

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.)
_____)

Reply Brief of the Industrial Customers of Northwest Utilities

June 17, 2014

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I. INTRODUCTION

1 Puget Sound Energy, Inc.’s (“PSE” or the “Company”) Opening Brief presents
few surprises. It is consistent with the Company’s testimony and position at the hearing in this
case. It is also, as the Industrial Customers of Northwest Utilities (“ICNU”), the Washington
Utilities and Transportation Commission (“Commission”) Staff, and Public Counsel all
demonstrated, in error.

2 Because ICNU has already addressed most the substance of PSE’s Opening Brief,
it will not repeat those arguments here. The Company raises a few issues, however, to which
ICNU will respond.

II. ARGUMENT

A. PSE has no Constitutional right to the full amount of the proceeds.

3 In responding to Commissioner Goltz’s question at the hearing regarding what an
appropriate incentive payment to PSE would be for negotiating the sales price of the distribution
assets (“Assets”) it sold to the Jefferson County Public utility District (“JPUD”), the Company
issues a warning to the Commission “not to go down such a road that is fraught with legal
pitfalls.”^{1/} PSE states that:

A broker’s commission is inadequate compensation when private
property is forcibly taken for public use. PSE negotiated a sale of
its Service Area under threat of condemnation There is no
legal precedent that warrants a substitution of this small ‘incentive’
for the full amount of ‘just compensation’ due a property owner for
the deprivation of its property by the exercise of the authority of
eminent domain To pay owners a small percentage of the gain
on sale, as an incentive for brokering a good sale price, would deny
PSE’s shareholders the just compensation that was negotiated by
PSE under threat of condemnation.^{2/}

^{1/} PSE Br. ¶ 42.

^{2/} Id. ¶¶ 41-42.

4

The Commission should dismiss out-of-hand PSE’s suggestion that it is constitutionally entitled to the full amount of the proceeds from its sale of the Assets to JPUD. The Company’s argument is flawed for at least two reasons. First, PSE, as a regulated-monopoly utility that has government-approved rates, which include the full costs of its property, is fundamentally distinct from other property owners. Second, the proceeds at issue here do not represent “just compensation” for the Assets.

1. Under all parties’ proposed allocation of the proceeds, PSE will be made whole.

5

The Fifth Amendment of the United States Constitutions declares that “... nor shall private property be taken for public use, without just compensation.”^{3/} Similarly, the Washington State Constitution declares that “[n]o private property shall be taken or damaged for public or private use without just compensation having first been made”^{4/} The United States Supreme Court has found that “‘just compensation’ means the full monetary equivalent of the property taken. The owner is to be put in the same position monetarily as he would have occupied if his property had not been taken.”^{5/} Washington Courts have also adopted the U.S. Supreme Court’s reasoning behind what constitutes “just compensation:” “The just compensation to be paid to an owner of property, in a constitutional sense, is what an owner has lost at the time of condemnation, and not what the condemner has gained.”^{6/} This means that “just compensation” is “compensation sufficient to make good the loss of the owner. In the words of Mr. Justice Butler, the owner is ‘entitled to the full money equivalent of the property

^{3/} U.S. Const. amend. V.

^{4/} Wash. Const. art. I § 16 (amend. 9).

^{5/} U.S. v. Reynolds, 397 U.S. 14, 16 (1970).

^{6/} State v. Wilson, 6 Wn. App. 443, 448 (1972) (citation and internal quotations omitted); Sintra, Inc. v. City of Seattle, 131 Wn.2d 640, 655 (1997).

taken, and thereby to be put in as good a position pecuniarily as it would have occupied, if its property had not been taken.”^{7/}

6 Thus, for both Federal and Washington courts, the constitutional question to be asked is, what amount of compensation is sufficient to put the owner in the same position monetarily it would have been in had the property in question not been taken? In this case, the answer to that question is simple: PSE would be entitled to a return of, and the opportunity to earn a reasonable return on, its investment in the Assets, nothing more.

7 That is precisely what PSE is getting in this case. It has received depreciation payments from customers that constitute the difference between the original cost of the Assets and net book value; all parties recommend returning to PSE its remaining investment, represented by the net book value of the Assets; and PSE can continue to earn a return on this investment if it puts those proceeds into new plant used to serve its remaining customers, which it has stated it plans to do.^{8/} Under these circumstances, PSE can hardly support a claim that it is not receiving “just compensation” for the Assets when its financial interest in the Assets is fully preserved. It is for this reason that the U.S. Court of Appeals for the D.C. 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.”^{9/} The only “legally protected interest [of the investor] resides in the capital he invests in the utility rather than in the items of property which that capital purchases for provision of utility service.”^{10/}

^{7/} Wilson, 6 Wn. App. at 449 n. 4 (citing L. Orgel, Valuation Under the Law of Eminent Domain § 46, 222, 223 (2d ed. 1953)).

^{8/} ICNU Ex. No. ___ (MPG-3) at 11.

^{9/} Democratic Cent. Comm. v. Wash. Met. Area Transit Comm’n, 485 F.2d 786, 800 (1973) (emphasis added).

^{10/} Id. at 801.

8 That is not to say that “just compensation” for utility property is limited to the net book value of such property.^{11/} It is simply that “just compensation” does not accrue solely to the utility. Both Federal and Commission precedent hold that customers “bear the full burden of cost responsibility” for in-service utility property and that utility assets are not “exclusively the property of the utility’s investors”.^{12/} Thus, even when “just compensation” is determined (which did not occur here), a utility is not constitutionally entitled to all of it. To the extent the utility realizes a gain, its remaining customers have a claim to this amount if it is determined that they bore the risks and burdens associated with the condemned assets. Even Redding II, the decision PSE relies on so heavily here, would give proceeds from a condemnation action to a utility’s remaining customers to the extent they were harmed by the transaction.^{13/}

9 Indeed, PSE’s position that it is entitled to everything in a forced sale would lead to absurd results. Nowhere in this proceeding has the Company challenged the legal validity of prior Commission decisions that allocated the proceeds from a voluntary sale to customers. The only constitutional requirement in a forced sale is that PSE be made whole.^{14/} If PSE does not believe it is being legally deprived of its property in a voluntary sale, it is not apparent why such would be the case if the Commission followed the same allocation principles in a forced sale.

2. The proceeds do not represent “just compensation” to PSE.

10 There is a second reason to disregard PSE’s unconstitutional takings argument. Simply, “just compensation” was never established for the Assets. Under the Washington State

^{11/} Indeed, both Washington and Federal courts determine “just compensation” based on the fair market value of the property. Reynolds, 397 U.S. at 16; Wilson, 6 Wn. App. at 447.

^{12/} Docket No. UE-070725, Order 03 ¶ 39 n. 40 (May 20, 2010); Democratic Central, 485 F.2d at 800.

^{13/} 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 at *4 (July 6, 1989).

^{14/} Reynolds, 397 at 16; Wilson, 6 Wn. App. at 447.

Constitution, “compensation shall be ascertained by a jury, unless a jury be waived”^{15/} What constitutes “just compensation” can only be established by a finder of fact.^{16/} That is not what occurred here. The proceeds at issue in the case are the result of a “settlement of threatened litigation.”^{17/} The proceeds do not, therefore, represent any legally determined “just compensation” for PSE. They are simply the price that was paid.

11 Nor does any part of the proceeds represent “going concern” damages to which any fact-finder found PSE was entitled. PSE states as much: “The settlement did not state the amount of ‘going concern damages’ that was embedded in the \$109 million purchase price. The amount of ‘going concern damages’ incurred by PSE was a question for a jury to determine had this case gone to trial.”^{18/} Thus, PSE has no constitutional claim to going concern damages in this case. Indeed, as PSE previously stated, “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, and that ‘benefit’ should be accounted for as a discount against the purchase price.”^{19/} Thus, PSE’s claim that it suffered “going concern” damages is pure speculation, and it is certainly not legally entitled to any portion of the proceeds for “going concern” damages.

12 There is no merit to PSE’s assertion that, by giving the Company the equivalent of an incentive payment from the proceeds, the Commission would be on shaky legal ground. PSE will be in the same position it would have been had it not sold the Assets, which is all that is

^{15/} Wash. Const. art. I § 16 (amend. 9).

^{16/} Sintra, Inc., 131 Wn.2d at 657 (“The amount of compensation necessary to satisfy the constitutional mandate is a matter for judicial determination”).

^{17/} PSE Ex. No. __ (SSO-5) at 1:13-14.

^{18/} PSE Br. ¶ 40.

^{19/} PSE Ex. No. __ (SSO-5) at 17:3-6.

constitutionally required. The purchase price of the Assets is not “just compensation” for PSE, and the Company has no legal basis to suggest otherwise.

B. PSE shifts the risk of loss to customers.

13 PSE argues that the accounting treatment it is seeking here is “completely consistent” with the treatment it sought in prior cases to pass losses to customers when it voluntarily disposed of utility property.^{20/} ICNU is unsure how to reconcile the Company’s claim that its requested accounting treatment in this case is consistent with prior voluntary dispositions of property and its claim that this transaction is “unique” and warrants a special rule for allocation of the proceeds. The Company is correct, however, that this transaction is indeed consistent with prior dispositions of in-service utility property – customers bore the same risks and burdens of supporting the assets sold to JPUD as they do with any other in-service utility property.^{21/}

14 PSE notes that the Commission has granted its prior requests to pass losses to customers after the Commission made a determination that the Company’s decision to sell or otherwise dispose of the property was in the public interest.^{22/} Whether or not the Company made the right decision to dispose of this property, however, is beside the point. The question is, who bears the risks and burdens associated with the sold plant? Even assuming PSE made the least cost decision in these cases, it is absurd to suggest that customers “benefit” from paying millions of dollars for assets that are no longer used and useful for service.^{23/} Regardless of the merits of this policy that asks customers to shoulder the losses from sold plant (which is not

^{20/} PSE Br. ¶ 44.

^{21/} ICNU Ex. No. ___ (MPG-1T) at 15:8-13; Staff Ex. No. ___ (EJK-1T) at 15:5-16:7.

^{22/} PSE Br. ¶ 44.

^{23/} Id.

unique to PSE), it is indisputable that it shifts the risk of loss to customers, which is the pertinent point in resolving this case.

15 That PSE does not bear these risks is evident by comparing its regulated monopoly business to a competitive enterprise. Competitive enterprises must also make decisions about whether to sell or continue to run uneconomic plant. Yet, these businesses cannot recover their stranded costs from customers without the threat of competition. While Dr. Levin would likely argue that competitive businesses build those costs into their prices,^{24/} the fact is that, even if this assumption is true, these businesses can only project those costs and hope that their projections are more-or-less accurate. If a competitive business is faced with an unexpected material loss, no matter how prudently it operated it must bear the consequences. PSE, on the other hand, has no such uncertainty. It can recover its losses by turning to customers after-the-fact. Under these circumstances, and regardless of the voluntary nature of the transaction, the risks and burdens of supporting utility plant that has been determined to be prudently invested in (as with the Assets) are plainly on the customer.

C. Deferred accounting does not “benefit” customers.

16 Finally, ICNU cannot let PSE’s claim that deferred accounting “benefits customers” go unchallenged.^{25/} This “benefit,” according to the Company, is in deferred accounting’s ability to “smooth out costs for PSE’s customers.”^{26/} As an organization that represents many of Washington State’s largest utility customers, ICNU submits that it would be happy to forego this “benefit.”

17 Once upon a time, utilities would come in for rate cases, and anything that happened in between rate cases, be it income or loss, would accrue to the utility. Today, more

^{24/} PSE Ex. No. __ (SLL-1T) at 10:8-12.

^{25/} PSE Br. ¶ 48.

^{26/} *Id.* ¶ 45.

and more, utilities are seeking to defer for later recovery any cost they incur that is not already included in rates. While deferred accounting may, as the Company states, be “a means for recovery of prudently incurred costs that are necessary to provide safe and reliable service to PSE’s customers,” it is also a means of achieving one-sided ratemaking by tracking costs for later recovery, but not benefits for later refund. And, it is a mechanism that only regulated utilities, as opposed to competitive businesses, can take advantage of.^{27/} Consequently, as Commissioner Jones recognized, deferred accounting is yet another means for utilities to mitigate their risk of cost-recovery by shifting it to customers.^{28/}

D. An appropriate incentive payment to PSE is at or near its authorized return on equity.

18 While ICNU agrees with the vast majority of Staff’s testimony and briefing in this case, it disagrees with Staff’s proposal to give 25% of the appreciated value of the Assets to PSE.^{29/} Staff notes that this amount represents approximately seven percent of the total proceeds from the JPUD Transaction, which reflects a standard brokerage fee for negotiating real property sales.^{30/}

19 ICNU continues to believe that an incentive payment that approximates PSE’s authorized return on equity is more consistent with the regulated nature of the Company.^{31/} Just as PSE should not expect (and is not entitled to) the level of profits and losses experienced by competitive enterprises, including real estate brokerage firms, it should not expect a similar incentive payment. PSE’s authorized return on equity reflects what the Commission believes is a reasonable return for PSE in the current market; a similar incentive payment is also reasonable.

^{27/} Tr. 107:2-19; FAS 71.

^{28/} Tr. 108:5-16.

^{29/} Staff Br. ¶ 121.

^{30/} Id. ¶ 120.

^{31/} Tr. 210:1-8 (Gorman).

ICNU's proposal to give PSE ten percent of the appreciated value of the assets is in line with the Company's currently authorized 9.8 percent return on equity.

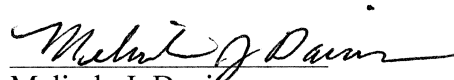
III. CONCLUSION

20 For the foregoing reasons, and as stated in ICNU's Opening Brief, the Commission should reject PSE's proposed allocation of the proceeds from its sale of assets to the Jefferson County Public Utility District and enter an order consistent with the relief requested in ICNU's Opening Brief.

Dated this 17th day of June, 2014.

Respectfully submitted,

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