent going to customers and ten percent to PSE.

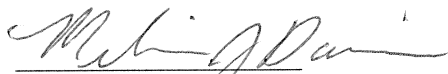
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<sup>155/</sup> ICNU Ex. No. \_\_ (SSO-9CX).

Dated this 10th day of June, 2014.

Respectfully submitted,

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