BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

REPLY BRIEF OF

PETITIONER PUGET SOUND ENERGY, INC.

JUNE 17, 2014

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I. INTRODUCTION

1. Under threat of condemnation by Jefferson County Public Utility District ("JPUD"), PSE negotiated a settlement that provided full and just compensation for the Jefferson County assets ("Assets") and for the commercial value of its business in the Jefferson County service area ("Service Area"). The settlement PSE negotiated achieved more than double the net book value of the Assets and exceeded by a significant amount the highest value JPUD had assigned to the Assets and Service Area. The allocation of the gain on this sale is the issue before the Commission in this proceeding.

2. While recognizing PSE's success in negotiating a higher price for the Assets and Service Area, the other parties to this proceeding recommend that the Commission allocate at most only seven percent of the gain from this transaction to PSE. These recommendations rest upon allegations of "harm" to customers that are drawn from evidence that shows, to the contrary, that remaining customers will financially benefit from this transaction. These recommendations disregard the commercial value of PSE's lost business opportunity and assign a *zero value* to PSE's former customers.

3. The Commission is called upon to regulate, in the public interest, the outcome of a competitive taking of the Service Area. If the Commission finds that remaining PSE customers were harmed, then they should be compensated. The same is true for shareholders. The evidence shows that the value of this lost business opportunity to be an amount not less than $76,000,000. Not as an "incentive," but as a harm, this loss must be compensated. These equitable principles protect the public interest. Any additional proceeds are appropriately shared between customers and shareholders.

II. REPLY

A. Competitive Acquisition of Assets and Service Area.

4. PSE was forced to sell the Assets and the Service Area by a utility that *wanted its business*, not just its real and personal property. This taking entitled PSE, as a matter of law, to "just compensation" for the value of the confiscated assets[1] and for the commercial value of its lost business opportunity.[2] This constitutionally-based rule of law compensates regulated utilities for the "going concern" value lost to a *competitive* taking of a business that operates, under normal circumstances, without threat of competition.[3] This rule of law recognizes that the regulatory compact that protects investors from competitive risk has been permanently and irrevocably terminated, in its entirety in the case of a total liquidation, and relatively in the case of a partial liquidation. These are precisely the *competitive* circumstances the California Public Utilities Commission ("CPUC") addressed in *Redding II*.[4] In so doing, the CPUC adopted a rule that regulates *the outcome of an event* over which the CPUC had no regulatory control. This rule compensates remaining customers for any harm that they might have incurred as a result of this event, and only then, compensates shareholders for the loss of their assets and future revenues. Striking this balance returns the

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[1] Wash. Const. Art. I, §16; *Sintra, Inc. v. City of Seattle*, 131 Wn.2d 640 (1997); *City of Medina v. Cook*, 69 Wn.2d 574 (1966).

[2] *Kimball Laundry Co. v. U.S.*, 338 U.S. 1 (1949); *City of Omaha v. Omaha Water Co.*, 218 U.S. 180 (1910).

[3] The U.S. Supreme Court has stated: "The situation is otherwise, however, when the Government has condemned business property with the intention of carrying on the business, as where public-utility property has been taken over for continued operation by a governmental authority. . . . . The owner retains nothing of the going-concern value that it formerly possessed; so far as control of that value is concerned, the taker fully occupies the owner's shoes. *Kimball Laundry* at 12-13.

[4] *In re Rate-making Treatment of Capital Gains Derived from the Sale of a Public Utility Distribution System Serving an Area Annexed by a Municipality or Public Entity*, D. 89-07-016, 32 CPUC 2d. 233 (1989) ("*Redding II*").

remaining customers and shareholders to the position they were in prior to the taking, and is the equitable balance the Commission should reach in this case.[5]

B. Equities to be Considered in this Case.

5. The confiscation of the Service Area resulted in a permanent reduction in load of approximately 33 aMW. Near term (six year) forecasts demonstrate that this load reduction provides a *net power cost benefit* to PSE's remaining customers. Viewed over a 20-year horizon, the net power cost benefit to remaining customers is $103 million. Shareholders, however, lost customers and revenues. While other parties ascribe *zero value* to these customers, the lost investment value to shareholders of reduced revenues is at least $76,000,000.[6] Absent any credible evidence of harm to the remaining customers, no equitable sharing of the gain can or should be considered unless and until this demonstrable harm to shareholders has been fully compensated.

C. The Commission is Free to Equitably Allocate the Gain Because there is No Commission Precedent for this Case.

6. Other parties attempt to pigeonhole this case into a familiar category such as a voluntary asset sale,[7] a rate proceeding,[8] a premature retirement of assets,[9] or some other

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[5] *Redding II* at 3 (Westlaw pagination).

[6] Bellemare, Exh. No. RCB-1T 3:1-7.

[7] *See* Brief of Public Counsel at ¶ 21 referencing *Application of Avista Corp. for Authority to Sell its Interest in the Coal-Fired Centralia Power Plan,* Docket UE-991255, *et al.*. Second Supplemental Order (March 6, 2000).

[8] *See* Initial Brief on Behalf of Commission Staff ("WUTC Staff Brief") at ¶ 21, referencing *Application of PacifiCorp,* 68 Pub. Util. Rep. (PUR) 4th 573, 485-86 (Wyo. PSC 1985); ¶ 34, referencing *Federal Power Comm'n. v. Hope Natural Gas Co.* 320 U.S. 591 (1944); *Bluefield Water Works & Improvement Co. v. Public Service Comm'n.* 262 U.S. 679 (1923).

[9] *See* Opening Brief of ICNU at ¶ 38.

established regulatory transaction.[10] These cases do not apply to the facts and circumstances of this case.[11]

7. Rather than apply inapplicable precedents and theories, the Commission is called on to make a policy decision that equitably balances the interests of shareholders and customers *as affected* by an asset transfer and loss of service area compelled by eminent domain.[12] It is this Commission's duty to articulate clear principles in this proceeding because the facts involving this competitive loss are clearly different from those of the cases referenced by WUTC Staff, Public Counsel and ICNU.

D. The Legal Principle that Should Guide the Commission in this Case Is to Regulate in the Public Interest.

8. The legal principle that should guide the Commission's decision in this case is clear and succinct. RCW 80.01.040(3) states that the Commission must r*egulate in the public interest*. The attention therefore turns to the circumstances that the Commission is called upon to regulate. The Commission had no authority to approve the transaction. While the Commission did rule that the amount of the proceeds was sufficient, the amount of the proceeds was established by constitutionally-based principles that determine "just compensation," not the principles applicable to ratemaking. Net book value may be the basis to determine rate base in a ratemaking proceeding but it is not sufficient under the laws of the State of Washington to compensate PSE for its assets and its lost business interest.

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[10] *See* Initial Brief on Behalf of Commission Staff at ¶ 14, referencing *Amended Petition of PSE for an Order Authorizing the Use of the Proceeds From the Sale of Renewable Energy Credits and Carbon Financial Instruments,* Docket UE 070725, Order 03, Final Order.

[11] ICNU claims that PSE's negotiations and sale were "entirely voluntary;" Initial Brief of ICNU at ¶ 31; and ICNU sees no difference between a forced sale and any voluntary sale of depreciable rate base property; *id.* at ¶ 36. This view simply ignores what actually occurred.

[12] Contrary to WUTC Staff's claim, PSE does not argue that shareholders are entitled to 100 percent of the gain "as a matter of law." See *Petition* at ¶ 37.

Were that the law, JPUD's purchase price would have been $46,686,435 plus severance damages (or stranded costs as frequently and mistakenly referred to in this proceeding).[13]

9. Applying the public interest test in this case does not involve re-characterizing this case as a ratemaking proceeding in order to give rise to "equitable claims," legitimate in other contexts, but not this one. The public interest is applied here to address *the outcome of an event* that no party to this proceeding, or even the Commission, could control. In this regard:

- If the Commission is persuaded, based on the evidence in the record, that remaining PSE customers were harmed by this transaction, then these customers should be compensated.
- If the Commission is persuaded, based on the evidence in the record, that PSE's shareholders were harmed by this transaction, then this harm should also be compensated.

These are the equitable principles that protect the public interest in this case. After these wrongs have been righted, any additional proceeds are appropriately shared between customers and shareholders.

E. Striking the Equitable Balance in this Case.

10. All parties agree that the $46,686,435 net book value of the Assets should be returned to the shareholders. The decision to be made relates solely to the allocation of the $59,864,235 gain on sale.

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[13] Stranded Costs are recoverable under FERC Order 888 for certain costs associated with retail-turned-wholesale customers, a situation that can arise through new municipalizations and municipal annexations. No stranded costs were incurred in connection with the JPUD acquisition. In this case, rather than stranded costs, the transaction gave rise to a $103 million "stranded" power cost benefit." Were state law as the other parties to this proceeding mistakenly assert it to be, with this offset JPUD's purchase price would have been less than net book value.

11. In the absence of their own analysis, the other parties attempt to recast Mr. Piliaris's analysis[14] to show financial harm to PSE's remaining customers derivative from "stranded costs" they claim are embedded in Jefferson County delivery system revenue requirements. The arguments of WUTC Staff, Public Counsel and ICNU with respect to delivery system revenue requirements rest on extreme assumptions and undercut one another's conclusions. The credible evidence before the Commission is "a negligible effect on the delivery component of remaining customers' overall revenue requirements."[15] As it relates to power costs, again in the absence of their own analysis, the other parties claim Mr. Piliaris's analysis is speculative but nonetheless use it to assert that remaining customers will incur a $34 million harm over a four year period that is "constant and will continue in perpetuity."[16] However, the credible evidence before the Commission is that, by year five, remaining customers receive a benefit of $34 million, by year six, a benefit of another $33 million, and looking out over a 20-year horizon, a net benefit of $103 million.[17] It is difficult to discern any harm to remaining customers--either short term or long term–flowing from *the outcome of the event* that the Commission is called upon to regulate in the public interest.

12. Shareholders, on the other hand, suffered harm attributable to the liquidation of their business. Collectively, the parties in opposition argue that PSE's former Jefferson County customers had zero value to PSE's shareholders.[18] This is contrary to the evidence. The evidence before the Commission shows a permanent loss of the Service Area and revenues

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14 Piliaris, Exh. No. JAP-3.

15 Piliaris, Exh. No. JAP-9T 31:1-2.

16 Keating, Exh. No. EJK-1T 26:1-6

17 Public Counsel concedes this benefit but values it at $58 million; Dittmer, Exh. No. JRD-1T 33:5-9; and if this amount is adjusted so as to be responsive to Mr. Keating criticisms of the underlying analysis, is at least $79 million. Piliaris, Exh. No. JAP-14.

18 *See* Keating, Exh. No. EJK-1T 32:19-22; Dittmer, Exh. No. JRD-1T 14:17-20; Gorman, Exh. No. MPG-1T 8:3-11.

from 18,000 customers. Contrary to the economics proffered by the parties in opposition, this loss of revenues is not "made up" by selling the same service to fewer customers in a smaller service area.[19] Rather, the Commission was presented evidence by a qualified appraiser showing that shareholders lost investment value of at least $76 million.[20] PSE respectfully submits that compensation of this harm is compelled by the public interest. The equities in this case require no less than the following allocation of the proceeds of sale to shareholders (inclusive of transaction costs[21]):

Proceeds	**Shareholders**
Net Book Value:	$46,686,435
Harm Resulting from Transaction	$29,313,572
Total	$76,000,000

13. Once the shareholders have been so compensated, the equities converge. The Commission has broader discretion in deciding how it will allocate the remaining $30,550,663[22] in the public interest. PSE proposes to share these dollars equally with customers, resulting in the accounting treatment proposed in this proceeding.[23] The Commission may well choose to allocate these remaining dollars differently, guided by its own assessment of the equities of this case, and its own views of how to strike this balance

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19 The evidences shows that embedded in the $109,273,196 settlement amount are credible claims, never presented to a jury, of "going concern damages" of as much as $70 million (more than the entire gain on sale). Bellemare, TR. 187: 9.

20 Bellemare, Exh. No. RCB-1T 3:1-7.

21 WUTC Staff asserts that PSE did not "meet its burden" to show that transaction costs incurred were $2,722,448, not the lesser amount of $2,404,643 claimed by WUTC Staff. (*See* WUTC Staff Brief at ¶ 107.) WUTC Staff apparently overlooks the rebuttal testimony of Mr. Marcelia, at Exh. No. MRM-5T 36:1-14. The correct number is $2,722,448. *See also* Exh. No. MRM-6, "Other Costs".

22 $59,864,235 - $29,313,572 = $30,550,663.

23 Exh. No. MRM-5T 8:4-6.

in the public interest.

F. The Opposing Parties Make Several Mischaracterizations

14. The parties in opposition raise many other issues; in reply, PSE stands on its briefing and the record in this proceeding. A further reply is offered to the following:

15. *Accumulated Depreciation*: Neither WUTC Staff, Public Counsel or ICNU made any effort to determine the amount of accumulated depreciation paid by PSE's former customers. The only evidence before the Commission shows that PSE's former customers paid their proportionate share of depreciation expense, in an amount equal to the $29,939,000 accumulated depreciation expense applied to the Assets.

16. *Regulatory Compact*. PSE's proposed accounting treatment is consistent with the regulatory compact for the same reasons cited by the CPUC in *Redding II*. PSE agrees with the principles articulated by *Federal Power Commission v. Hope Natural Gas Co.*[24] and *Bluefield Water Works & Improvement Co. v. Public Service Commission*[25] and their applicability to ratemaking, including the relevance of "net book value" for purposes of determining the value of rate base for ratemaking purposes.[26] This is not a ratemaking case.

17. *Customers Overpaid Depreciation*. ICNU claims, without any supporting evidence, that customers overpaid depreciation and should be compensated.[27] ICNU cannot now

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[24] 320 U.S. 591 (1944).

[25] 262 U.S. 679 (1923).

[26] WUTC Staff also relies upon the "Cody Wyoming" decision to support its position in this case. *See Application of PacifiCorp*, 68 Pub. Util. Rep. (PUR) 4th 573, 485-86 (Wyo. PSC 1985). This reliance is misplaced because this decision is a ratemaking proceeding and is inapplicable to the facts in this case. Various parties cite the "the City of Hermiston" decision for the proportion that 'the Oregon PUC allocated the gain between PacifiCorp's shareholders and customers." *See, Application of PacifiCorp*, Docket UP-187, 2001 WL 1335742 (Or. PUC Sept. 26, 2001). In that case, the allocation of a roughly $4 million gain was agreed to by the parties and presented to the Oregon Commission as a stipulation.

[27] *See* Opening Brief of ICNU at ¶ 50.

make a collateral attack on depreciation rates approved and relied upon by the Commission in prior proceedings.

18. "*Ownership Risk" and "Business Risk:"* Distinguishing risks arising in the context of a sale sheds light upon, but does not dictate, appropriate regulatory treatment. Ownership risk is the risk of incurring a gain or loss on sale when an asset is sold--it is a risk arising from the owner's decision to sell the asset. Business risks equate to costs of doing business, and for a regulated entity, these costs are reflected in revenue requirements. Ownership risk and business risk are both relevant to (but neither are determinative of) the totality of the circumstances affecting the regulatory treatment of a gain or a loss on sale. It is not true that PSE "is trying to have it both ways" and bears repeating:

> There is *no presumption by the Company*, or a past practice, that customers bear losses for sales of property when the sale is below book value. Rather, when presenting any voluntary sale to the Commission for approval, PSE must demonstrate that the proposed sale is in the public interest.[28]

19. *"Regulatory Assets"* Regulatory assets may be created, in an appropriate case, to capitalize costs that *would otherwise be charged to expense*.[29] This provides a mechanism to regulate in the public interest under the appropriate facts and circumstances--it has nothing, however, to do with the facts and circumstances of this case.[30] It provides a means

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[28] *See* PSE's Post Hearing Brief at ¶ 45.

[29] For example, prepayment of Mid-Columbia power costs and other expenses that are reasonable for recovery in rates. *See* PSE's Post-Hearing Brief at ¶¶ 45-49.

[30] WUTC Staff points to ASC 980-340-25 at ¶ 72 of their brief. WUTC Staff, however, overlooks the reference to cost that would *otherwise be charged to expense.* The rule provides: Effects of Regulation (Recognition of Regulatory Assets)

> An entity shall capitalize all or part of an incurred cost that ***would otherwise be charged to expense*** that would be charged if both of the following criteria are met:
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> a. It is probable … that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
> b. Based on the available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs.

for a regulated company to pass through to customers the costs of doing business, which would otherwise be passed through to customers by a non-regulated entity. PSE believes that the appropriate application of this mechanism, in other cases with different facts, is no reason to penalize shareholders or to provide a windfall to remaining customers in this case.

III. CONCLUSION

20. Recognizing the unique facts and circumstances presented in this case, PSE respectfully requests that the Commission issue an accounting order approving PSE's proposed accounting treatment of the proceeds of sale the Assets and the Service Area.

DATED this 17th day of June, 2014.

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