



Puget Sound Energy, Inc.
P.O. Box 97034
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October 5, 2005

Ms. Carole J. Washburn, Executive Secretary
Washington Utilities and Transportation Commission
P.O. Box 47250
Olympia, Washington 98504-7250

Filed Electronically (hard copy to follow in regular mail)

Re: **Tariff Filing To Recover Revenues Related to IRS Tax Disallowance
Request for Filing to Become Effective with Less than Statutory Notice (LSN)
Request for One-Time Waiver of WAC 480-90/100-194**
Advice No. 2005-43 – Electric Tariff Filing
Advice No. 2005-44 – Natural Gas Tariff Filing

Dear Ms. Washburn:

Pursuant to RCW 80.28.060, WAC 480-80-101 and -105, enclosed are the following revised tariff sheets:

WN U-60, Tariff G, Electric Service:

27 th Revision	Sheet No. 7	Residential Service
2 nd Revision	Sheet No. 7-b	Master Metered Residential Service
25 th Revision	Sheet No. 24	General Service
14 th Revision	Sheet No. 25	Small Demand General Service
8 th Revision	Sheet No. 25-a	Small Demand General Service (Continued)
14 th Revision	Sheet No. 26	Large Demand General Service
21 st Revision	Sheet No. 29	Seasonal Irrigation & Drainage Pumping Service
26 th Revision	Sheet No. 31	Primary General Service
20 th Revision	Sheet No. 35	Seasonal Primary Irrigation & Drainage Pumping Service
2 nd Revision	Sheet No. 40	Large Demand General Service Greater Than 3 aMW
1 st Revision	Sheet No. 40-a	Large Demand General Service Greater Than 3 aMW (Continued)
17 th Revision	Sheet No. 43-a	Interruptible Primary Service For Total-Electric Schools (Continued)
26 th Revision	Sheet No. 46	High Voltage Interruptible Service
8 th Revision	Sheet No. 46-a	High Voltage Interruptible Service (Continued)
25 th Revision	Sheet No. 49	High Voltage General Service
25 th Revision	Sheet No. 50	Limited Street Lighting Service
13 th Revision	Sheet No. 52-a	Custom Lighting Service Company Owned (Continued)
12 th Revision	Sheet No. 53-a	Street Lighting Service Sodium Vapor (Continued)
9 th Revision	Sheet No. 53-b	Street Lighting Service Sodium Vapor (Continued)
26 th Revision	Sheet No. 54	Customer-Owned Street Lighting Energy Service Sodium Vapor
25 th Revision	Sheet No. 55	Area Lighting Service

23 rd Revision	Sheet No. 57	Continuous Lighting Service
21 st Revision	Sheet No. 58	Flood Lighting Service
9 th Revision	Sheet No. 58-a	Flood Lighting Service (Continued)

WN U-2, Natural Gas Service:

5 th Revision	Sheet No. 116-A	General Gas Lighting and Street Lighting Service (Continued)
50 th Revision	Sheet No. 123	Residential General Service
45 th Revision	Sheet No. 131	Commercial and Industrial General Service
31 st Revision	Sheet No. 136-B	Special Commercial Heating Service (Optional) (Continued)
52 nd Revision	Sheet No. 141	Large Volume High Load Factor Gas Service (Optional)
8 th Revision	Sheet No. 150	Compressed Natural Gas (CNG) for Vehicle Fuel
7 th Revision	Sheet No. 151-A	Special Multiple Unit Housing Service (Optional) (Continued)
6 th Revision	Sheet No. 153-B	Propane Service (Continued)
11 th Revision	Sheet No. 157-C	Distribution System Transportation Service (Firm & Interruptible) (Continued)
21 st Revision	Sheet No. 172	Large Volume Water Heater Rental Service
14 th Revision	Sheet No. 174	Gas Conversion Burner Rental Service
13 th Revision	Sheet No. 185-C	Interruptible Gas Service with Firm Option (Continued)
13 th Revision	Sheet No. 186-C	Limited Interruptible Gas Service with Firm Option (Continued)
14 th Revision	Sheet No. 187-D	Non-Exclusive Interruptible Gas Service with Firm Option (Cont.)

The purpose of this filing is to adjust rates due to the recent decision by the Internal Revenue Service (“IRS”) that reversed the tax benefit of \$72 million that was treated as a reduction to rate base in the Commission's Order No. 06: Final Order Rejecting Tariff Sheets; Authorizing and Requiring Compliance Filing; Requiring Subsequent Filing in Docket Nos. UG-040640, UE-040641, UE-031471 and UE-032043 (the “Order”).

The issue giving rise to this proposed tariff revision was addressed in Puget Sound Energy’s (“PSE” or “the Company”) last general rate case, Docket Nos. UG-040640 et al., in particular in the prefiled direct testimony of Mr. James Russell, the rebuttal testimony of Mr. John Story, and in the Commission’s Sixth Supplemental Order at paragraphs 156-159. The Commission determined that it was premature to issue a ruling on the dispute at that time. However, events subsequent to the Commission’s Order in that case now make it appropriate for the Commission to permit PSE’s tariff revisions to become effective as proposed in this filing.

A deferred tax balance was created by the Company taking advantage of a tax deduction proposed by Deloitte & Touche. Deloitte advised the Company that, based on Deloitte's research and informal discussions with the IRS, the rules that were adopted as a result of the 1986 Tax Act for the allocation of internal labor and overheads between self constructed assets and products held for sale would also apply to utility companies. Deloitte developed a methodology for reviewing a company’s capitalization policy to determine whether a company could allocate more costs to energy production and less to self-constructed assets. This allocation methodology would only apply for income tax purposes and would not affect capitalization for accounting purposes. Based on Deloitte's analysis of PSE’s books and records, Deloitte determined that application of its methodology would enable the Company to deduct a one time catch-up adjustment of approximately \$163 million and take a current deduction of \$23 million on the Company's 2001 tax return (which was filed in the fall of 2002). In

addition, the Company applied Deloitte's methodology to deduct approximately \$21 million for calendar years 2002 and 2003.

In Docket UG-040640 et al., the Commission Staff proposed to reduce PSE's test year rate base for electric operations by \$42.9 million and natural gas operations by \$29.7 million for the deferred tax balances related to this new method of determining overhead deductions that would previously have been capitalized. The Company agreed that such an adjustment could be appropriate, provided that if any such deductions were subsequently disallowed by the Internal Revenue Service ("IRS"), which was then investigating the method, the Company would then be able to immediately adjust rates to recover any revenue loss, including any assessed interest that might result from such disallowance.

In the Order, the Commission declined to prejudge this issue. However, the Commission did recognize that it would be appropriate for the Company to file for rate treatment in the event that this tax deduction was disallowed. The relevant part of the Commission's Order is presented below.

There is yet one additional dispute that we must resolve in this connection. The Company asks the Commission to pre-approve an adjustment to rates in the event that the Internal Revenue Service reverses the tax benefit of \$72 million that both Staff and PSE have treated as a reduction to rate base. PSE also asks the Commission to include any IRS assessed interest that might result from such a disallowance.¹

The Company states that the IRS is currently undertaking a review of all utilities that have taken this tax deduction and will not soon complete that review. The result is not predictable.¹ Staff argues that this means it is premature to grant PSE's request for pre-approval of an automatic rate adjustment that also includes IRS assessed interest.²

PSE argues that it is neither fair nor reasonable to include the benefits of this deduction (which is still contingent)³ in current rates while reserving for a future ruling – and presumably a potential disallowance argument – what should be a straightforward statement of the Commission's commitment to permit recovery of these funds if the Company is ultimately required to pay them to the Federal government.⁴

We cannot lawfully prejudge future rates. However, we do find it appropriate to recognize in principle that if the IRS successfully challenges in court the adjustment PSE and other utilities have taken, and requires future repayment of the current benefits taken, presumably with interest, PSE should file an accounting petition asking for appropriate treatment of any back taxes and interest assessed.

Order at ¶¶ 156-159.

On August 2, 2005, the IRS issued Revenue Ruling 2005-53 and new Regulations sections 1.263A-1T and 1.263A-2T (copy enclosed). These effectively make the method applied by PSE and other utilities impermissible and require utilities that took related tax benefits to pay back the benefits over tax years 2005 and 2006. PSE will be required to pay back one half of the benefits that are remaining on its books in December 2005 (\$33.2 million) and the other half (\$33.2 million) in its quarterly tax payments during 2006.

Enclosed is a memorandum dated October 4, 2005 to Vice Presidents Bert Valdman and Kimberly Harris from Matt Marcellia, Director, Tax, in regards to Capitalized Overheads Deducted for Tax. In addition to providing additional background the memorandum specifies that PSE will remit half of the balance (\$33.15 million) with the next quarterly tax payment on December 15, 2005. The balance will be remitted to the IRS with quarterly tax payments on March 15, June 15, September 15, and December 15, 2006.

PSE will be required to increase its capital borrowings to make these tax payments. However, because PSE's ratebase was reduced by these deferred taxes in the 2004 general rate case, PSE is not earning its carrying costs on such capital. PSE, therefore, seeks in this filing to restore to its ratebase the approximately \$72.6 million that was removed during the 2004 general rate case and to collect in its rate schedules the revenues associated with PSE's authorized return on such ratebase.

PSE notes that it is unclear from the Order whether the Commission contemplated permitting PSE to file proposed tariff revisions as one manner of handling a reversal of the new tax method. Paragraph 159 of the Order states:

We cannot lawfully prejudge future rates. However, we do find it appropriate to recognize in principle that if the IRS successfully challenges in court the adjustment PSE and other utilities have taken, and requires future repayment of the current benefits taken, presumably with interest, PSE should file an accounting petition asking for appropriate treatment of any back taxes and interest assessed."

The IRS has now issued a new Revenue Ruling and regulations regarding the deductibility of internal labor and overheads. As the IRS has the authority to make this type of change, a court challenge would most likely be prolonged, without a very high probability of success, and PSE would still be required to make the reversal payments over the next two years to avoid interest charges and potential penalties for underpayment of federal taxes. Even if PSE were to prevail in a court challenge, the tax turn around associated with this deduction would have likely occurred so no benefit would be achieved.

Given this change in the revenue ruling and the regulations, which are a matter of public record, and the fact that the underlying issue has already been litigated before this Commission, PSE believes that it is more appropriate to address this issue through tariff revisions than through an accounting petition. There does not appear to be any reason why recovery in rates of the carrying costs of these funds should be delayed for future consideration. (The Company is not seeking interest related to this reversal at this time, as no interest has yet been assessed by the IRS and it is not clear whether PSE will ultimately be required to pay any interest. If interest is ultimately assessed, PSE will request appropriate treatment at that time.)

The attached revised tariff sheets reflect an addition of \$5,839,185 in the amount to be spread to electric rates and \$4,182,029 in the amount to be spread to natural gas rates when compared to the amounts approved in the Order. These amounts were spread to rates using the same methodology authorized in the Order. Work papers that demonstrate the derivation of the rates proposed to be changed by the enclosed tariff sheets are attached. The requested increases do not trigger the general rate proceeding requirements under WAC 480-07-505.

The tariff sheets described herein reflect issue dates of October 5, 2005 and effective dates of November 5, 2005. Posting of proposed tariff changes, as required by law and the Commission's rules and regulations, is being accomplished immediately prior to or coincident with the date of this transmittal letter, through web, telephone and mail access in accordance with WAC 480-100-193. Notice of proposed tariff changes, as required by law and the Commission's rules and regulations, will be given to the public in accordance with WAC 480-100-194(2), through a published notice. In addition, as this filing relates to Docket Nos. UG-040640, UE-040641, UE-031471 and UE-032043 (consolidated), a copy of this filing has been mailed to each party in that proceeding.

The Company respectfully requests that the Commission issue orders allowing these filings to become effective on November 1, 2005, coincident with the expected effective date of the Company's Power Cost Only Rate Case (PCORC) in Docket No. UE-050870. The Company is requesting LSN treatment in order to avoid the confusion of two rate changes within days of each other and to provide a clear and unified message to customers of the impact of the PCORC and the instant filing. In accordance with WAC 480-80-122, enclosed is the information required on the LSN form provided by the Commission.

Due to the time necessary to order advertising space and design an advertisement, the Company requests that pursuant to WAC 480-90-008 and WAC 480-100-008 the Commission grant a one-time waiver of the number of days of notice to the public required by WAC 480-90-194 and WAC 480-100-194. The Company expects to have the notice required by WAC 480-90-194(2) and WAC 480-100-194(2) published by October 10, 2005, thereby giving the public in excess of two weeks notice prior to the Commission's open meeting scheduled for October 26, 2005. In addition to this notice, the Company will provide a bill-print message in the first bill to each customer after November 1, 2005 reflecting the combined impact of this filing and the PCORC.

If you have any questions please contact me at (425) 456-2797.

Very truly yours,



Karl R. Karzmar
Director, Regulatory Relations

Enclosures

cc: Kirstin Dodge, Perkins Coie
Service List

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing letter and enclosures via regular mail in accordance with WAC 480-07-150(6)(b).

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Dated October 5, 2005.



Deborah Sifferman
Puget Sound Energy, Bellevue, Washington
Rates & Regulatory Department

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

LESS THAN STATUTORY NOTICE AND WAIVER OF CUSTOMER NOTICE RULES REQUESTED BY:

(Utility Name) **Puget Sound Energy, Inc.** (Utility UBI Number) **179010055**

(Utility d/b/a if different than registered name)

Utility proposes to change **Electric Tariff G & Natural Gas Tariff** Number **WN U-60 & WN U-2**
(tariff title, price list title, etc.)

Present provisions are: Present rates are based on the Commission's Order No. 06 in Docket Nos. UG-040640, UE-040641, UE-031471 and UE-032043 (the "Order").

Proposed changes are: To adjust rates due to a recent decision by the Internal Revenue Service that reversed a tax benefit that was treated as a reduction of rate base in the Order.

Indicate below, or attach, an explanation of the reason the company requests permission to file the proposed provisions with less than statutory notice and to provide notification to customers on less than required notice. The Company currently has a power cost only rate case before the Commission under which rates are expected to be allowed to become effective on November 1, 2005. In order to avoid the confusion of two rate changes within days of each other the Company desires that the filings under Advice Nos. 2005-43 and 2005-44 be allowed to become effective November 1, 2005 as well. Additional information regarding this request is included in the cover letter to the filing.

Karl R. Karzmar is authorized to issue and file tariffs on behalf of Puget Sound Energy, Inc.
(Name and title of issuing agent) (Name of Utility)

Signature and Title of Company Officer

Kimberly Harris Kimberly J. Harris, Vice President, Regulatory and Government Affairs

I request these provisions become effective on November 1, 2005 (Date) October 5, 2005

Kar (Signature of Authorized Agent) (Title) Director, Regulatory Relations

(Print Name) Karl R. Karzmar

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WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

ORDER

The Commissioners, having determined this order is consistent with the public interest, directed the Secretary to enter this order granting the provisions requested above.

DATED and signed at Olympia, Washington, this _____ Day of _____
(Month and Year)

Secretary