

EXHIBIT NO. ___(SSO-1T)
DOCKET NO. UE-13___
WITNESS: SAMUEL S. OSBORNE

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

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

Docket No. UE-13___

**PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
SAMUEL S. OSBORNE
ON BEHALF OF PUGET SOUND ENERGY, INC.**

OCTOBER 31, 2013

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PUGET SOUND ENERGY, INC.
PREFILED DIRECT TESTIMONY OF
SAMUEL S. OSBORNE

5 **Q. Please state your name, business address, and present position with Puget**
6 **Sound Energy, Inc.**

7 A. My name is Samuel S. Osborne. I am Assistant General Counsel and Assistant
8 Secretary at Puget Sound Energy, Inc. ("PSE"). My business address is 10885
9 N.E. Fourth Street, Bellevue, Washington, 98009.

10 **Q. Have you prepared an exhibit describing your professional qualifications?**

11 A. Yes, I have. It is Exhibit No. ____ (SSO-2).

12 **Q. What is the purpose of your testimony?**

13 A. My testimony will describe the steps taken by PSE to reach a settlement of
14 threatened litigation with Public Utility District #1 of Jefferson County ("JPUD").
15 These steps were taken in response to JPUD's planned condemnation of PSE's
16 transmission and distribution facilities in Jefferson County. My testimony will
17 also discuss the terms and conditions of the settlement as set forth in the Asset
18 Purchase Agreement ("APA") and the terms and conditions of the Customer
19 Transition Agreement, which agreements are included as Exhibit No. ____ (SSO-3)
20 and Exhibit No ____ (SSO-4). Finally, my testimony will describe the post-closing
21 adjustments that resulted in the determination of a final purchase price for the
22 assets sold to JPUD ("Assets") of \$108,362,251.04

1 **Q. Please describe the course of events that led PSE to enter into a settlement**
2 **with JPUD.**

3 A. These events were fully described in the Prefiled Direct Testimony of Karl R.
4 Karzmar, former Director of Regulatory Relations for PSE, filed in *In the Matter*
5 *of the Petition of Puget Sound Energy, Inc., For a Declaratory Order Regarding*
6 *the Transfer of Assets to Jefferson County Public Utility District* (Docket No. U-
7 101217). Mr. Karzmar's testimony in that proceeding is attached at Exhibit
8 No. ___(SSO-5).¹ I am also familiar with these events and am able to sponsor his
9 testimony in this proceeding. I will now briefly summarize those portions of Mr.
10 Karzmar's testimony that are relevant to the proposed accounting treatment of the
11 proceeds of the sale of the Assets.

12 PSE provided electrical service to its customers in east Jefferson County (the
13 "Service Territory") for approximately 96 years. In the summer of 2008, a
14 sufficient number of signatures were gathered in Jefferson County, Washington,
15 to submit "Proposition No. 1" to the voters for consideration in the November
16 general election. Proposition No. 1 authorized JPUD to "construct or acquire
17 electric facilities for the generation, transmission or distribution of electric
18 power." Proponents of Proposition No. 1 advanced this proposal as a means to
19 forcibly take over PSE's Service Territory.

¹ Note that Mr. Karzmar's testimony in Docket No. U-101217 was confidential per WAC 480-07-160 during that proceeding, but it is no longer confidential and PSE has not designated Exhibit No. ___(SSO-5) as such.

1 Proposition No. 1 was a controversial ballot measure. There was open and
2 vigorous public debate on the relative merits of "going public" as opposed to
3 maintaining PSE as the preferred service provider. Proposition No. 1 was
4 ultimately approved by the voters at the November election by a narrow margin.
5 As a result of this election, RCW 54.16.020 now authorized JPUD to acquire
6 PSE's assets and the Service Territory by eminent domain.

7 In November of 2008, JPUD was still a small water and sewer utility, with
8 approximately 4,000 customers. Although JPUD was now authorized by law to
9 forcibly acquire the Service Territory, JPUD lacked the financing, expertise and
10 resources necessary to go into the electric business. It was not clear in 2008 if
11 JPUD would be able to acquire these resources. In this context, PSE advised
12 JPUD that it was an "unwilling seller" and that PSE believed that it was still best
13 suited to be the electric service provider in the Service Territory.

14 **Q. Please describe the actions taken by JPUD that manifest JPUD's intention to**
15 **condemn the Assets and to assume exclusive responsibility for providing**
16 **retail electric service to PSE's customers in Jefferson County.**

17 A On June 3, 2009, the JPUD Commissioners approved a motion regarding the use
18 of JPUD's condemnation authority to obtain the Assets. A further motion was
19 approved by the JPUD Commissioners on September 2, 2009 authorizing the
20 JPUD general manager to enter into negotiations with PSE regarding settlement
21 and a potential purchase of the Assets in lieu of condemnation. JPUD's intentions
22 are further reflected in the APA itself, which states:

1 This Agreement is being entered into by the Parties as the definitive
2 agreement contemplated under the LOI, and the transactions described
3 herein are proceeding under JPUD's threat of condemnation and, if
4 consummated, will constitute a settlement between the Parties and a
5 disposal of property to a special purpose district pursuant to RCW
6 80.12.020(2).

7 Exhibit No. ____ (SSO-3) at 5.

8 On June 11, 2010, the JPUD Board of Commissioners unanimously passed
9 Resolution No. 2010-008, approving the APA and directing the general manager
10 to immediately file a request for service with the Bonneville Power
11 Administration ("BPA"), and to acquire financing for the interim and long term
12 needs of the utility in order to accommodate the electric utility function.

13 Resolution No. 2010-008 states in relevant part:

14 WHEREAS, the Commission finds that entering into the Asset Purchase
15 Agreement dispenses with the need for the proposed condemnation
16 previously considered by the Commission, but it does not ultimately
17 preclude its authority to condemn the electric facilities if that becomes
18 necessary for the establishment of an electric utility.
19

20 Exhibit No. ____ (SSO-6).

21 During the period from June 11, 2010 through March 31, 2013 ("Transition
22 Period") JPUD negotiated a contract with BPA to provide power and transmission
23 services to JPUD. By letter dated June 14, 2010, provided as Exhibit
24 No. ____ (SSO-7), JPUD requested an expeditious determination that it had
25 "sufficiently demonstrated compliance with all of BPA's Standards for Service
26 and is eligible to receive power from BPA as a newly formed public utility." In
27 this letter JPUD stated with respect to the APA:

28 In the unlikely event that the transaction terminates prior to closing, JPUD
29 intends to immediately commence condemnation proceedings.

1 Exhibit No. ____ (SSO-7) at 3. In April of 2012, the U.S. Department of
2 Agriculture's Rural Utility Service agreed to guarantee a \$115.5 million loan to
3 JPUD from the Federal Financing to purchase the Assets. Based upon this
4 commitment, JPUD waived its financing contingency and subsequently applied
5 these funds to close the transactions contemplated by the APA.

6 On March 15, 2013, in approving an amendment to the APA providing for a final
7 adjustment of the purchase price, the JPUD Board of Commissioners passed a
8 motion related to its use of condemnation authority, and clarifying and ratifying
9 prior actions of the district, which states in relevant part:

10 Under the threat of condemnation, Puget Sound Energy and the District
11 entered into the Asset Purchase Agreement providing for a Transition
12 Period and purchase of the Assets of Puget Sound Energy, among other
13 things, as further defined in the Asset Purchase Agreement on June 10,
14 2010, and the Amendment to the Asset Purchase Agreement approved
15 simultaneously with this Motion.

16 Exhibit No. ____ (SSO-8)

17 **Q. Why did PSE not contest this hostile acquisition and force JPUD to initiate**
18 **condemnation proceedings?**

19 A In a condemnation proceeding, the condemning authority must obtain a judicial
20 determination of "public use and necessity," meaning a determination that the
21 contemplated use of the property sought to be appropriated is a public use and that
22 the acquisition of this property is required and necessary for such public use.
23 RCW 54.10.020 provides for the establishment of public utility districts to
24 conserve the water and power resources of the State of Washington "for the
25 benefit of the people thereof." RCW 54.16.020 expressly authorized JPUD to

1 condemn facilities for such purposes. JPUD did not seek to acquire any facilities
2 from PSE other than facilities within Jefferson County that were needed to
3 providing retail electric service to PSE's customers. Were JPUD to proceed with
4 condemnation of PSE's transmission and distribution facilities, and based upon
5 the facts presented in this case, PSE concluded that it lacked sufficient grounds to
6 successfully challenge a public use and necessity determination.

7 The second phase of a condemnation proceeding is the damages trial. Under
8 Washington law, a property owner is entitled to full and just compensation when
9 its private property is taken for public use. There is no single method or approach
10 to determining "full and just compensation" in a condemnation proceeding, and
11 Washington courts have not specifically endorsed any one method of valuation.
12 Unlike the "public use and necessity" determination, the amount of damages in a
13 condemnation case can vary widely and is a vigorously contested issue in a
14 condemnation proceeding. Ultimately, PSE concluded that the purchase price
15 PSE negotiated in the APA was a favorable amount that eliminated the risk
16 associated with a jury trial to determine "fair and just compensation."

17 **Q. On what did PSE base its determination that the purchase price negotiated**
18 **in the APA was a favorable amount?**

19 A. Mr. Karzmar's testimony recounts the analyses undertaken by the parties to
20 establish the value of the Assets. Mr. Karzmar's testimony also states the reasons
21 why PSE concluded that a settlement was in the best interest of PSE and its
22 remaining customers. To summarize:

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- In determining the value of its assets, PSE considered the assessed value (\$22 million) and the net book value (\$48 million) of the Assets. PSE also considered (a) an "income approach" to valuation that supported a range in value from \$47 million to \$91 million, (b) a comparable sales analysis that supported a range in value from \$50 million to \$74 million, (c) a market sales analysis that supported a range in value from \$50 million to \$74 million; (d) a reproduction cost less depreciation analysis that supported a value of up to \$85 million (exclusive of real estate), and (e) a reproduction cost new less depreciation analysis that supported a range in value from \$58 million to \$136 million.
- Based upon these analyses, PSE concluded that its "all in" number for the fair market value of the assets was \$100 million. This included recovery of going concern damages.
- To calculate litigation risk, PSE used JPUD's low Replacement Cost New Less Depreciation ("RCNLD") valuation (\$58 million) and PSE's highest number (\$136 million). As compared to the offered purchase price of \$103 million, PSE considered a "downside risk" of approximately \$45 million and an upside potential of \$33 million. However, much of the "upside" potential was embedded in speculative real estate values and arguments to support claims for greater "going concern" damages. In light of these risks, PSE concluded that a \$103 million settlement is reasonable and prudent from the standpoint of avoiding litigation risk.

1 **Q. Were there other aspects of settlement that were potentially beneficial to PSE**
2 **and its customers?**

3 A Yes. The terms of JPUD's final offer were memorialized and accepted by PSE in
4 a letter of intent dated April 30, 2010. The parties subsequently negotiated the
5 APA to address the details of the proposed settlement. In order to be made whole
6 and to protect PSE's remaining customers and shareholders post closing, the APA
7 included the following terms and conditions:

- 8 • a specific list of distribution assets and real property interests then in
9 service to be transferred to JPUD at closing;
- 10 • a purchase price for the Assets of \$103 million;
- 11 • a mechanism to increase the purchase price to compensate PSE for the net
12 book value of any additions to or betterments of the Assets placed in
13 service during the transition period;
- 14 • a condition that all Assets were to be transferred at closing by PSE and
15 accepted by JPUD "as is, where is, with all faults and defects, and without
16 warranty or representation of any kind;"
- 17 • terms reserving to PSE the unfettered discretion during the Transition
18 Period, to construct, operate and maintain its facilities in Jefferson County
19 at the same quality and level of service that PSE provides to its other
20 customers;
- 21 • an indemnity from JPUD for any future liability arising from (a) existing
22 environmental conditions that are reasonably expected in the ordinary

1 course of utility operations, and (b) all environmental conditions arising
2 after the closing date;

- 3 • an indemnity protecting PSE remaining customers from adjustments by
4 the BPA for any overpayment of benefits, for the period October 1, 2001,
5 through September 30, 2008 allocable to PSE's residential and small farm
6 customers in Jefferson County;
- 7 • other indemnities from JPUD covering matters related to the Assets or
8 assumed liabilities that arise after closing;
- 9 • an express disclaimer of any warranties and representations with respect to
10 the Assets, a waiver of consequential damages and a limitation of liability;
- 11 • provisions that allowed (as a condition of closing) PSE to require a
12 Customer Transition Agreement addressing the obligations and cost
13 responsibilities of the parties concerning the transition of electric utility
14 service obligations to JPUD; and
- 15 • conditions to closing that allowed PSE to obtain all necessary regulatory
16 approvals on terms and conditions satisfactory to PSE.

17 **Q. Did the severance of the Service Area and the transition to JPUD as the retail**
18 **electric service provider negatively impact service to PSE's remaining**
19 **customers?**

20 A. No. The sale of the Assets and the severance of the Service Territory did not
21 negatively affect the level, quality or reliability of service to PSE's remaining
22 customers. The Assets are all located within the Service Territory. No assets

1 located outside of Jefferson County were sold or affected by the sale. None of the
2 Assets sold were used to provide service outside of Jefferson County. Unique
3 characteristics of the configuration of PSE's system in Jefferson County provided
4 for a complete separation from the remainder of PSE's system. Jefferson County
5 is served by a radial transmission and distribution system originating primarily
6 from the BPA Fairmount substation. There were no generation assets involved in
7 or affected by this transaction. The Assets sold to JPUD served no function or
8 purpose outside of the Service Territory. No electrical facilities of any
9 significance were stranded or rendered uneconomic by reason of this sale.

10 **Q. What steps did PSE take during the Transition Period to protect the interests**
11 **of customers and shareholders?**

12 A. PSE and JPUD's obligations with respect to transitioning the Service Territory
13 were memorialized in the CTA. In order to be made whole and to protect PSE's
14 remaining customers and shareholders post closing, PSE put substantial efforts
15 into negotiating the CTA that included the following terms and conditions:

- 16 • payment by JPUD of costs incurred by PSE in connection with the
17 transition of the Service Territory (\$800,000);
- 18 • payment by JPUD of accounts receivable from March 10, 2013 to March
19 31, 2013 (\$1,966,080);
- 20 • payment by JPUD for "stores" (e.g., consumables and other incidental
21 items) left behind in Jefferson County (\$44,429);

- 1 • non-recourse assignments of contracts, customers contracts, and permits
- 2 "as is, where is and with all faults and defects," together with indemnities
- 3 addressing prospective liabilities associated with such contracts, customers
- 4 contracts, and permits;
- 5 • a non-recourse bill of sale for transfer of the Assets;
- 6 • full and unconditional releases by JPUD for environmental studies and
- 7 other written materials provided to JPUD in connection with the
- 8 transaction;
- 9 • indemnities from JPUD covering matters such as any faults or defects in
- 10 the properties and services provided by PSE pursuant to the CTA and
- 11 JPUD's use thereof, reliance thereon, and acts and omissions with respect
- 12 thereto; and
- 13 • an express disclaimer of any warranties and representations, a waiver of
- 14 consequential damages and a limitation of liability.

15 **Q. How did PSE and JPUD arrive at the final purchase price of**
16 **\$108,362,251.04.?**

17 A. On March 29, 2013, the parties executed an Amendment to the APA
18 ("Amendment") that provided for an adjusted purchase price for the Assets due at
19 closing of \$107,158,524.85. The Amendment provided for a further and final
20 adjustment of the purchase price by the Transition Advisory Committee ("TAC")
21 to reflect further additions to or betterments of the Assets, not previously
22 accounted for, and to adjust for the accumulated depreciation of any Assets placed

1 in service during the Transition Period. At closing, JPUD paid PSE
2 \$107,158,524.85 for the Assets, subject to further adjustment on or before July 1,
3 2013.

4 On July 1, 2013, the TAC met to make the final adjustments to the purchase price.
5 The TAC is comprised of five members, three PSE members and two JPUD
6 members. Having reviewed amounts due PSE for additions to or betterments of
7 the Assets placed in service during the Transition Period, and adjusting for
8 accumulated depreciation of any Assets placed in service during the Transition
9 Period, the TAC determined that an additional \$1,203,726.19 should be added to
10 the purchase price. As adjusted, the final purchase price for the Assets sold to
11 JPUD under threat of condemnation pursuant to the APA was \$108,362,251.

12 **Q. Has PSE been fully paid for the Assets sold to JPUD?**

13 A. Yes. On August 2, 2013, PSE received final payment from JPUD in the amount
14 of \$1,203,726.19. In making this payment, JPUD advised PSE that there are
15 approximately \$416,000 in charges for Assets placed in service during the
16 Transition Period that are still under review. PSE is reviewing these charges to
17 determine if any further adjustments are warranted.

18 **Q. Does this conclude your testimony?**

19 A. Yes, it does.