SERVICE DATE
SEP 21 1993

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

PETITION OF PUGET SOUND POWER & LIGHT COMPANY FOR AN ORDER REGARDING THE ACCOUNTING TREATMENT OF RESIDENTIAL EXCHANGE BENEFITS	DOCKET NO. UE-920433
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. PUGET SOUND POWER & LIGHT COMPANY, Respondent.	DOCKET NO. UE-920499
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. PUGET SOUND POWER & LIGHT COMPANY, Respondent.	DOCKET NO. UE-921262 ELEVENTH SUPPLEMENTAL ORDEF nd

PROCEEDINGS: On October 30, 1992, Puget Sound Power & Light Company (Puget or company) filed revisions to its currently-effective tariff sheets WN U-60, Tariff G. The filing would have increased rates by approximately $219 million, when compared to the base rate established in the company's previous general rate case, which is $116.8 million above the levels after PRAM 2. On rebuttal, the company reduced its request somewhat. When calculated from the base of rates approved in the last general rate case, Puget's rebuttal request would increase rates by $203.5 million, which is $101.3 million above the levels after PRAM 2.

This filing was consolidated with a petition for an accounting order regarding treatment of residential exchange benefits which the company receives from the Bonneville Power Administration (BPA) on behalf of its residential customers.

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HEARINGS: The Commission held 23 days of hearings on these issues. The hearings were held before Chairman Sharon L. Nelson, Commissioner Richard D. Casad, Commissioner A.J. Pardini, Commissioner Richard Hemstad, and Administrative Law Judge Alice L. Haenle of the Office of Administrative Hearings. The Commission gave proper notice to all interested parties.

PARTIES: The following parties entered appearances:[1] Respondent Puget was represented by James M. Van Nostrand and Steven C. Marshall, attorneys, Bellevue.

The Commission was represented by Donald T. Trotter and Sally G. Brown, assistant attorneys general, Olympia.

Charles F. Adams and William Garling, assistant attorneys general, Seattle, appeared as Public Counsel.

Intervenor Washington Industrial Committee for Fair Utility Rates (WICFUR) was represented by Mark P. Trinchero and Grant E. Tanner, attorneys, Portland, Oregon, Peter J. Richardson, attorney, Boise, Idaho, and Craig Gannett, attorney, Seattle.

Intervenor Skagit Whatcom Area Processors (SWAP)[2] was represented by Carol S. Arnold and Adam Gravley, attorneys, Seattle.

Intervenor Department of Defense, on behalf of the consumer interests of the Federal Executive Agencies of the United States (FEA), was represented by Norman J. Furuta, Vasio Gianulias, and Jose Aguirre, attorneys, San Bruno, California.

Intervenor Building Owners & Managers Association of Seattle and King County (BOMA) was represented by Daniel Compton and John Cameron, attorneys, Portland, Oregon, and Arthur A. Butler, attorney, Seattle.

Intervenor BPA was represented by Barry Bennett, attorney, Portland, Oregon.

Intervenor Northwest Conservation Act Coalition (NCAC) was represented by Linda K. Williams, attorney, Portland, Oregon, and Jon Wellinghoff, attorney, Las Vegas, Nevada.

Intervenor The Washington Water Power Company (WWP) was represented by David J. Meyer, attorney, Spokane.

Intervenor PacifiCorp, d/b/a Pacific Power & Light Company (PacifiCorp), was represented by James C. Paine, attorney, Portland, Oregon.

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[1] In addition, the Commission denied a petition for intervention of March Point Cogeneration Company, represented by Paul Kaufman, attorney, Portland, Oregon. The Commission also entered its Seventh Supplemental Order, denying intervenor status to SESCO, Inc., Free Lighting Corporation, and Lakeland Utility Conservation, Inc., which were represented in a petition submitted by Daniel W. Meek, attorney, Portland, Oregon.

[2] SWAP companies in this case are Bellingham Cold Storage Company, Trident Seafoods, Versacold, Americold, National Frozen Foods, and Bellingham Frozen Foods.

Intervenor PacifiCorp, d/b/a Pacific Power & Light Company (PacifiCorp), was represented by James C. Paine, attorney, Portland, Oregon.

SUMMARY: The Commission authorizes the company to refile for rates at an approximate level $36.8 million above the base rates from the last general rate case, which is a decrease of $64.1 million from current rates measured from the PRAM 2 level. The company must rerun its power supply model to reflect modifications. The parties must recalculate an adjustment to reflect the 35% income tax level.

The Commission retains the PRAM mechanism with modifications.

The Commission finds the company failed to demonstrate the prudence of its new resource acquisitions. The company is directed to file by November 1, 1993, a power supply case to demonstrate the prudence of its new resource acquisitions. The Commission therefore directs the company to calculate a PRAM 3 projection to act as a temporary rate, subject to refund.

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I. SCOPE OF PROCEEDINGS

A. PROCEDURAL HISTORY

By Order entered November 25, 1992, the Commission consolidated three Puget filings. A rate design case (Docket No. UE-920499) was filed on April 30, 1992. Puget filed an accounting petition regarding treatment of Bonneville exchange benefits (Docket No. UE-920433) on April 7, 1992. On October 30, 1992, the company filed a general rate increase request (Docket No. UE-921262).

The Commission set a separate hearing schedule for rate design issues, to ensure those rate design issues would be fully reviewed. The Commission entered its Order on cost of service and rate design issues on August 17, 1993.

The remaining issues include the general rate increase request, the accounting petition, and rate spread issues which the Commission deferred from the Rate Design Order. Those issues will be treated in this Order.

The Commission held 28 days of hearing on these consolidated cases.[3] The Commission heard public comment on both rate design and general rate filing issues on June 21, 23 and 24, 1993. Briefs on the general rate increase request were due on August 13, 1993.

During the course of these hearings, Puget also filed its Periodic Rate Adjustment Mechanism (PRAM) filing for the third accounting period, in Docket No. UE-930622. The PRAM 3 was heard separately and a separate order will be issued. This order will include an evaluation of the PRAM mechanism itself, but will not discuss the recovery of deferrals sought in the PRAM 3 filing.

B. WITNESSES

The parties presented the following witnesses: For the company in its direct case, Richard A. Sonstelie, policy witness; William S. Weaver, cost of money; Terran A. Miller, cost of money; William A. Abrams, cost of money; Charles E. Olson, cost of equity; Russel E. Olson, cost of money; J. Richard Lauckhart, power supply; Gary B. Swofford, conservation program; Corey A. Knutsen, company cost control programs; John M. Bertko, post-retirement benefits other than pensions; John H. Story, revenue

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[3] Five of those days were directed primarily toward cost-of-service issues and issues of rate design.

requirements; Colleen E. Lynch, cost of service; David W. Hoff, rate design. Those witnesses (except Messrs. Abrams, Miller and Bertko) also appeared on rebuttal, along with the following additional witnesses: Andrew W. Patterson, management study; Maura L. O'Neill, conservation advertising; Laura J. Rittenhouse, investor relations; and John C. Dell, cost of money.

Commission Staff witnesses were Kenneth L. Elgin, policy; Richard J. Lurito, cost of money; Diane R. Sorrells, conservation; Tho H. Nguyen, revenue requirements; Thomas E. Schooley, revenue requirements; Roland C. Martin, revenue requirements; Andrea L. Kelly, cost-control measures; Patrick J. Moast, revenue requirements; Alan P. Buckley, elasticity adjustment; and Curtis K. Winterfeld, power supply.

Public Counsel's witnesses were Stephen G. Hill, cost of money; and Glenn Blackmon, power supply, conservation and PRAM.

FEA presented John B. Legler, cost of money; and Hugh Larkin, Jr., revenue requirements. BPA presented Richard A. Raynor, accounting for residential exchange benefits. NCAC presented Kevin Bell, PRAM and policy; Richard H. Watson, PRAM and decoupling; David C. Parcell, decoupling and demand-side management; Ralph Cavanagh, decoupling and incentives; and Thomas Michael Power, decoupling. WICFUR presented Donald W. Schoenbeck, PRAM and revenue requirements; and Dennis E. Peseau, cost of money. WWP presented Kelly O. Norwood regarding streamflow normalization. PacifiCorp presented Diana F. Lozovoy regarding streamflow normalization.

II. ISSUES AND GOVERNING PRINCIPLES

The ultimate determination to be made by the Commission in this matter is whether the rates and charges proposed in respondent's revised tariffs are fair, just, reasonable, and sufficient, pursuant to RCW 80.28.020. These questions are resolved by establishing the fair value of respondent's property in service, determining the proper rate of return permitted respondent on that property, and then ascertaining the appropriate spread of rates charged various customers to recover that return.

The purpose of a rate proceeding is to develop evidence from which the Commission may determine the following:

(1) The appropriate test period, which is defined here as the most recent 12-month period for which income statements and balance sheets are available. The test period is used for investigation of the company's operations for the purposes of these proceedings;

(2) The company's results of operations for the appropriate test period, adjusted for unusual events during the test period, and for known and measurable events;

(3) The appropriate rate base, which is derived from the balance sheets of the test period. The rate base represents the net book value of assets provided by investors' funds which are used and useful in providing utility service to the public;

(4) The appropriate rate of return the company is authorized to earn on the rate base established by the Commission;

(5) Any existing revenue deficiency; and

(6) The allocation of the revenue requirement, if any, fairly and equitably among the company's ratepayers.

RCW 80.04.130 places the burden of proving that a proposed increase is just and reasonable on the public service company proposing such an increase.

In addition to the basic issues listed above, this case presents several issues which have been deferred to this general rate filing from previous cases. These issues include a review of the Periodic Rate Adjustment Mechanism (PRAM) experiment and a review of the prudence of new power supply contracts.

III. TEST PERIOD

The test period for purposes of this proceeding is the 12 months ending June 30, 1992. This is the most recent and most complete information available throughout the period of this proceeding. It was used by all the parties as the basis for analysis of the company's performance and condition.

The 12 months ending June 30, 1992, is found to be the appropriate test period for examination of the company's operations for purposes of this proceeding.

IV. PRAM REVIEW

A. Existing Pram/decoupling Mechanism

In Docket Nos. UE-901183-T and UE-901184-P, the Commission adopted an experimental ratemaking mechanism for Puget which decouple sales from revenues and profit and established the "periodic rate adjustment mechanism" (PRAM).

Under the experiment Puget's revenue requirement is recovered in two categories of cost: base costs and resource costs. Each of these two cost categories is subject to a different adjustment mechanism; both mechanisms are applied annually in the PRAM.

The purpose of the base cost portion of the adjustment mechanism is to remove the short-term incentive for the company to sell additional electricity in order to increase its earnings (which would be a barrier to conservation). The mechanism is termed a "decoupling" mechanism because it decouples revenue from sales.

As initially established, following the company's proposal, base costs included production depreciation, Bonneville Power Administration Exchange Power (BEP) ten-year amortization, Pebble Springs and Skagit amortizations, and transmission costs excluding variable power supply costs.

The total revenue allocated to base costs is divided by the number of customers on Puget's system to provide an authorized revenue per customer. As the number of Puget's customers increases or decreases, booked revenue increases or decreases. Disparities between authorized and collected revenue are reconciled in the annual PRAM.

The purpose of the resource cost portion of the adjustment mechanism is to make the company whole for certain types of expenses related to energy resource acquisition. Resource costs include variable power supply costs, production operation and maintenance (O&M) expenses, production rate base, and conservation costs. The mechanism is similar to the prior energy cost adjustment clause (ECAC) mechanism in that it sets up a deferred account allowing a reconciliation of revenue and expenses that are subject to hearing and review.[4]

The determination of resource costs in the PRAM proceeding varies depending on the specific cost item. Production O&M, including many purchased contracts and production rate base costs, is based on the level included in the most recent general rate proceeding. Conservation and new contracts are included in the revenue requirement on an actual-cost basis. PRAM recovers variations in power supply costs due to hydro by using actual stream flows in the determination of power supply costs rather than the normalized levels from the general rate case.

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[4] See, Third Supplemental Order, UE-901183-T and UE-901184-P, p. 10.

The Commission has allocated base revenue adjustments on an equal percentage change per class. Resource costs have been assigned 80% to energy and 20% to capacity, based on the cost-of-service study in the last general rate case. These costs will now be spread as described in the Commission's Ninth Supplemental Order on Rate Design Issues in this proceeding.

1. Conservation

The Commission adopted a three-part treatment of conservation costs. First, included in rates is a return on net conservation rate base calculated on an average-of-monthly-averages basis, based on the investment in conservation identifiable and reviewable on a prescribed cut-off date. Second, conservation amortization is based on conservation investment at the same cut-off date. Third, the Commission adopted a method to calculate an allowance for funds used to conserve energy (AFUCE) at the company's authorized return net of tax. In the following rate period, the company would place into rates the newly-established conservation investment including the accumulated AFUCE.

2. Schedule

The company proposed, and the Commission adopted, a three-year PRAM cycle. This cycle includes a PRAM filing in the first year, a PRAM filing in the second year, and a general rate case in the third year. The general rate filing fulfills two primary objectives: it gives the Commission an opportunity to review costs that may be changing which are not modified in the PRAM (for example, in this proceeding the Commission is able to recognize in rates the reduction in Puget's cost of capital), and it is the forum in which the Commission reviews the prudence of Puget's conservation and new resource acquisitions.

3. PRAM 2 Proceeding (Docket No. UE-920630)

In the PRAM 2 proceeding we modified the PRAM/Decoupling mechanism by:

(1) removing amortization costs associated with the fully-amortized Pebble Springs plant from base cost revenue requirement;

(2) extending the deferral recovery period. The Commission originally extended the deferral period to three years, with a return allowed on the unamortized balance. The company requested that we modify this to a first-in, first-out (FIFO) amortization **without** carrying charges, which guaranteed that all dollars would be recovered within two years after December 30 of the year in which they were deferred. The company petition was granted; and

(3) clarifying that the rate of return band had expired.

In addition, the Commission made it clear that Puget was required to file this general rate case to (1) review the PRAM experiment and (2) demonstrate the prudence of the resource acquisitions made by Puget since the last general rate case.

B. Examination of Pram

In the PRAM 2 proceeding the Commission expressed dissatisfaction with the existing PRAM/decoupling mechanism stating that "[i]n general, the Commission believes that the decoupling mechanism which is a part of this PRAM experiment has failed to meet the requirements of the NOI."[5] This statement has been interpreted by some as a total condemnation of the experiment. However, as indicated by the Order as a whole, it was only the Commission's intent to reevaluate the PRAM and make changes where necessary. Some of those changes were implemented in the PRAM 2 proceeding, as discussed above.

The First Supplemental Order in PRAM 2 recited four general criteria, first set out in the Notice of Inquiry (NOI) on regulatory barriers, which a mechanism designed to attain the goals of least cost planning should meet:

- The mechanism must be measurable;
- The mechanism must be reasonably simple to administer;
- The mechanism must be intuitive enough to allow a straightforward explanation to utility customers; and
- The mechanism must be an improvement, on balance, over the then-current method of regulation at the WUTC.[6]

In that Order the Commission also pointed out areas of particular interest to be considered in the overall evaluation of the experiment, to be conducted in this general rate case. These included the following:

Is there a true cause and effect relationship between PRAM and conservation expenditures? Does the mechanism create perverse economic incentives for the company? (For example, is the company tempted to shift expenses, such as conservation advertising expenses, between base and resource cost categories

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[5] Docket No. UE-920630, First Supplemental Order, p. 3.

[6] Id., p. 3.

to its advantage?) How are the logistics of carrying on a general rate case intertwined with the PRAM proceedings?

In addition, the Commission deferred several issues raised by parties in the PRAM 2 proceeding to the general rate case. These specific issues included: coal plant availability; prudence of new contracts; amortization period for conservation; conservation tax; and conservation advertising. Finally, the Order asked the parties to examine whether the base/resource split should be modified.

Some of the above issues are addressed in this order on an issue-specific basis, while others are considered more implicitly as part of the overall evaluation of the PRAM/decoupling experiment.

1. Should the Pram/decoupling Mechanism Continue?

Puget argued that the PRAM/decoupling mechanism should be continued as modified by the Commission in its First Supplemental Order in the PRAM 2 proceeding (Docket No. UE-920630), claiming that the experiment had achieved increased investment in the acquisition of least-cost resources, including energy efficiency, and that the recent large rate increases were due largely to poor hydro conditions and warm weather. Puget also argued that the mechanism meets the goals and objectives of the NOI and that the Commission should "stay the course" to provide stability and certainty required by investors.

Commission Staff recommended that the mechanism continue with modifications relating to the base/resource cost split, secondary sales and purchases used in the simple dispatch model, and allocation of revenue requirements.

Public Counsel stated that the question of whether decoupling had caused the admittedly great expansion of conservation programs has not been resolved because Puget had committed to expand its programs before decoupling was adopted. Nonetheless, Public Counsel recommended that the mechanism continue with modifications relating to allocation of base and resource costs, normalization of weather and hydro conditions, and secondary sales and purchases.

WICFUR argued that, although the experimental mechanism has decouple revenues from the sale of kilowatt hours (kWh), several fundamental flaws result in an inappropriate shifting of risks to the ratepayers, such as those associated with weather, hydro, and purchased power and resale opportunities. Because of this risk shift, WICFUR argued Puget has no incentive to minimize production-related costs under the Resource Costs deferral mechanism. WICFUR's preference was that the PRAM be replaced by

a "pure" decoupling mechanism, that severs the link between profits and kWh sales, together with a least cost resource tracker account. As an alternative, WICFUR offered modifications to the PRAM/decoupling mechanism relating to allocation of base and resource costs, limited recovery for booked ECAC-related costs, adjustments for hydro and weather conditions, and rate moderation.

NCAC stated that the improvements in Puget's conservation programs would not have been possible without decoupling. NCAC asserted that large gas power purchase contracts, not decoupling, have been the driving factor in the PRAM rate requests. NCAC recommended that the Commission develop a pure decoupling mechanism, with the primary focus being to cure the perverse incentive of lost revenue occasioned by investments in conservation. NCAC made no specific recommendations about the base/resource allocation, resource performance, or hydro and weather adjustments beyond the recommendation that the Commission issue a firm decision on the overall assessment of risk allocation between customers and investors.

The Commission accepts the parties' representations that PRAM has achieved its primary goal -- the removal of disincentives to conservation investment. Puget has developed a distinguished reputation because of its conservation programs and is now considered a national leader in this area. Therefore, the PRAM/decoupling experiment should continue for at least another three-year cycle, as modified herein. In addition, the parties should discuss further improvements in the collaborative process and present refined proposals to the Commission during the next general rate case.

2. How Should the Pram/decoupling Mechanism Be Modified?

a. Base and Resource Allocations

The appropriate allocation of total revenue requirements to the base and resource categories is an area where the parties have had much disagreement. The Commission expressed an interest in revisiting this allocation in its PRAM 2 Order.

The current base/resource split is the one proposed by the company in the original filing in which it sought approval of the PRAM. The only change proposed by Puget is that, consistent with the PRAM 2 Order, abandoned plant amortization should be removed from base costs at the end of the amortization period.

Commission Staff argued that the current base/resource classification is unprincipled and is highly favorable to Puget because there has been no showing that base costs grow in relation to customer growth. As such, Puget receives additional

revenues even where it incurs no additional costs. For example, the abandoned plant expenses for the Skagit nuclear plant will not grow over time with base costs as additional customers are added to the Puget system, so these fixed amounts should be re-classified as resource costs.

Commission Staff argued that resource costs should be composed of power supply and power production-related costs, as well as costs incurred with planned but failed construction and acquisition of power resources. WNP-3 Exchange Power ten-year amortization, Skagit/Hanford nuclear amortization expense, Creston preliminary survey costs and production depreciation expense, and certain operating expenses that were established in the previous general rate case which are integral parts of items already included in resource costs, should all be moved to the resource category. Staff recommended that all non-resource costs be included in the base category.

Commission Staff also stated that if the Company believes that a multiplier is necessary to keep pace with increasing base costs, the company should demonstrate that its base cost will not grow at an appropriate rate and prove what size multiplier is needed. The company, on rebuttal, did not argue that a multiplier would be needed if the Commission Staff base/resource split were adopted.

Public Counsel supported Commission Staff's proposed reclassification of base and resource cost categories. Public Counsel emphasized the point that expenses which do not increase over time should not be included in the Base Cost category, where the associated revenue requirement increases over time with customer growth.

Public Counsel also recommended that, because the company's 500 kilovolt (kV) transmission investment is functionally part of the Colstrip coal plant, it should be re-classified as a resource cost.

WICFUR proposed that only those costs associated with providing the customer access to utility services (delivery-related costs: transmission, distribution, and associated administrative and general expenses) should be included in base costs. WICFUR stated that this position is consistent with that of Commission Staff and Public Counsel.

The company argued that no evidence was presented to support the need for a change in the base and resource cost allocations, and that changes will create instability and uncertainty. Puget also cautioned that changes should be carefully analyzed to avoid placing its Clean Air Act credits in peril. Specifically, Puget supported the existing allocation as

"principled" in that it allocates those costs into resource that vary by kWh sales, much like ECAC costs.

The Commission is not persuaded by the company's argument that the current allocation method is principled. The current method includes production rate base in the resource category, while production deprecation is included in the base category. The Commission will adopt Commission Staff's proposal for allocating costs to base and resource categories. Accordingly, the decoupling mechanism will be modified so that resource costs will include WNP-3 Exchange Power ten-year amortization, Skagit/Hanford nuclear amortization expense, Creston preliminary survey costs and production depreciation expense and certain operating expenses that were established in the previous general rate case which are integral parts of items already included in resource costs. All non-resource costs will be included in the base category. In addition, the 500 kV transmission investment associated with the Colstrip coal plant will be included as a resource cost.

b. Normalization of Hydro and Temperature

Several parties, including Public Counsel, WICFUR, and NCAC, recommended that some of the risks the PRAM shifts to ratepayers, such as those associated with fluctuations in hydro and weather conditions, be shifted back to the company because the company is in a better position to manage the risk.

Commission Staff believed there is merit to the view that deferred accounting be eliminated, and that the utility be responsible for managing variations in hydro and temperature conditions. However, Commission Staff stated that, if such a proposal were adopted, Commission Staff would recommend the Commission simply return to traditional rate base regulation. Commission Staff stated that decoupling in and of itself is not necessary because in the long run a prudent utility should pursue all cost effective resources, including conservation.

Puget's witness Mr. Richard Sonstelie testified that the hydro risk should not be borne by the shareholders because the benefits of hydro accrue to the ratepayers. The company claimed that, because there is no mark-up on hydro costs they are not included in rate base, its shareholders earn nothing and should not bear the risk.

As the Commission stated in its Order rejecting Puget's ECAC, ratepayers should receive the benefit of a power cost adjustment clause (PCA) because a PCA introduces rate instability

for ratepayers and produces earnings stability for stockholders.[7] In that Order, the Commission rejected the ECAC because, among other things, none of the parties had adequately quantified the influence of the ECAC on Puget's cost of capital, so no downward adjustment could be demonstrated to balance the shift in risk.

In this case, Commission Staff and Pubic Counsel measured a reduction in Puget's required rate of return due to the PRAM. The company should, in future rate filings, specifically address the relationship between the PRAM and its required rate of return. Unless the shifting of hydro and temperature risk continues to provide quantifiable rate reductions, these risks may be shifted back to the shareholders. For the next three years, however, the Commission will retain the current PRAM adjustments for hydro and temperature.

c. WICFUR's 90/10 Deferral Incentive Mechanism

In order to provide an economic incentive to Puget to minimize the impact of hydro, weather, and other conditions affecting power costs, WICFUR recommended either eliminating the ECAC component of PRAM or limiting the amount of power cost variations that are deferred for recovery through PRAM. Specifically, WICFUR proposed that only 90 percent of the difference between forecasted and actual expenses modeled by the simple dispatch model (SDM) be deferred for subsequent recovery. As such, 10 percent of the difference would serve as an incentive. If the actual costs were below the forecast, Puget would retain the difference. On the other hand, if actual costs were above those forecast, Puget would not recover the excess costs.

The Commission believes this proposal should be discussed with others as part of the collaborative. While the proposal may create an incentive for Puget to control costs, it may not be equitable if there are major fluctuations in power costs not within the control of Puget. These issues should be explored in the collaborative.

d. Allocation of PRAM Revenue Adjustments

Under the current PRAM/decoupling mechanism, each customer class is assigned base costs on an equal-percentage basis. Commission Staff recommended in prefiled testimony that the base costs be allocated to different rate classes based on the costs attributable to each class, because base costs vary substantially across customer classes. WICFUR made a similar

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[7] Third Supplemental Order, Docket No. U-89-2688-T and U-89-2955-T (January 17, 1990).

recommendation. However, Commission Staff withdrew this recommendation, stating that, although theoretically correct, it could create a perverse economic incentive for Puget to move customers from one schedule to another.

The Commission agrees with Commission Staff that allocating more costs to one class than to another may create a perverse economic incentive for Puget to move customers from one schedule to another in order to maximize its revenues. The mechanism should remain as simple as possible; the Commission particularly seeks to limit opportunities to manipulate the structure in order to maximize revenues. Therefore, the existing cost allocation method will be retained.

e. Treatment of Secondary Sales

Commission Staff recommended that the SDM be modified to reflect the fact that Puget consistently purchases secondary power at a price lower than it sells power. Commission Staff asserted that the current method prices secondary sales the same as secondary purchases even though they are very different. Commission Staff also proposed that price spread factors be developed to project prices for secondary purchases and sales and that projected prices be trued up to actual prices.

Public Counsel also recommended that the SDM be adjusted to account for the differences in secondary sales and purchases.

On rebuttal the company accepted Commission Staff's adjustment to reflect the difference in the purchase and sales price in the secondary market. However, Public Counsel requested the Commission clarify that emergency backup power costs not be included in the calculation of actual secondary purchase rates.

In addition, Public Counsel recommended that the calculation of secondary costs in the SDM incorporate the net revenues from secondary purchases and sales that occur within a given month so that profits from transactions can be included in the current model.

The Commission has determined that the company should modify the SDM to reflect differences in prices for purchases and sales of secondary power, as recommended by Commission Staff and accepted by the company. Puget should develop price spread factors to project prices. Puget should true up secondary sales and purchases in the manner shown on pages 7 and 8 of Exhibit 782. Emergency backup power costs are not to be included in the calculation of actual secondary purchase rates.

f. Elimination of Resource Cost Recovery

WICFUR proposed eliminating the ECAC (resource cost recovery) component of PRAM and substituting a pure decoupling mechanism along with a "least-cost resource tracker" to provide recovery of conservation-related investments. WICFUR argued that, while the decoupling and conservation investment recovery aspects of PRAM relate to the elimination of the regulatory barriers to least-cost planning, to the aggressive pursuit of conservation, and to the minimization of the effects of regulatory lag, the ECAC portion does nothing to eliminate these regulatory barriers. Instead, the ECAC provides earnings stability to the company and price volatility to the ratepayers.

WICFUR's "least-cost resource tracker" proposal would arguably provide recovery of incremental new resource costs and eliminate the deferred accounting that makes Puget whole for the variations in hydro and temperature. Under this proposal, both conservation and supply-side resource additions which the Commission finds comply with Puget's acknowledged least-cost plans would be tracked in a Least-cost Tracker account and deferred for subsequent recovery in rates. It appears that WICFUR is recommending that these expenditures be reviewed in a tracker filing and that resource additions be compared with secondary power purchases to determine the "appropriateness" of the expenditures and whether they should be allowed in rates. Any increases resulting from the tracker filing would be allocated in the same manner as the resource cost component is currently allocated. WICFUR also argued that, if the Commission adopts the least-cost resource tracking proposal, Puget's proposed rate moderation proposal would be unnecessary because the incremental costs of purchase power contracts would be included in rates as the projects come on line.

The Commission believes the PRAM shares many of the problems we experienced with the former ECAC, such as the scope of expenses to be included in the mechanism, the limited time for review, and the absence of an incentive to control costs. The Commission agrees with Commission Staff that many of the proposals raised in this proceeding may have merit, but that the record is not adequately developed to adopt them in this order. Interested parties should discuss WICFUR's proposal for the least-cost tracker along with other proposals as part of the collaborative, discussed in greater detail below.

g. Rate Moderation Proposal

The company offered a rate moderation proposal which would phase in its rate increase over three years, with carrying charges. The Commission will not phase in the rate changes it approves in this order. While the increase is significantly more

than rates approved in Puget's last general rate case, the intervening temporary increases in the PRAM have been of such magnitude that the current increase in general rates should not cause rate shock.

h. Simplification of Tariffs

Skagit Whatcom Area Processors (SWAP) recommended that Puget's tariffs in the general rate case show the Schedule 100 PRAM adjustments separately from the base rate so that customers can better understand their rates. In addition, SWAP recommended that the Commission direct Puget to work with the rate collaborative to simplify the annual changes in the PRAM. Interested parties should address these issues in the collaborative, discussed below.

i. Elimination of PRAM Filing at Time of General Rate Case

WICFUR proposed that PRAM filings only be allowed between general rate cases and not be allowed in the year in which the company seeks general relief. The Commission agrees that PRAM filings should not be made as a separate proceeding in years in which the company seeks general rate relief. The parties, in the collaborative discussed below, should work out the logistics of including PRAM in the general rate filing.

j. Amortization of Deferral Amounts

WICFUR recommended that the Commission retain flexibility to amortize recovery of deferral amounts over a two-year period to avoid rate shock. The Commission has recognized the value of flexibility with respect to amortization periods in previous orders and will continue to retain this flexibility in the future. The Commission notes again that the current amortization method is not a two-year amortization, but first-in first-out methodology proposed by the company.

3. IN WHAT FORUM SHOULD THE PRAM/DECOUPLING MECHANISM BE MODIFIED?

Although Puget's position is that the mechanism should not be modified, the company suggested a thorough examination of any proposed changes be conducted in a collaborative process.

Commission Staff stated its belief that the theoretical basis for the proposals of WICFUR, Public Counsel, and NCAC may have validity, particularly the point that decoupling does not require a full resource recovery mechanism. However, Commission

Staff believed future proceedings are necessary to develop these proposals because the present record is inadequate.

NCAC recommended that a mediation process be opened to address issues that are not resolved in this proceeding.

The Commission believes it is appropriate to make some modifications to the PRAM/decoupling mechanism in this order, as discussed above, because these changes have been discussed since the original PRAM proceeding, and the record on them is well developed. There were, however, several proposals made in this proceeding which could benefit from further study. We would like the parties to consider these proposals in a collaborative, discussed below. Some parties have recommended that a facilitator assist in the collaborative process. The Commission believes an independent facilitator might prove useful in identifying the key issues and assisting the parties in reaching consensus. We would be interested in learning if this is the case.

4. COLLABORATIVES

In this order the Commission refers several issues to collaboratives. Some of these issues are simple, implementation issues, while others are more complex, involving evaluation of the PRAM/Decoupling experiment and potential alternatives to the experiment. Because these issues are so diverse, the Commission believes it would be appropriate to assign two collaboratives: one to address the implementation issues, and the other to address evaluation and alternatives.

The Commission has determined that the proposals relating to implementation, namely, tariff simplification and the elimination of PRAM during the year of the general rate case, should be adopted. The details of how these proposals are to be implemented should be determined by an implementation collaborative. Puget should invite all parties to this proceeding to join in the this collaborative. Puget should present the two implementation modifications to the Commission in the PRAM 4 proceeding.

In addition, the Commission will order an evaluation collaborative. We were not satisfied with the quality of the evaluation of the PRAM/Decoupling mechanism in this proceeding. Many of the parties suggested a further collaborative effort prior to implementation of major changes in the PRAM. We concur with this recommendation and believe that a more detailed evaluation and discussion of alternatives to the existing mechanism could be conducted in an evaluation collaborative. This collaborative should present a detailed evaluation of the PRAM/Decoupling experiment and investigate other alternatives to

the experiment and traditional ratemaking (without a Power Cost Adjustment), including those adopted by other states. In addition, the collaborative should analyze whether the PRAM is better than traditional ratemaking or other alternatives to traditional ratemaking.

Throughout this order, the Commission has referred proposals that may be of some interest to this evaluation collaborative. The Commission does not expect that all of the issues forwarded to the collaborative need to be resolved, nor do we pre-judge how we will evaluate the resulting proposals. We are hopeful that the process will identify areas where consensus can be reached and provide a common understanding of issues that remain contested.

Puget should invite all parties to this proceeding to join in the evaluation collaborative to discuss, at a minimum, the issues discussed above. We request that a status report on the evaluation collaborative be presented in PRAM 4 and PRAM 5. At the conclusion of the evaluation collaborative, and no later than May 1, 1995, Puget should submit a report to the Commission which includes, at a minimum, the following:

- Details of positions on issues where the parties have reached consensus, including the rationale for those positions;

- Description of any issues which remain in dispute and details of positions on those issues, (these may be statements by the parties themselves) and details of any proposals which remain outstanding;

- Recommendations on how the outstanding issues should be resolved, i.e., through the hearing process, mediation, etc.

V. PRUDENCE OF NEW RESOURCE ACQUISITIONS

Since the last general rate case, Puget has entered into numerous purchased power contracts. The Commission, in its PRAM 2 Order, required that Puget demonstrate the prudence of these resource acquisitions in this proceeding. Despite this specific direction, the company case did not provide such a demonstration. Several fundamental issues relating to the prudence of new resource acquisitions were raised in this proceeding: the burden of proof, the standard for prudence review, and the forum for demonstrating prudence. Each of these issues is discussed below.

A. Burden of Proof

Puget suggested in its brief that there is a presumption that expenditures are reasonable and that such

presumption alone is sufficient to satisfy its burden of demonstrating the prudence of its resource acquisitions. These suggestions were apparently based on the FERC and Vermont Commission cases cited by Puget in its brief.

On the other hand, Puget's witnesses seemed to argue that Puget had demonstrated the prudence of these acquisitions because they were acquired under the competitive bidding framework, they were consistent with the company's integrated resource plan, and they had been the subject of extensive briefing with Commission Staff.

Nevertheless, Puget offered no specific evidence to support even its interpretation of what it takes to demonstrate prudence. Puget submitted Ex. 784, which briefly describes the nature of its decisions on new resources, but it claimed that supporting documents were too voluminous to duplicate, that it did not retain documents used in the briefing of Commission Staff, and that it no longer possesses any memorandum or study supporting its decisions to enter into the contracts.

Commission Staff argued that Puget has the burden of proof to demonstrate that any resource it acquires is prudent. Commission Staff witness Patrick Moast testified that the company did not demonstrate the prudence of the new resources in this proceeding, and that Commission Staff had never conducted a full prudence review of the contracts. Nonetheless, Staff did not recommend that any portion of the costs of these contracts be disallowed for imprudence.

RCW 80.04.130 provides that the utility has the burden of proof to demonstrate that rate increases are fair, just, and reasonable. In addition, the Commission has stated that the burden of proof rests squarely on the company. (See discussion and citation below from the Fourth Supplemental Order in Cause U-83-54 pp. 32-33.)

The Commission rejects the company's position on burden of proof. Puget must make an affirmative showing of the reasonableness and prudence of the expenses under review. This is true even in the absence of a challenge by another party. The Commission concludes that Puget has not carried its burden of demonstrating that its new resource acquisitions were prudent.

B. Prudence Standard

The Commission defined the test to measure prudence in a Puget general rate proceeding where the Commission disallowed expenses related to the Skagit/Hanford nuclear power plant, finding that the expenses were not prudent:

> **The test this Commission applies to measure prudence is what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision. This test applies both to the question of need and the appropriateness of the expenditures.**
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> * * *
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> The most credible evidence in this record supports a finding that such a study would have demonstrated the futility of continuing the licensing process on a new Hanford site. Such a study was not performed, however, and no one can state unequivocally that abandonment would have been recommended by mid-year 1980. **However, the responsibility for this absence of proof rests squarely on Puget's executive officers and directors.** They elected to preserve the option of building a nuclear plant without a full review of the economic consequences of that action. It is the Commission's conclusion that a full review would have shown the nuclear project to be uneconomic when compared to the coal alternative. It follows that all costs incurred on the Skagit/Hanford project after the point in time when a complete cost-effectiveness study would have been available must be deemed imprudent and disallowed. (Fourth Supplemental Order, Cause U-83-54, pp. 32-33. Emphasis supplied.)

A demonstration of prudence of resource acquisition includes showing both that the selection of the resource was necessary and reasonable and that the costs of acquisition were appropriate. That is, did the company spend twice as much as it had to spend to acquire a resource, even if the result were below avoided cost?

Puget's case seemed to be based on new standard of prudence which would equate prudence with a demonstration that new resources are consistent with Puget's least-cost plan, that new resources are below avoided cost, that new purchased power contracts were acquired through competitive bidding, and that Puget briefed Commission Staff on its decision to acquire specific projects.

Commission Staff recommended that the Commission reject this "new" standard for several reasons. First, the least cost plan was not intended to be a document upon which prudence could be demonstrated, and the least-cost plan is not rigorous enough to demonstrate prudence. For example, dispatchability is a major factor that can change the economics of a project substantially, yet it is not quantified in Puget's least-cost plan. Second, contracting below avoided cost is a broad check of prudence, but

is not proof, because it does not offer a clear comparison with other bids or address dispatchability or transmission issues. Third, Puget's claim that its supply side resources are prudent because they were acquired through a competitive bid "framework" is misleading because in fact much of the new supply was acquired outside the bidding process. Finally, both Commission Staff and Public Counsel asserted that informal Staff briefings do not constitute a prudence review.

Commission Staff stated that the proof in a prudence review should address at a minimum dispatchability, transmission impacts, other bids, building options, and financial and rate impacts, and recommended that the Commission apply the same standard used in the Pebble Springs and Skagit/Hanford prudence reviews (Causes U-82-38 and U-83-54).

Although a least-cost plan (LCP) may contain information helpful in determining the prudence of resource selection, this is only one consideration in the evaluation. Additional information is required to prove prudence as indicated in the LCP rule itself. (WAC 480-100-251)

The Commission's acceptance of a Company's least-cost plan does not represent a finding of prudence of a particular resource. The rule does not require any formal Commission approval, and the Commission routinely states in its letters accepting least-cost plans that the letter does not constitute an approval and should not be taken as an endorsement of any element of the plan. The Commission accepts plans only as being in minimal compliance with the rule. Furthermore, the least-cost planning process is not sufficiently rigorous or specific to support an independent finding of prudence.

Avoided cost is just one more factor which may be considered in determining prudence. However, cost values must be adjusted for items such as load factor and seasonality in order to make a reasonable evaluation of the prudence of the acquisition.

Although the competitive bidding rule (WAC 480-107-060) provides that information gathered in a competitive bid may be used for analysis in a general rate case, the prices submitted pursuant to the bid may be used only for a general, qualified comparison with the acquired resource as another component of the prudence review.

Puget argued in this proceeding that purchased power creates imputed debt, and that the equity component of its capital structure should be increased to cover the imputed debt. Puget did not quantify this added cost of purchased power in its least-cost planning.

Puget should not use different assumptions regarding resource impacts on cost of capital in the planning and acquisition stages than it uses in the ratemaking process. If Puget attempts to raise cost issues not considered in the least-cost planning process in order to recover those costs in rates, it must explicitly explain and justify these deviations. Puget should not attempt to justify a resource as least-cost based on the least-cost plan and then alter the cost of the resource for rate recovery.

The Commission sees no reason to deviate from the traditional prudence standard recited above, and we concur with Commission Staff that the review should include at a minimum dispatchability, transmission impacts, other bids, building options, and financial and rate impacts.

C. Forum

Puget seemed to believe that it does not have to prove prudence of the new acquisitions in this proceeding because it has presented the information in various other forums (the least-cost planning process, Commission Staff briefings, the competitive bidding process, and annual PRAM reviews).

Both Commission Staff and Public Counsel argued that the Commission should examine prudence issues exclusively in general rate cases, which are formal, contested proceedings.

The Commission has stated consistently that the prudence review of new resource acquisitions would be conducted in general rate cases only[8]. The Commission in its PRAM 1 Order[9] specifically rejected Puget's request that the evaluation of new contracts included in that proceeding be defined as the final prudence review of those contracts.

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[8] See, Seventh Supplemental Order, Cause No. U-85.87 (June 1, 1992).

[9] "The Commission reserves the right to conduct prudence reviews of new contracts in future proceedings, although the contracts may be included in rates for the first time in a PRAM proceeding. In a subsequent general rate case, the Commission may review contracts and the company's experience under the contracts, to determine proper ratemaking treatment and to examine items which may be disallowed for ratemaking purposes. Initial review of contracts included in a PRAM proceeding does not foreclose the Commission's later full review in a general rate case." (First Supplemental Order, Docket No. UE-910626, p. 7)

The Commission again clearly stated that the prudence of resource contracts would be decided in the context of the general rate case in the First Supplemental Order in the PRAM 2 proceeding (Docket No. UE-920630). Puget had ample notice of its responsibility to demonstrate prudence in this proceeding.

The Commission sees no reason to modify its previous decisions with respect to the appropriate forum to consider prudence reviews. Prudence reviews of new resource acquisitions will continue to be conducted in general rate case proceedings unless otherwise ordered.

Commission Staff made no recommendations to disallow purchased power costs for lack of prudence. However, Commission Staff stated that Puget had not provided enough evidence to allow an evaluation of prudence. Puget had not carried its burden of proof because it failed to provide any documentation, studies, or quantitative analyses showing that the resources were acquired at the least-cost or were good matches with firm system needs. Staff and Public Counsel both recommended that the Commission order that in the future Puget maintain all documents related to its decisions to enter into specific contracts.

Public Counsel made specific recommendations for disallowing a portion of the purchased power costs, arguing that, despite the deficiencies in Puget's case, the record contains enough information to show that Puget's decisions with respect to certain cogeneration contracts were not prudent.

D. Supplemental Review

It is clear that the utility seeking permanent recovery of resource acquisition costs in general rates bears the burden of proof with respect to the prudence of the acquisitions. In this case Puget has not met this burden.

The Commission agrees with the Commission Staff that the record in this proceeding is not sufficient to judge the prudence of Puget's resource acquisitions. Allowing these resources to be recovered in general rates, without such support, would violate the Commission's duty to ensure that rates are based on prudent costs. However, a 100 percent disallowance at this juncture would not be in the best interest of the ratepayers or the shareholders.

The company will be given one last opportunity to demonstrate the reasonableness of its new resource acquisitions. The company will be allowed to file a PRAM 3 projection which includes the costs of new resource contracts that are already providing power. These costs will be subject to true-up at the conclusion of the prudence review filing the Commission now

orders. The PRAM 3 projection is a temporary rate, subject to refund.

The company should file, by November 1, 1993, a power supply case which demonstrates the prudence of its resource acquisitions since the last general proceeding. The specific contracts are listed in section VII. C.2.d below. For each contract, the company must describe the resource alternatives available to it at the time the contract was entered into and describe, at a minimum, dispatchability, transmission impacts, other bids, building options, and financial and rate impacts. Puget is directed in the future to maintain all documents related to its decisions to enter into specific contracts. If any cost disallowances result from the prudence proceeding they will be trued up against the PRAM 3 projection.

The Commission has similar concerns regarding the prudence of Puget's four-year firm energy sale to the Bonneville Power Administration. Puget has not shown the net benefits of the sale under a reasonable range of market and resource conditions that could be expected to occur. When asked by Commission Staff to demonstrate the prudence of the sale, Puget did not provide any documents describing or quantifying the financial risk associated with the BPA sale. Puget should include the BPA sale in the PRAM 3 projection; the company may not shift the risks of this sale to ratepayers in general rates until it has demonstrated its prudence in the November 1 prudence filing ordered above.

VI. BPA ACCOUNTING PETITION

The company filed a petition for an accounting order regarding the treatment of BPA residential exchange credits. That petition was consolidated with the general rate case for hearing and decision.

Currently, a credit balance in the residential exchange account is reflected through a reduction to working capital. The BPA took exception to this treatment during a compliance audit. As a result, the company filed a proposal to directly accrue interest on any balance in the residential exchange account, at a rate equal to the company's short-term debt rate.

Commission Staff expressed concern that the company proposal would result in benefits of the exchange being retained by Puget shareholders. Commission Staff preferred to treat the exchange balance similarly to customer deposits, by excluding the balance from rate base and treating the interest expense as an operating expense. Commission Staff contended this would satisfy BPA's primary concern, that the accrual of interest be direct and flow only to residential ratepayers. The Commission Staff agreed

on brief that the exchange balances should accrue interest monthly on actual account balances, at the short-term debt rate.

Public Counsel proposed requiring the company to accrue interest at its overall authorized rate of return, rather than at the short-term debt rate. Public Counsel argued that this modification would resolve both BPA's requirements and Commission Staff concerns about benefiting Puget shareholders.

BPA on brief indicated it had proposed that Puget directly accrue interest in a restricted, separate account outside of Puget's rate base. BPA proposed that Puget pay interest at Puget's short-term debt rate, because Puget can use the undistributed residential exchange balances as short-term debt. BPA stressed that its primary concerns were that the interest be accrued on actual monthly residential exchange balances, and that it be passed through to residential and small farm customers only.

The Commission agrees that the company proposal would overcollect from customers the proper level of residential exchange credit. It is improper for Puget to receive its overall rate of return on residential exchange balances, while paying only the short-term debt rate.

The Commission accepts the Commission Staff's preferred method. The account should be deducted from rate base. Exchange balances in the account should accrue interest monthly on actual account balances, at the short-term debt rate. Benefits should be passed through to residential and small farm customers only. This treatment should satisfy the concerns of BPA as the Commission understands them.

VII. RATE OF RETURN

A. Legal Principles

A utility is entitled to the opportunity to earn a rate of return sufficient to maintain its financial integrity, attract capital on reasonable terms, and receive a return comparable to other enterprises of corresponding risk. Bluefield Water Works Improvement Co. v. PSC of West Virginia, 262 U.S. 679 (1923) and FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944).

Appendix A, attached to this order, compares the capital structures and cost rates proposed by various parties.

B. Capital Structure

To determine the overall authorized rate of return, the Commission must establish an appropriate capital structure for

the company. This capital structure need not be the actual capital structure the company experienced during the test year.

The Commission determines an appropriate balance of debt and equity within the capital structure on the bases of economy and safety. Because the composite cost of debt is generally less than that of equity, overall capital costs can be expected to decrease as a greater portion of the capital structure is composed of debt. The economy of lower capital cost must be balanced against the safety of the capital structure.

The concept of "safety" refers to the fact that the company has no legal obligation to pay a return to the holders of common stock. In dire financial circumstances, a company can reduce or suspend the payment of dividends to the owners of common stock without the legal consequences that would flow from a failure to pay interest on debt. In return, holders of common equity generally demand a greater return than do lenders who have a claim on the company's earnings.

This case presents four primary issues regarding capital structure. First, what is the appropriate amount of the equity component? Second, what is the appropriate amount of short-term debt? Third, should capital structure be modified to reflect rating agencies' perceptions of the effects of purchased power? Fourth, should capital structure be modified to reflect the effects of PRAM?

In June 1993, the company sold additional common stock, adding $90 million to common equity and resulting in a capital structure with 45% common equity. Company witness Russel Olson expects this to be the equity level during the rate year. The company therefore reported its pro forma capital structure at June 30, 1993, to be 42% long-term debt, 3% short-term debt, 10% preferred and 45% common equity.

The company supported a 2% short-term debt ratio. The company calculated that the Commission Staff's recommendation of 5% short term debt would use up $140 million of the company's credit line of $150 million, leaving the company insufficient flexibility in financing.

The Commission Staff contended the short-term debt level should be 5%, since short-term rates are currently so low. The Commission Staff also noted that Puget has had a short-term debt ratio of 4.4%, on average, at year end, over the past five years. The company replied this would leave the company at the mercy of rising interest rates and sacrifice long-term stability.

The Commission Staff supported the capital structure it expected to be in place at year-end 1994, which is the middle of the period when rates will be in effect. Commission Staff witness Richard Lurito contended that the company's purchased power program does not mandate a higher revenue requirement, since any perceived risk is already reflected in Puget's cost of money. Dr. Lurito tested his recommended overall rate of return and common equity component, determining that Puget would still have an after-tax interest coverage of 2.15, even if the rate of return fell by 6.67% (a deviation that can be expected to occur only one out of 160 times).

The company contended rating agencies demanded a 45% common equity ratio as the minimum for Puget, in part because of its purchased power obligations. In evaluating the other parties' recommendations, the company adjusted its debt ratios to impute additional debt as the result of purchased power. After this adjustment, the company argued the resulting coverages would be insufficient and would result in a downgrade of debt rating. The company provided testimony about rating agencies from several witnesses supporting this theory. If the adjustments to impute additional debt were not made, Mr. Olson agreed that all parties' recommendations would meet the Standard & Poor's guidelines.

Other parties contended the capital structure should not be adjusted to impute additional debt. Commission Staff noted the rating agencies described a "generic" process, which did not take into account the low cost of Puget's hydro contracts, or the lower risk as the result of PRAM. Public Counsel opposed the adjusted capital structure as not cost-effective.

WICFUR changed its recommendation about capital structure on brief. At pages 42-46, WICFUR recommended recognition of the company's move to an actual 45% equity ratio, and noted that such an increase should be recognized by reducing WICFUR's cost of equity recommendation to 10.4-10.6%. This is due to the fact that a capital structure with 45% equity is less risky than the capital structure in place when WICFUR measured Puget's cost of capital. WICFUR also indicated that if the Commission adopts a 42.5% equity ratio (which is no longer WICFUR's recommendation), the Commission should use WICFUR's original cost of equity of 10.5-10.8%.

Company witness Charles Olson testified at one point that decoupling could be argued to reduce potential profits and therefore add to risk (p. 8).

The Commission Staff contended the effect of PRAM is to ensure timely recovery of purchased power so there is no need to adopt a higher debt ratio. Dr. Lurito calculated that PRAM has

resulted in a 50-basis-point reduction in the cost of equity since Puget's last general rate case. Commission Staff recommended on brief the PRAM be discontinued if the Commission set a 45% equity component in the capital structure without accordingly lowering the cost of equity to reach approximately the same overall rate of return.

Public Counsel contended the decoupling-type mechanism reduces volatility of revenue and income streams, therefore reducing risk. Public Counsel witness Stephen Hill calculated that this results in a cost of equity 50 basis points below that of similar utilities. He recommended that the equity ratio be adjusted rather than lowering the cost of equity by 50 basis points.

Public Counsel therefore recommended a different capital structure with PRAM than without PRAM. With PRAM, he recommended a 40.5% equity component. Without PRAM, he recommended a 42.5% equity component. Public Counsel recommended these levels even if the result were a downgrade in debt rating. Mr. Hill calculated the additional cost of debt between an A and a BBB rated utility to be less than $2.25 million per year, compared to the $9.2 to $13 million per year additional cost of a 45% equity component.

All of the parties except the company recommended a change in the cost of equity, depending on the capital structure adopted by the Commission, so that the cost of equity and capital structure decisions must be made together. If the Commission set the equity ratio at 45%, WICFUR recommended changing the cost of common equity to maintain an overall weighted cost of capital at 9.03% to 9.15% (which would be a 10.5-10.8% cost). FEA on brief indicated that if the Commission allowed a lower return on equity, the company would not be able to attain a 45% equity ratio, and, therefore, the Commission should set a lower equity ratio also.

C. Cost of Debt and Preferred Stock

On rebuttal, the company updated its costs of debt and preferred stock to reflect all issuances already completed in 1993 and one bond issue anticipated in November 1993. The company calculated cost of long-term debt at 7.91%, and forecast short-term debt at 4.42%. The company calculated the cost of preferred stock at 8.10%.

On brief, Public Counsel and the FEA accepted these updates.

The Commission Staff indicated that either its recommendation or the company's was acceptable for costs of long-term debt and preferred equity, since they were so close. Commission Staff contended its 4% cost of short-term debt was better, since it was close to the company's current cost of short-term debt at 3.825% and rates are likely to remain low. The company's calculation for short-term debt was based on a Data Resources Incorporated (DRI) forecast.

D. Cost of Common Equity

Five parties sponsored witnesses regarding the appropriate cost of equity. Two primary areas of dispute remain. First, what is the appropriate growth rate to be used in the discounted cash flow (DCF) method. Second, does the current climate require flotation cost/market pressure adjustments.

1. Growth Rate

All five witnesses stated they used some form of the DCF method. As shown in the following table, the DCF results differ among the various parties' witnesses, primarily in the growth rate assumed by each witness.

Table 1 Discounted Cash Flow Results

Puget	6.87% div. yield	+	4.5-5% div. growth	+	factor	=	11.52-12.04%
Staff	6.76% div. yield	+	3.5 % div. growth			=	10.26%
P.C.	6.6 % div. yield	+	3.31% div. growth			=	9.91%
WICFUR	6.87% div. yield	+	3 % div. growth			=	9.87%
FEA	6.8 % div. yield	+	3-4 % div. growth			=	9.8-10.8%

Puget witness Charles Olson used a six-month period ending September 30, 1992, to compute his dividend yield, then marked up the dividend yield for one-half year's dividend growth expectations. In calculating his growth rate, Dr. Olson considered and discarded the Institutional Brokers Estimate Service (IBES) growth rate; the 5-year and 10-year growth in earnings per share, dividends per share and book value per share, and a retention growth analysis. No basis other than judgment was provided for the growth estimate he selected.

Dr. Olson then discarded the results of his DCF analysis. He concluded that a higher number was required because of the historical increase in market price of Puget stock. He double-checked his result with a risk premium analysis. Dr. Olson made similar calculations with a group of six comparable utility companies.

On rebuttal, Dr. Olson recommended an equity return of 12.25%. He presented no revised DCF study to support his rebuttal figure. He testified that the interest rate reduction since his original testimony suggested a return of 12.15%, but that Puget's risks and the potential for bond rating reduction led his recommendation to increase to 12.25%. He compared his recommendation to rates of return granted to other utilities throughout the country.

Commission Staff witness Richard Lurito's calculation of growth rate was based on his study of Puget and the same six comparable electrics used by Dr. Olson. Dr. Lurito analyzed financial and market data for the period 1983 through 1992, with particular emphasis on data since 1987. He calculated for Puget and six comparable companies the annual rate of growth in dividends per share and book value per share for all periods.

Public Counsel witness Stephen Hill calculated a sustainable growth rate for Puget and for the same sample group of six companies chosen by Dr. Olson. Mr. Hill corroborated his numbers with an earnings-price ratio, market-to-book ratio, and capital asset pricing model (CAPM) method.

WICFUR witness Dennis Peseau used the most recent security analysts' estimate from IBES of 3%. Dr. Peseau noted 3% was the same growth rate accepted by the Commission in the previous general rate case. WICFUR challenged Dr. Olson's method of estimating growth rate, arguing that growth in stock price is unrelated to investor expectations of growth in dividends for estimating factor "g" in a DCF study.

FEA witness John Legler reviewed historical growth rates, analyst-forecasted dividend growth rates, and retention growth to reach his growth rate of 3.0% to 4.0%. He checked the results with a risk premium analysis, CAPM analysis, and comparable earnings approach.

2. Flotation Costs/Market Pressure Adjustments

The parties also differed in the adjustment -- or lack of an adjustment -- for market pressure and flotation costs. Their final recommendations after any adjustment to bare cost of equity are reflected in the table at the beginning of this section.

Dr. Olson used an 8% markup to account for financing costs and market pressure. Dr. Lurito recommended a 7% markup, consisting of 4% for flotation and 3% for market pressure. Mr. Hill contended no adjustment was necessary because Puget had just sold stock at 1.5 times book value, making dilution unlikely.

Dr. Peseau adopted Dr. Olson's market pressure and financing adjustment.

Dr. Legler recommended the Commission apply a 4% flotation cost to only that portion of equity raised through common stock offerings. FEA argued on brief that a market pressure adjustment was not necessary to protect shareholders from dilution, because Puget currently has a market-to-book ratio of approximately 1.5. After reaching a cost of equity, Dr. Legler increased his recommendation (9.8% to 10.8%, plus an issuance cost adjustment of no more than 20 basis points) to the midpoint of the range of 11.0% to 11.5% (including an issuance cost adjustment), predicting "investor shock" if the Commission set the return on equity strictly by a financial model at less than 11%.

E. Commission Decision

The Commission has determined that Puget will have the opportunity to earn a rate of return sufficient to maintain its financial integrity, attract capital on reasonable terms, and receive a return comparable to other enterprises of corresponding risk if it earns an overall rate of return of 8.93%. This overall rate of return consists of the following elements:

Table 2 Overall Cost of Capital

Description	Ratio	Cost	Weighted Cost of Capital
Long term debt	43.00%	7.91%	3.40%
Short term debt	4.00%	4.00%	0.16%
Preferred	8.00%	8.10%	0.65%
Common	45.00%	10.50%	4.73%
Total	100.00%		8.94%

The company has increased the equity component of its capital structure to 45%, and the Commission does not find this to be an inappropriate or imprudent capital structure. The Company's historical level of short-term debt has been 4.48%; 4% is a more likely and economic level of short-term debt than the 2% level proposed by Puget.

While the Commission recognizes the increase in the equity component of the capital structure, it also must recognize that this increase in equity reduces the risk measured in the

cost of money studies performed by the parties. The Commission agrees with Dr. Lurito that regardless of how purchased power expense is treated, the revenue requirement should remain unchanged. It is persuaded by Dr. Peseau's argument that an adjustment must be made to Puget's return on equity figure because of the company's revised equity position.

The cost figures used for debt and preferred stock costs are embedded, and therefore remain unchanged. We find the Commission Staff's 4% cost of short-term debt to be the more accurate estimate. The cost of equity of 10.5% is the mid-range of Dr. Peseau's recommendation (with 45% common equity) of 10.4 to 10.6%. The overall cost of 8.94% is close to, and slightly higher than, Dr. Lurito's recommendation of 8.91%. His tests proving the safety of the 8.91% overall return equally confirm the safety of the 8.94% overall return established by the Commission.

VIII. RESULTS OF OPERATIONS

A. Legal Principles

Having determined the appropriate test period and rate of return for this case, the Commission must analyze the company's test year operations. The parties agree the company's net operating income (NOI) per books is $211,474,422.

The booked results of the company's test year operations must be adjusted to remove amounts which are not representative, or which are not properly included within the test period. This type of adjustment is called a "restating actual" adjustment. Additional adjustments are then made to test period results to give effect to known and measurable changes which are not offset by other factors occurring during or after the test year. These adjustments are called "*pro forma*" adjustments.

The parties made restating actual and *pro forma* adjustments based upon their respective exhibits pertaining to the financial data of the company. Table 1 compares the results of operations issues contested by the parties. In all of the following sections, the numbers used to identify the adjustments are those used by the Commission Staff, for convenience of reference.

Table 3
PUGET SOUND POWER & LIGHT COMPANY RESULTS OF OPERATIONS
Contested Adjustments For The 12 Months Ended 6/30/92

NO.	Description		Company Position	Staff Position
Per Books Actual			211,474,422	211,474,422
Total uncontested Adjustments			1,403,943	1,403,943
Contested Adjustments:				
2.01	General Revenues		44,728,226	(17,268,396)
2.02/.03	Power Supply Adjustments	(3)	(111,333,219)	(84,367,199)
2.04	Temperature Adjustment	(3)	18,100,891	16,152,179
2.05	Conservation	(3)	(8,142,402)	(7,704,875)
2.07	Property Sales		242,865	429,799
2.08	Storm Damage		(4,247,103)	(2,145,630)
2.09	Self Insurance	(2)	(531,460)	(238,024)
2.10	Environmental	(2)	(374,807)	1,033,957
2.11	Employee Insurance		(637,485)	(611,136)
2.12	SFAS 106	(2)	(801,292)	(269,029)
2.13	Company Insurance	(2)	4,268	142,451
2.14	Wage and Salary	(2)	(2,802,118)	(1,112,187)
2.15	Investment Plan		(93,878)	(79,723)
2.16	Retirement Plan		(2,195,954)	(1,516,658)
2.17	Bad Debts	(2)	(307,290)	(307,290)
2.19	Creston		(786,928)	(309,924)
2.20/21/22	Stone Creek-Black Creek-Sma		(203,135)	0
2.24	Working Capital	(2)	0	(250,020)
2.26	Rate Case Expense		(131,380)	41,870
2.27:	Non-Recurring & Operating Expense:			
2.27b	Corporate Dues	(2)	108,047	261,386
2.27j	Conservation Advertising	(3)	0	171,531
2.27l	Colstrip Interest Income		(203,180)	(203,180)
2.28	Production Adjustment		1,247,334	1,767,958
3.03	Montana Corp. Tax		(152,271)	(143,110)
3.04	Pro Forma Interest		(7,716,824)	(6,950,412)
3.05	Montana Energy Tax		86,323	28,938
4.02	Skagit Hanford	(1)	11,925	11,925
4.03	Corporate Publications		84,337	95,162
4.04	Vegetation Management		3,332,252	3,425,985
4.05	Future Use Plant	(2)	4,328	28,653
4.06:	Miscellaneous Adjustments:			
4.06a	Public Util. Tax Credit		223,293	188,315
4.06c	Vehicles - Other		202,136	202,136
4.06e	Tree Trimming Sales Tax		(327,954)	(321,429)
4.06g	Outside Services		0	58,151
4.06h	Nintendo		0	80,234
4.06i	Miscellaneous General		0	20,790
4.06j	OBC Relocation		0	72,011
4.06 (FEA)	Employee Expenses	(2)	0	0
	Research and development	(2)	0	0
Total Contested Adjustments			(72,612,455)	(99,584,791)
Total Adjustments			(71,208,512)	(98,180,848)
Pro Forma Results (NOI)			140,265,910	113,293,574

(1) Not contested by parties but adjusted by Commission
(2) FEA had an independent position
(3) Public Counsel had an independent position

B. Uncontested Adjustments

The following table shows adjustments which are not contested among the parties.

Table 4
PUGET SOUND POWER & LIGHT COMPANY
RESULTS OF OPERATIONS
Uncontested Adjustments
For The 12 Months Ended 6/30/92

Adjustment	Description	Commission
2.06	Depreciation /Amortization	$7,242,533
2.18	Interest on Customer Deposits	(291,878)
2.23	Pebble Springs	4,856,240
2.25	OBC Lease Income	292,937
2.27:	Non-Recurring & Operating Expense:	
2.27a	Advertising	(18,815)
2.27c	North Division Write offs	434,067
2.27d	Supplemental Pension	298,093
2.27e	Overhead Lines	363,000
2.27f	PTO Adjustment	58,252
2.27g	PCI	9,024
2.27h	Software Amortization	46,155
2.27i	Remove Operating Expense	16,500
2.27k	Idea$ Plu$	138,903
3.01	WUTC Fee	(520,600)
3.02	Property Taxes	(1,048,512)
3.06	Federal Income Taxes	(10,714,201)
4.01	Company Car	88,661
4.06:	Miscellaneous Adjustments:	
4.06b	Bank Fees	16,216
4.06d	Kirkland Project Center	135,705
4.06f	Executive Expense	1,663
Total Uncontested adjustments		$1,403,942

The Commission has reviewed the uncontested adjustments and finds they are proper for purposes of this case.

C. Contested Adjustments

1. 2.01 General Revenues
   2.04 Temperature Adjustment

The differences between Puget and Commission Staff presentations are due to the methods used to present PRAM revenues in this rate proceeding. Puget annualized the impact of PRAM revenues as a *pro forma* adjustment to revenues.

The Commission Staff excluded the impact of PRAM revenues from its adjustment. This resulted in showing the revenue requirement before PRAM. The Commission Staff then included a PRAM offset to adjust the revenue increase to the increase required over current rates in effect through PRAM 2.

The Commission prefers the Commission Staff's method of presenting the impact of PRAM revenues. The Commission Staff's method is more clear. It will show the actual general rate increase produced by this filing, above the rates approved in the previous general rate case. It will assist the Commission in making rate spread determinations, since the Commission determines later in this order that rates should be spread using the previous general rates as the base. The commission has recalculated staff's adjustment to reflect our discussion on bad debts.

In future cases parties should reflect the impact of PRAM revenues by using the Commission Staff's method of excluding the impact of PRAM revenues from the adjustment and using a PRAM offset.

2. 2.02 Power Supply
2.03 Sales/Resale Secondary

The company's test year power costs must be updated for known and measurable changes expected during the rate year, such as changes in contract prices and the introduction of new power purchase contracts. The test year power costs also must be adjusted to normalize variable power supply expenses and secondary sales.

To develop normalized pro forma power supply costs, the company projects rate year power supply costs, using its production costing system (PCS) computer model, then discounts the results by its "production factor." It uses its PCS model to look into the future to predict what rate year power costs will be at the rate year loads the company expects to serve and the resources the company expects to have. The PCS model estimates normalized values for variable fuel expense and nonfirm wholesale energy transactions; monthly energy purchased or sold under firm contract is treated as fixed quantity and is not dispatched by the model. The "production factor" used to discount the projections is the ratio of the company's test year loads to its forecasted rate year loads. The production factor mechanism allows the company to take into account loads and power supply that will exist during the rate year, and thereby recover growth-related production costs.

The company identified on brief eleven issues relating to power costs. The Commission Staff, Public Counsel, and intervenor WICFUR addressed several additional issues. The discussion of this topic will generally follow the form used by the Commission Staff on brief. Power cost issues related to the company's sales to Nintendo, the costs associated with the Creston investment, and the treatment of individual resources for purposes of calculating power costs under the PRAM's simple dispatch model are discussed in other sections of this order.

a. Load Forecast/Production Factor

The company initially calculated a production factor of 93.6%, which all parties accepted. In its rebuttal case, the company updated the production factor to its most current load forecast, based on its assumption that Boeing employment cutbacks will reduce the company's sales during the rate year. The company's recalculated production factor is 95.5%. Commission Staff objected to the company's revised forecast as unduly pessimistic. Both Commission Staff and Public Counsel supported use of the 93.6% figure. The hearing testimony by company witness Corey Knutsen was to the effect that more recent forecasts are that the aerospace layoffs will occur at a slower rate than the company used in its new forecast.

The Commission agrees with Commission Staff that the company's new load forecast is unduly pessimistic, based on the testimony of the company's own witnesses. The Commission accepts the initial production factor of 93.6%.

The Commission notes that the production factor makes little difference so long as PRAM is continued. The power supply costs to which the factor is applied are trued up during the PRAM proceeding.

b. Colstrip 1 and 2 Coal Costs

The company is a part owner of the Colstrip 1 and 2 thermal generating plants. The company is being billed at a contract price of $7.45 per ton for the cost of the coal the plants use, but is presently paying only $5.51 per ton; the price is currently subject to arbitration. The company proposed that the Commission use a third price for setting rates, or, in the alternative, use the price currently being paid, $5.51 per ton, with true-up in PRAM 4. Company witness Richard Lauckhart argued that the $5.51 price should not be used because it is only a partial payment. Commission Staff and Public Counsel initially recommended that the Commission use the $5.51 price, but on brief Commission Staff accepted the company's alternative proposal of $5-51 per ton, with true-up in PRAM.

The Commission agrees with Commission Staff that none of the prices mentioned is a proper pro forma price due to the pending arbitration. The Commission accepts the company's alternative of $5.51 for setting rates in this proceeding, with the price be trued up in PRAM 4.

c. Tenaska Costs

The company has contracted to purchase power from the Tenaska cogeneration project, which is presently under construction in Ferndale. Tenaska is projected to start commercial operation in April 1994, and to be on line during April and during June through September of the rate year. The company proposed to recover five months of the project's anticipated purchased power costs through rates.

Commission Staff witness Patrick Moast recommended that Tenaska costs not be permitted in rates at this time, and that the issue of Tenaska power cost recovery be addressed as part of the June 1994 PRAM 4 filing. Mr. Moast's rationale for not allowing the costs was that extensive construction remains to be done, the April 1994 on-line date is just a projection, and the actual date of commercial operation is uncertain; that equity dictates that customers should not pay for power until construction is completed and commercial operation occurs; and that the PRAM 4 cycle is the time which is most synchronized with the company's projected commercial operation date. The company's witnesses did not rebut Mr. Moast's testimony, and its brief does not address the issue.

The Commission adopts the Commission Staff's recommendation. Both the timing and the uncertainty associated with the construction completion date persuades us that the Tenaska costs are more equitably recovered in PRAM 4. Even if the plant does come on line as projected, the company is not harmed by this treatment. These power costs would be included in the true-up of the PRAM 3 period. This approach is consistent with the Commission's treatment of the costs attributable to the Encogen and Sumas projects in the First Supplemental Order in Docket No. UE-920630 (PRAM 2 Order).

d. Costs of New Purchased Power Resources Acquired Since Previous General Rate Case

As discussed in Section V of this order on Prudence of New Resource Acquisitions, the company's power supply adjustment includes the cost of numerous new sources of power supply added since the company's previous general rate case. The new resources have resulted in the addition of 1,114 MW of capacity and 684 aMW of firm energy. Approximately 600 aMW of that total will be provided under large capacity cogeneration contracts,

including March Point Phases I and II, Sumas Energy, Encogen Cogeneration, and Tenaska Cogeneration. The company has calculated the pro forma power supply expense for its new purchased power contracts to be $194 million, which is 40% of the total power supply expense it seeks to include in rates.

As Section V explains, the company failed to demonstrate the prudence of its decisions to acquire its new purchased power resources. The Commission will not allow the full amount of those contracts to be recovered in general rates at this time. Pending the outcome of the prudence proceeding ordered in Section V of this Order, the Commission has included each new purchased power contract in general rates at the company's monthly secondary purchase rate. This results in a rate year reduction in Expenses of $82,311,653.

The Commission does not accept Dr. Blackmon's contention that, despite the deficiencies in the company's case, the record contains enough information for the Commission to make a prudence determination on the cogeneration contracts and to disallow a portion of their costs for general rate purposes. The Commission does not believe that the record is sufficient for it to make any decision on the contracts' prudence.

The contracts which are to be reviewed in the prudence proceeding, and which are subject to the above treatment, are the following: Snohomish conservation power sales agreement; Montana Power Company firm power purchase; Koma Kulshan hydro; March Point Phase I; March Point Phase II; Sumas Energy; Encogen Cogeneration; and Spokane Regional Solid Waste Disposal Facility.

The Tenaska Cogeneration contract is treated above in subsection "c."

e. Out-of-period Expenses

Commission Staff witness Patrick Moast recommended that "Other Power Supply Expense" be reduced by $57,333 and "Transmission Expense" by $11,825 because these expenses were incurred prior to the test year. The $57,333 "Other Production Expense" represents survey charges booked on December 31, 1991, for investigating a Texaco Mission Pipeline to the company's Fredonia and Whitehorn facilities. The $11,825 amount represents Third AC Intertie preliminary survey expenses booked on December 31, 1991. The company did not contest these adjustments.

The Commission adopts Commission Staff's recommendation.

f. Planned 358 Megawatt Capacity Purchase Agreement

The company proposed to adjust power costs by adding $4,296,000 for the purchase of 358 MW of additional firm power to cover potential extreme winter peaks such as the "Arctic Express" event. It proposed to enter into a capacity purchase agreement with another utility which would give Puget the right to receive power if needed, and to include in rates the fixed capacity payment, subject to true-up in PRAM.

Company witness J. Richard Lauckhart argued that the company's analysis of its loads and resources indicated that the need exists, and that inclusion of the cost in the general rate case will minimize deferrals in PRAM. He requested that, if the Commission excluded the cost, it indicate whether the company will be able to include actual costs of such a contract in the PRAM 3 true-up, or if it should attempt to secure on the spot market the power necessary to serve during an extreme peak event.

Commission Staff recommended that the Commission reject the company's proposed adjustment. It argued that Puget's method of forecasting extreme peak needs is uncertain, and that it has supplied insufficient data to justify the planned capacity recovery. It argued that PRAM is the appropriate place to recover such capacity costs.

WICFUR's witness Donald Schoenbeck also recommended rejection, calling the costs "phantom." He argued that the costs are not known and measurable, and that Puget has a firm capacity surplus and does not need the contract.

The Commission agrees with Mr. Schoenbeck's characterization of the costs, and adopts Commission Staff's and WICFUR's recommendation. The PRAM is the appropriate place to recover such capacity costs.

g. Coal Plant Availability

The amount of power the company must purchase, and therefore its power costs, depends upon the availability of power from the company's own plants. The company proposed to calculate pro forma power supply expense using an assumption that the output of its partially owned coal plants is equal to its calculation of a national average level based on figures for similarly sized coal units in the Generating Availability Data Systems (GADS) data base. It proposed to assume that level of availability until the next general rate case, and not true-up the levels to actual in the PRAM. The coal plants are Centralia (7 percent ownership), Colstrip 1 and 2 (50 percent ownership), and Colstrip 3 and 4 (25 percent ownership).

Company witness J. Richard Lauckhart acknowledged that, for the past seven years the plants have operated at a higher level than the GADS national average, but argued that the plants cannot be expected to maintain that extraordinary level. He argued that allowing the company the benefit of extraordinary performance is an incentive to efficient operation. He contended that incentives are appropriate because the company has some control over the operation of the plants. He argued that, if the Commission wants to change to actual performance, it can best accomplish this by using the company's actual figures, and by requiring this item be trued-up in PRAM.

Commission Staff witness Curtis Winterfeld recommended that the Commission reject the company's proposal to assume that output will be at an average national level. He contended that the company's own analysis of the GADS data base shows that performance depends on plant age and other factors besides size, and that the national average the company calculated using a GADS sample based only on size therefore is not a useful standard.

Public Counsel witness Glenn Blackmon also urged rejection of the company's proposal. He argued that the company's incentive argument is weak because the company is merely a partial owner of the plants and sits on a management panel, and the superior performance may be due to design and construction rather than management. Public Counsel argued on brief that the ratepayers are paying the fixed costs of the plants and deserve the benefits of the plants' actual performance.

Commission Staff and Public Counsel both recommended that the Commission estimate coal plant availability based on actual past performance of Puget's plants, and that there be no PRAM true-up. Both argued that basing projected coal plant availability on a historical average provided an incentive to efficient performance. Extraordinary performance will by definition exceed average, and Puget will keep the benefits. Mr. Winterfeld proposed use of an average for the past 5 years. Dr. Blackmon proposed a 7-year average, arguing that use of a longer period provided a greater incentive.

The Commission rejects the company's proposal. It is persuaded by the arguments of Commission Staff and Public Counsel. It does not find the national average the company calculated using a GADS sample based only on size to be a useful standard. The company's incentive argument is weak, given its minority ownership and the fact that it does not manage the plants. The Commission disfavors the use of national averages to project production plant availability when actual figures are available.

The Commission adopts Commission Staff's and Public Counsel's recommendation that coal plant availability be based on a historical average, with no true-up in PRAM. It adopt's Public Counsel's recommendation that an average for the past seven years be used. Availability during the first two years of the seven year period was unusually poor. Including them will provide an average that is fairer to the company than use of a five-year average, given the likelihood that efficiency of the plants will decline as they grow older.

h. Hydro Availability

The company's ability to rely on hydro power is a major power cost variable. Its estimate of the availability of hydro power affects its estimates of non-hydro power supply costs.

The company's adjustment of its test year hydro power costs to normal levels involved a two-step process: hydro "normalization" (determining normal hydro conditions based on historical records) and hydro "realization" (translating the hydro conditions into an availability amount through the use of a computer model). The company proposed that its normal hydro conditions be estimated on the basis of a 50-year historical average. It contended that the regional hydro realization computer model currently in use overestimates hydro generation, and proposed a 4% hydro realization adjustment to its purchased hydro expense to correct for the overestimate.

i) Number of Water Years

In the company's previous general rate case, Docket No. U-89-2688-T, in its Fifth Supplemental Order on Reconsideration, the Commission required the use of a rolling 40-year average for determining "normal" hydro conditions, which in that case was 1939 through 1978. It rejected the company's contention that "normal" hydro conditions should be determined using all available records from regional hydro regulation studies, which cover 50 years (1929 through 1978). It concluded that a rolling average will result in less cumulative error than the 50-year average the company proposed. It invited the state's three investor-owned electric utilities and other interested parties to evaluate the best method to use in the entire state.

The company again has proposed that normalized power supply costs be estimated on the basis of all historical water years for which regional hydro regulation studies are available, the 50 years from 1929 through 1978. The company contended that the first ten years of the 50-year period were very similar to the dry years we have recently experienced, and that excluding them biases the average. It contended that the findings of an industry group which it convened do not support continued use of

a rolling 40-year average. It contended that the possible impact of the Endangered Species Act also compels a conservative hydro generation estimate.

Intervenors Pacific Power & Light and The Washington Water Power support Puget's position. PP&L's witness Diane Lozovoy argued that the first 10 years of the 50-year record have been shown not to be abnormal, and that no trends or cycles have been shown to exist in the record. WWP's witness Kelly Norwood argued that a 50-year average is more reliable, that the 40-year period is not representative, and that use of a rolling 40-year average causes future ratepayers to make up for under collection from current ratepayers.

Public Counsel's witness Glenn Blackmon presented a statistical analysis of the available hydro generation data specific to the company, from 1928 to 1977, and argued that his analysis supported use of the most recent available 30 years of data to define normal hydro conditions. Dr. Blackmon contended that his analysis indicates that hydro availability is subject to some sort of trend or pattern, which would mean that using the largest number of years may not produce the most reliable estimate. On brief, Public Counsel contended that the company's proposal should be rejected because the industry meetings that Puget called to evaluate the issue did not allow sufficient consideration, and because Puget hasn't demonstrated that its alternative is the most reasonable. He contended that Commission Staff's proposal to use a 40-year rolling average also is a reasonable one.

WICFUR's witness Donald Schoenbeck contended that the company could and should have used an extended data base of 110 years used by the Northwest Power Planning Council, and that the company only went back far enough to capture the effect of the 1928-31 drought years and thereby skew the results. He contended that hydro conditions are random from year to year, and that Dr. Blackmon's conclusion that hydro cycles exist is wrong. He found that the Commission Staff's recommended 40-year average produces nearly the same result as a 110-year average, and suggested that it is a reasonable temporary alternative approach until the industry working group agrees on the appropriate methodology.

Commission Staff recommended that the Commission continue to rely on the 40 years of most currently available stream flow records. It argued that Puget presents no evidence or analysis that it had not presented in previous cases. It maintained that the 40 years of information is reliable and its use statistically defensible. It argued that Public Counsel's, Commission Staff's, and WWP's evidence shows that stream flows may follow cycles, and that use of continuous records therefore is not superior to use of a 40-year rolling average.

The Commission accepts the Commission Staff position, and directs the company to continue to use a 40-year rolling average. The Commission believes that the parties spent far too much time revisiting this issue. They repeated arguments and evidence that they have presented in previous rate cases. Mr. Winterfeld's presentation in Docket No. U-89-2688-T demonstrated convincingly that the cumulative error would be less under a 40-year rolling average than under the company's proposal. While a rolling average may not be the most precise estimate, errors tend to offset one another as the method is applied over time. The evidence presented in this proceeding does not persuade the Commission that hydro availability is subject to cycles or trends. The company is put on notice that this will remain the Commission's position on this issue unless and until a clear and convincing argument supports a superior alternative.

ii) Hydro "Realization" Adjustment

To translate hydro conditions into an expected hydro generation amount, the industry relies on the Pacific Northwest Utility Coordinating Council (PNUCC) regulator model estimate. The company contended that the estimates of generation from the Mid-Columbia hydro projects provided by the PNUCC regulator model, which translates hydro conditions into an availability amount, overestimate hydro generation by 6.1%. It proposed a "conservative" adjustment to its purchased hydro expense of 4%, which would add $7.1 million to its pro forma power supply expense.

Commission Staff witness Curtis Winterfeld, Public Counsel witness Glenn Blackmon, and WICFUR witness Donald Schoenbeck urged the Commission to reject the company's proposed 4% hydro realization adjustment.

Commission Staff and Public Counsel argued that the study upon which the adjustment is based is of limited analytical value because 1) it failed to control for specific factors, other than modeling error, such as unit outages, unplanned spill, and reservoir draw down, that could explain the lower than estimated generation; 2) it included only 47 months of data, which does not include enough months in the upper range of flows to allow development of an accurate model (only one data point was in the upper range); and 3) no statistical tests to verify the accuracy of the study or its conclusions were performed. Commission Staff argued that Puget then misapplied its study by applying a uniform rather than a variable percentage to each month when it and WWP's studies showed larger relative error in high flow months, resulting in Puget overstating the adjustment in lower flow months, and understating it in higher flow months. Public Counsel argued that Puget has ignored the "realization" issue in

its planning and reporting, and it is inappropriate for Puget to make this adjustment in a rate case.

Mr. Schoenbeck argued that the Commission should only recognize the regional coordinated planning results of the mid-Columbia project owners, who are responsible for determining the project capability to be used in coordinated regional hydro studies.

Company witness J. Richard Lauckhart responded that the actual data the company collected during a four-year period clearly indicates that the PNUCC regulator output model overestimates hydro generation at all flow levels. He contended that any imperfections in Puget's study are more than compensated for by its conservative proposed adjustment of only a 4% reduction in the model's estimate of availability at a given water quantity.

The Commission adopts the recommendation of Commission Staff, Public Counsel, and WICFUR that it not allow the company's proposed hydro "realization" adjustment. Mr. Winterfeld's and Dr. Blackmon's criticisms of the company's study are persuasive; the Commission finds the study to be of limited analytical value. It finds that the company failed to demonstrate that its figures are more accurate than the estimates of the PNUCC regulator output model. The Commission rejects WICFUR's position that it should recognize only the project owners' estimates.

i. Winter Sale to Bonneville Power Administration

The company's wholesale power sales affect its net power supply costs. Like a new power purchase agreement, a new power sale agreement can have the effect of either increasing or decreasing retail rates. One of the sales whose effects Puget proposed to include in its power supply expense calculation is a firm but flexible winter energy sale to BPA. It projected annual benefits of $6.7 million. The company would input the sale into its PCS model as a negative purchase.

As described in Section V of this Order, the Commission has concerns regarding the prudence of this sale, similar to its concerns regarding the company's new purchased power contracts.

Company witness J. Richard Lauckhart contended that Commission Staff's own exhibits demonstrated the prudence of the sale.

Commission Staff witness Curtis Winterfeld recommended that Puget's proposed treatment of the BPA sale be rejected because Puget failed to adequately evaluate the benefits and risks. Commission Staff took a different approach on brief. It

first argued that Puget had failed to justify the adjustment; that Puget has not shown the net benefits of the sale under a reasonable range of market and resource conditions that could be expected to occur. It argued that if loads grow more quickly than expected, hydro conditions remain below average, and secondary prices greatly increase, the projected benefits could evaporate and leave instead a net cost which Puget would end up recovering in PRAM. However, Commission Staff recommended that the BPA sale be included as part of the determination of Puget's net power supply expense in this proceeding, and that Puget be required to hold the ratepayer harmless should the anticipated $6.7 million benefit evaporate.

The Commission agrees with Commission Staff that the company failed to demonstrate the prudence of the sale. It did not provide sufficient information for the Commission to evaluate the sale's benefits and risks. The Commission does not, however, adopt Mr. Winterfeld's recommendation that it reject the company's proposed treatment of the sale. To do so might encourage the company to try to direct all the benefits of its more advantageous sales to the shareholders by failing to demonstrate their prudence. The Commission orders the company to demonstrate the prudence of the sale in the prudence proceeding it has ordered for review of the company's new purchased power contracts.

The BPA sale should not be included in general rates at this time. Its inclusion in the ordered prudence filing, and its treatment in PRAM 3, are set out above.

j. Inclusion of 3rd AC in PCS Model

The company proposed modifying its PCS model to account for using its prospective entitlement in the Third AC intertie to market non-firm energy to the Southwest. Its proposed modification assumes full utilization of its future entitlement.

Commission Staff witness Curtis Winterfeld expressed concern that the assumed full utilization may be too optimistic, which would result in the company's proposed net power supply expense being understated, and that the effects on a PRAM true-up are unclear. Commission Staff did not recommend that Puget's treatment be disallowed, but did recommend that the issue of the treatment of the projected benefits of Puget's Third AC intertie entitlement and the acceptance of risk by Puget and/or the ratepayers in the PRAM be addressed in PRAM 4. Staff also recommended that since the projected revenue requirement of the 3rd AC investment embedded in the *pro forma* power cost as an expense was calculated using the company's proposed rate of return, the company should be ordered to synchronize such

calculations in the company's compliance filing in this case using the level of return approved by the Commission.

The Commission adopts Commission Staff's approach and its recommendations. It shares Mr. Winterfeld's concern that the company's estimates may be overly optimistic; the company's extremely lengthy response to a bench request setting out its analysis of the benefits of the ownership rights does not eliminate that concern. However, the Commission will allow the modification at this time. Wheeling for others is an offset to purchased power, the benefit of which the company should share with ratepayers. The Commission directs the company to address the issue of the treatment of the projected benefits of the Third AC intertie entitlement, and the acceptance of risk in the PRAM by Puget and/or the ratepayers in PRAM 4. It orders the company to synchronize its calculations as recommended by Commission Staff.

k. Secondary Purchases and Sales

The company's wholesale power transactions amount to millions of dollars of revenue and expenses in a year. Secondary power represents a substantial portion of Puget's net power costs. In its PCS model, the company proposed to make a number of assumptions about wholesale purchases and sales.

The company initially assumed a single rate for purchases and sales. Commission Staff witnesses Patrick Moast and Curtis Winterfeld contented that this assumption did not reflect reality and caused the company to overstate its costs when it is selling power and understate its revenues when it is buying power. Each witness proposed that the company use separate prices for secondary purchases and sales, but proposed somewhat different solutions to the problem. On rebuttal, company witness J. Richard Lauckhart accepted Commission Staff's contentions, proposed that the company use the Commission Staff method, and recalculated the company's pro forma power supply expense using separate rates for monthly secondary sales and purchases using what he said was the Commission Staff method.

Public Counsel witness Glenn Blackmon contended that the company still has not accurately calculated secondary purchase and sale rates. He further contended that the company has not accounted for the net revenue from secondary market transactions that occur within a single month.

i) Secondary Purchase and Sale Rates

Dr. Blackmon contended that the company had not correctly implemented the Commission Staff solution, because its calculations resulted in purchase rates that in some months are

higher than sale rates. He claimed that Commission Staff's solution itself is flawed, in that it changed only the assumed purchase rate, causing sale revenue to still be understated, which is significant because Puget sells more power than it buys. Dr. Blackmon proposed that the company correct the original error by re-calculating average purchase rates and average sale rates over the same historical period it used in its combined average, then applying those separate rates to its expected purchases and sales. Public Counsel recommended that the Commission adopt Dr. Blackmon's method in preference to the "Commission Staff" method.

The Commission adopts Commission Staff's recommendation that the company use different prices for secondary purchases and sales, and adopts the proposed solution recommended by Commission. Dr. Blackmon's method might yield more accurate figures, but would overly complicate a calculation that is trued up under PRAM.

ii) Within-month secondary transactions

Dr. Blackmon claimed that the company's use of monthly averages does not account for the net revenues resulting from the fact that Puget typically buys power at times of the month when rates are low and sells it at times of the month when rates are high. He found that the company on average receives more than $2 million annually on these within-month, buy-sell transactions, yet does not include them in the calculation of pro forma power supply expense. Dr. Blackmon recommended that the Commission Decrease net power supply expense by $2,355,500 to account for the company's net revenue on secondary power sale/purchase transactions. Commission Staff witness Curtis Winterfeld agreed that Commission Staff's calculations do not account for these transactions, but did not propose a solution.

The company witnesses did not rebut Dr. Blackmon's contention that Commission Staff's method does not account for the within-month transactions. The company did not address the issue on brief.

The Commission adopts Dr. Blackmon's proposed adjustment to the PCS model to recognize the company's net revenue on intramonth secondary power transactions that net out against one another. The effect on PRAM is too complicated and too little known to permit true-up of this item in PRAM.

3. 2.05 Conservation

This case includes new conservation investment incurred from May 1992 through April 1993. The company and Commission Staff have used different production factors. Conservation advertising is discussed under a separate adjustment.

In the rate base section, the Commission determined it would maintain the conservation amortization period at ten years. Consistent with the Commission's decisions, the NOI effect is a decrease of $7,704,875.

4. 2.07 Property Sales

This adjustment passes on to customers the gains or losses from former utility property transactions which have taken place since the previous general rate case. It also treats deferred amounts from the last case.

In the previous general rate case, the Commission adopted a Commission Staff adjustment to give the ratepayers a share of gains on sales of property formerly supported in rate base. This gain was determined either through the sale of the property outright, or sale after the transfer of the property to a subsidiary. The gains were allocated based on Commission Staff's position that the ratepayers were entitled to the portion of the gains relating to the period the property was included in rate base. This allocation was determined on a ratio basis by comparing the years the property was in rate base to the years the property was in non-utility accounts.

Puget appealed this portion of the Commission Order. After determination by the King County Superior Court, and prior to the next level of the appeals process, the Commission, Public Counsel, and the company came to a settlement on the issue. Essentially, the settlement adopted the Commission Staff's position that the gains should be allocated to ratepayers, but removed the portion of the gains received prior to January 1984.

In this proceeding the company proposed an adjustment that it claimed is in compliance with the settlement. Commission Staff argued that the company actually used a new method to calculate the ratepayers share of gains and that the company was inconsistent in its application of the new method.

The company proposed to determine the portion of the gain that should be apportioned to the utility by determining the appraised or assessed value of the property at the time the property is transferred to non-utility property. This appraisal would then be compared to original cost to determine the portion of the total gain at disposition that should be allocated to ratepayers. This contrasts with the method arising from the prior rate proceeding, which used a ratio of the years the property was held in rate base to the total years held, to allocate the gain to ratepayers.

The company added the gains calculated by the above method to the remaining gains as agreed to in the settlement. This total was then amortized over a three-year period.

Commission Staff disagreed with the company proposal in several respects. Commission Staff did not accept the company's new method to apportion the gain. Commission Staff witness Tho Nguyen argued that the remaining gains from the settlement should not be amortized over the next three years, but should be fully amortized within one year to prevent double amortization.

Mr. Nguyen also recommended that if the company's new method were used, all properties that were transferred to non-utility should be included within the adjustment. Mr. Nguyen showed that using either method consistently results in greater benefits to ratepayers than the company's proposal.

One other difference between the positions of Commission Staff and the company is the company's claim that Commission Staff miscalculated the excise tax.

The company on rebuttal included those properties that were planned to be transferred. The company also agreed that the method of apportioning the gain to ratepayers from the previous proceeding could be used, although the company did not adopt it as the company's position. The company did not agree that it is appropriate to recognize gains on properties that are still held by Puget, with no current plan for disposition because the property might still be in consideration for future utility use. Further, the company indicated that such gain recognition would not be includable in the company's financial statements.

Evaluation of this adjustment involves determination of several sub-issues. First, how should the gain be allocated to ratepayers? The Commission is concerned that the company's proposal has serious problems. Most importantly, the company's method calculates a gain on property at the time of transfer, but does not pass that gain to ratepayers until the property is actually disposed. When the company does finally dispose of the property -- at a date which may be many years later -- ratepayers have been deprived of the use of that money in the interim. The company has not proposed to compensate ratepayers by paying a carrying charge or by any other means.

An additional problem is reliance on appraisals taken on properties many years ago. How would these be verified? How would the company keep records? The company has not fully developed its proposals on these issues.

The Commission has determined these problems justify continuing the method used in the previous rate case. That method is straightforward -- instead of estimates or appraisals, the company considers the gain or loss at the time of transfer to a subsidiary, or sale, and apportions that gain or loss between ratepayers and shareholders based on the time the property was in and out of rate base.

The second sub-issue is the treatment of the remaining gain from the previous rate proceeding. The Commission agrees with the company that the remaining balance should be added to any new gains and amortized over the life chosen for the new gains. The remaining balance should therefore be amortized over three years. This treatment is consistent with the Settlement Agreement.

The final sub-issue is the proper amount of excise tax. The difference between the company and Commission Staff is only $6. The Commission accepts the company's figure.

As a result of the Commission's determination on these sub-issues, the proper adjustment is $392,152. This includes the gains on seven of nine properties in Exhibit 987 as calculated by staff in Exhibit 789. Items 24 and 29 will be included in the next general rate case.

5. 2.08 Storm Damage

The Commission must determine both the proper method for future accounting for storm damage and the appropriate method of calculating the adjustment in this case.

The company expensed an annual amount based on the preceding general rate case. The level of accrual assumed by the company was the nominal level used in each proceeding. The company continued to expense the same amount annually until the next general rate case order, without regard to growth between rate cases of the company's sales or rate base.

When the company booked the expense, it credited a storm damage reserve. When actual storm damage expenditures were made, the company debited the storm damage reserve. As a result, when the company experiences less cost than the level of accruals, the company builds a reserve balance. However, when the company expends more than it has accrued, it creates a reserve deficit. The company would be allowed to book this reserve deficit only if it were a regulatory asset. The company claimed that because the Commission has adopted an amortization of the reserve balance in several previous proceedings, the Commission in effect accepted the reserve deficit as a regulatory asset.

The Commission Staff stated that the company has improperly created a regulatory asset for storm damage without express authorization from the Commission. Commission Staff witness Thomas Schooley argued that the company's reliance on previous Commission Orders is unfounded. Mr. Schooley contended that the accounting as just described is improper general accounting, that it transfers substantial financial risk from the stockholders to the ratepayers, and that the creation of a reserve deficit is in violation of the Uniform System of Accounts because the Commission did not approve this accounting treatment.

Mr. Schooley proposed normalizing the storm damage expense based on a six-year period, and that truly extraordinary events should be deferred as extraordinary property damage and amortized into rates over a six-year period. Commission Staff also noted that the company in previous general rate cases has in fact been regulated on a normalized basis rather than on a deferral method as suggested by the company. Mr. Schooley proposed to define "catastrophic event" as one affecting 25% or more Puget customers, occurring infrequently, and affecting a wide geographic area.

The dispute between Commission Staff and company results in several differences. Commission Staff does not include amortization of the $16.5 million reserve deficit. In place of this, Commission Staff allows the company to amortize $11 million of extraordinary property loses. Commission Staff used a six-year period versus the four-year amortization period proposed by the company. With respect to ongoing storm damage, company witness John Story testified to a level of approximately $4 million. This is close to the four-year average calculated by Mr. Schooley's exhibit, excluding the extraordinary events. Commission Staff recommended ongoing expenses of $3 million based on a six-year average.

FEA witness Hugh Larkin contended that the company improperly charges overhead costs to the reserve account. He argued that ongoing expense should not be charged to a reserve account unless those expenses represent incremental costs to the company. These overhead costs are not incremental and should not be deferred.

The company argued that it has accounted for storm damage on a consistent basis and that Mr. Larkin's claims are without foundation.

The Commission agrees that it may be unclear from previous Orders what accounting treatment is appropriate for storm damage. Because those Orders appear to have tacitly approved the reserve account treatment used by Puget, the Commission will allow the entire $16.5 million to be amortized in

rates. This amount should be amortized over six years, as recommended by Commission Staff.

From the effective date of this Order, the company should account for storm damage in the manner recommended by Commission Staff. The deferred treatment used by Puget transfers the risk, and more, to the ratepayers. As demonstrated in Exhibits 876 and 877, if the company had increased its accrual levels based on its increase in revenues -- thus holding the expense to a constant percentage of revenue -- the reserve balance would have been reduced by $2 million since the Order in U-85-53. Failure to do so is unfair to ratepayers.

The treatment used by the company is not truly self insurance. The company does not adjust the accruals based on any factor other than general rate case Orders. If the company position prevailed, insurance would be provided by ratepayers.

The Commission therefore adopts the Commission Staff's recommendation to use a normalized level for storm damage. The amount used should be based on a six-year average, to somewhat dampen weather variability, to accommodate the current PRAM mechanism, and to reflect the intention that general rate cases be filed every 3 years.

The Commission also adopts for now Mr. Schooley's definitions of catastrophic/extraordinary events, and encourages the company to meet with interested parties to refine this definition. Extraordinary losses are, thus, defined as events which affect 25% of Puget's customers, occur infrequently, and affect wide geographic areas. If the company has any question whether a storm is a catastrophic/extraordinary event, which may be booked to the storm damage account, it should seek Commission guidance on a case by case basis.

The company may amortize $16.5 million in its storm damage reserve over six years. The resulting adjustment based on Mr. Schooley's calculation adjusted for the $16.5 million, instead of $11.1 million, is a $2,747,506 decrease in net operating income.

6. 2.09 Self Insurance

The company claimed to self insure for three risk categories: all risk property damage, liability, and workers compensation. The company proposed an adjustment to the three as a group. The company calculation was based on an average of the last four years' charges in these categories, plus a four-year amortization of a reserve deficit in the all risk property

category. The company contended that the reserve accounting has been adopted by this Commission in previous filings.

Commission Staff proposed adoption of a normalization of the self insurance amounts. Commission Staff proposed a six-year average of the three categories. Commission Staff's adjustment did not include any recovery of the reserve deficit as proposed by the company. Commission Staff argued that this Commission did not authorize the company to create these self insurance accounts. Commission Staff indicated that no previous Commission Order specifically authorized the company to create a regulatory asset and argued the company's treatment is not self insurance, because all cost recovery would be guaranteed.

In this category as well, the company expensed only the amount authorized in Docket No. U-89-2688-T, without increasing its yearly expense level to reflect growth in sales or revenues. Exhibits 876 and 877 indicate the reserve deficit total would be about $1.9 million less if the company had escalated the accruals based on a percentage of revenues. In this instance, as in the storm damage adjustment above, the company has attempted to shift the risk to ratepayers.

The Commission has not authorized the company to create a regulatory asset through this deferral treatment. The company may not unilaterally decide to do so. The Commission specifically rejects Puget's contention that Commission Staff's position would require the Commission to reverse a prior Commission determination.

The Commission finds disturbing the company's practice of creating regulatory assets through deferral accounting. The company's brief at page 67 acknowledges that "[t]he intent of using a historical year, adjusted for known and measurable changes, is not to recover past costs, but to set the relationship between expenses and revenues to recover future costs." The Commission orders the company to immediately cease creating unauthorized deferral accounts. If the company believes it has cause for creating a reserve deficit, it is well aware of its obligation to petition the Commission for an accounting order authorizing such action.

The self insurance adjustment should be based on a four-year average. This is a representative level of expense and is consistent with prior treatment. The adjustment amount sets the relationship between revenue and expenses. If the company finds this relationship gets too far out of balance in the future, it should request additional revenues through a separate filing. The Commission rejects the company's proposal for a deferral mechanism. Such a mechanism would remove any incentives

for the company to control costs and would result in an improper transfer of risk to ratepayers.

7. 2.10 Environmental Remediation

By its Order in Docket No. UE-911476, the Commission allowed the company to defer to future rate proceedings recovery of amounts paid to outside vendors and contractors for certain environmental remediation programs. The company here proposed an adjustment to amortize the balance of these deferred costs at the end of the test year ($5,881,944) over a three-year period. The company adjustment also removed certain environmental costs from the test year expense level because they were prior year expenses and not properly attributable to the test period.

Commission Staff opposed certain parts of the company proposal. Commission Staff witness Roland Martin recommended that the amortization period for the $5 million dollars be set at six years rather than three as proposed by the company. He argued that such treatment will not be detrimental to the company because the unamortized balances would be included in rate base, and that the six year amortization would minimize the impact on ratepayers.

Mr. Martin also proposed an adjustment to normalize environmental costs related to minor projects. He noted that during the test period the company expended more on these minor projects than it did in either 1991 or 1992. His adjustment compared an average cost over three and over two years (depending on the project) to the test year level. The test year level was $2.6 million, compared to $1.5 million on average.

The company responded to Mr. Martin's position by indicating that a two million dollar amortization as proposed by the company was not an excessive impact on the ratepayers and thus there was no need to extend the amortization period to six years. Company witness John Story also argued that Commission Staff's normalization adjustment was not a proper ratemaking adjustment. Mr. Story further argued that even though the costs of these projects could be expected to decline, others might increase and offset the decline.

FEA witness Hugh Larkin recommended that no amortization be allowed at this time. He proposed that the company wait until all possible insurance recovery is determined before the ratepayers be required to pay these costs. The company argued that this treatment is unnecessary because any insurance recovery would be credited to the ratepayers when received. The company also stated that, if such deferral were adopted, the company would have to write off the deferred balances because FASB 71 requires that it must be "probable" that

a cost will be recovered in rates before an incurred cost can be deferred.

First, the Commission must decide whether it is appropriate to amortize the costs that have been deferred under the accounting Order in this proceeding, and, if so, over what period of time. The Commission finds persuasive the position of the FEA. It is premature to recover these costs from ratepayers. There should be no current amortization of environmental remediation costs until such time as the insurance issue is resolved. According to its testimony, the company is actively pursuing recovery from insurance companies.

On the issue of environmental remediation costs not covered by the accounting Order, the Commission rejects the company's contention that costs should not be normalized because test year levels can be replaced by other costs in the future. The Commission has in the past allowed some costs to be normalized. In this case, the company proposed to normalize bad debt expense, which has the effect of increasing that expense as test period levels are low. The only question that should be considered is whether it is appropriate to normalize these particular costs.

The Commission concludes these particular costs should not be normalized. As quoted by the company on brief, the Commission has confirmed in the past that the intent of using an historical year, adjusted for known and measurable changes, is not to recover past costs, but to set the relationship between expenses and revenues to recover future costs.[10] The Commission expects that the company will continue to do environmental clean-up activities in the future.

As a result of these determinations, the proper adjustment is an increase in net operating income of $919,220.

8. 2.11 Employee Insurance

The company calculated its pro forma adjustment for employee insurance by multiplying the insurance rates that will be in effect during the rate year, times the number of employees at the end of the test period. Commission Staff accepted the level of expense per employee, but used the average number of test year employees.

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[10] Cascade Natural Gas Corporation, Cause No. U-71-34, cited in Puget's brief, page 67. Note that this argument would also have been appropriate in the discussion of Storm Damage and Self Insurance adjustments.

FEA characterized the 10% increase in costs as unsubstantiated and recommended the increase be rejected in its entirety.

Commission Staff argued that use of end-of-period employees would be a violation of the matching principle and would not fit the definition of a pro forma adjustment. The company argued that the use of end-of-period employees more closely matches the expense to be incurred during the rate year.

The Commission adopts the Commission Staff's calculation. The use of end-of-period employees would be a mismatch with the number of customers, and level of sales, during the test period. The average number of test year employees should be used. The Commission rejects the FEA's position, finding the increase in costs to be sufficiently substantiated.

9. 2.12 SFAS 106, Post-retirement Benefits Other Than Pensions

The Financial Accounting Standards Board (FASB) adopted new Statement of Financial Accounting Standard 106 (SFAS 106). Effective January 1, 1993, this standard changes the way large companies account for the granting of post-retirement benefits other than pensions. Prior to SFAS 106, most companies (including Puget) expensed these benefits as they were paid. SFAS 106 requires the accrual of these costs during the period the employees earn them. Companies are not required to flash cut prior benefits earned by its employees. Instead, they generally are allowed 20 years to amortize this pre-existing liability.

The company calculated an adjustment to shift from a pay-as-you-go level of expense to an actuarially-determined expense. No one questioned the determination of the actuary. The company's adjustment included a five-year amortization of previously deferred amounts above the pay-as-you-go level, and rate base inclusion of the unamortized balance.

Commission Staff witness Thomas Schooley did not accept the company's adjustment. He argued that the company imprudently incurred pension expense prior to 1992 because the company had never evaluated the cost of these programs. He cited testimony and exhibits which indicate that the company, in its own evaluation of these plans, eventually realized that they were too costly to be continued, and that the use of cash basis accounting only made them appear to be affordable. The company subsequently limited its exposure to these costs, based on an actuarial analysis of its liability. Employees retiring after January 1, 1992, will receive a defined dollar plan rather than the previously-effective defined benefit plan. Mr. Schooley recommended treating benefits greater than the revised policy as

imprudent. He recommended basing the level of expense for ratemaking purposes on the defined dollar plan.

Commission Staff also rejected the company's proposal to include the deferred balances in rate base. Commission Staff contended the company does not have any investment in these plans that needs a return.

The company argued that Commission Staff treatment is unfair. The company contended that such disallowances for imprudence would discourage the company from reevaluating any of its costs, for fear of future disallowance. The company also argued that the exclusion from rate base proposed by Commission Staff would result in a write-off.

FEA witness Hugh Larkin proposed a comprehensive phase-in of SFAS 106 in compliance with current generally-accepted accounting practices (GAAP), as published by the Emerging Issues Task Force (EITF) of the FASB in EITF 92-12. Mr. Larkin's plan used the EITF statement as a guideline. Based on this statement, a company under regulatory authority can phase in the adoption of SFAS 106 over five years, with the deferrals amortized over the remaining portion of the phase-in for SFAS 106, in this case 20 years. Mr. Larkin stated that, while such a phase-in is not directly in compliance with Commission Staff's recommendations issued in a white paper in July 1992, at the time of the white paper EITF had not been issued and, thus, Commission Staff had to base its paper on assumptions about the EITF's conclusions. Mr Larkin also opposed the company's rate base treatment of the deferred amounts.

The company opposed Mr. Larkin's position, arguing that phase-in is unnecessary due to the size of the adjustment. The company also claimed that Mr. Larkin made a calculation error. The Commission Staff did not oppose FEA's proposal.

The Commission must first determine whether it will adopt SFAS 106 for ratemaking purposes. If it is adopted, the Commission must decide how to implement it. The company proposal fully adopts SFAS 106 as of October 1, 1993, using a five-year period to amortize the deferred amounts. Mr. Larkin recommended a five-year phase-in, with a 15-year amortization as allowed by GAAP and EITF.

The Commission has determined it should adopt SFAS 106 for ratemaking purposes, and phase in the change as recommended by Mr. Larkin. Mr. Larkin's Exhibit 793, schedule 21, page 2, shows a comparison of his method to that of the company. The company's method yields its highest expense in the first year with declining amounts through the next 19 years. Mr. Larkin's method also results in a declining amount, although it is

somewhat flatter. Mr. Larkin's proposal results in lower expense in the early years, with slightly increasing amounts through year six. Mr. Larkin's method may also result in an increased rate base, topping out at just over $3 million in year four. This phase-in avoids any negative impact for financial reporting because amounts deferred for rate recognition would receive regulatory asset treatment. The phase-in would mitigate transitional costs associated with implementing the SFAS 106 accrual.

In addition to the method, the Commission must decide whether the costs of the benefits that the company has granted its employees have been prudently incurred. The Commission has never previously been asked to consider the appropriateness of these costs. The company nonetheless should have regularly and routinely evaluated the costs of providing these benefits. Company testimony indicates it changed the program in 1990 -- effective for those retiring in 1992 and after -- because of concern regarding escalating costs.

The Commission accepts the Commission Staff position that the company should have identified these costs earlier and acted to limit its exposure to prudent levels. Since the company apparently did not do so, the Commission Staff's proposal to base the expenses, for ratemaking purposes, for all employees and retirees on the level of the defined dollar plan should be accepted. The Towers Perrin study (Exhibit 688) commissioned by the company recommended a review of benefit costs, with a goal of reducing total costs for medical benefits for the company and its employees.

The Commission notes that three witnesses at the public hearings apparently felt the Commission Staff was requesting the Commission to direct Puget to reduce or eliminate benefits to older retirees. The determination made here is for ratemaking purposes only. Puget may determine that all plans should continue unchanged. It may decide to change payments under the plans. Those determinations will be made by management, not by the Commission.

Finally, the Commission must decide whether it is appropriate to make a _pro forma_ adjustment to rate base for the deferred amounts previously accrued. So far, the company has not incurred a cost and has no investment. Once the company does make an investment, it will most likely affect the calculation of rate base. The Commission does not agree that refusal to allow the _pro forma_ adjustment in this proceeding will necessarily result in any write-off, as suggested by the company.

The Commission therefore rejects the company's pro forma adjustment to rate base. In the future, the Commission expects that accruals and payments will affect working capital. To the extent that deferrals affect working capital, they will be included as incurred.

The adjustment therefore decreases net operating income by $69,000. The Commission calculates the adjustment by adjusting Mr. Larkin's calculation for the company fiscal actuarial study and Mr. Schooley's disallowance.

10. 2.13 Company Insurance

Puget and the Commission Staff agreed 3.07% of directors and officers (D&O) insurance should be allocated to subsidiaries. The remaining issue in this adjustment is the appropriate level of D&O insurance.

The company proposed to include coverage of up to $50 million for a total cost of approximately $694,000. Commission Staff proposed that only the first $25 million in coverage be allowed. This would allow approximately three-fifths of the expense, since the second $25 million of coverage is cheaper than the first $25 million. FEA witness Hugh Larkin recommended that half of the total cost be disallowed.

Commission Staff argued that the only support for the high level of coverage is the Wyatt report, provided to Commission Staff in response to a data request. Commission Staff claimed that the report indicated few successful claims against similar companies, and an average paid claim of only $3 million. Commission Staff noted that no claims have been made against Puget directors and officers. Commission Staff contended that the comparison offered by Mr. Olson only demonstrates that Puget has higher coverage on a revenue basis than the average company on the list. Commission Staff therefore recommended that the second $25 million be disallowed as excessive.

FEA argued that D&O insurance is a benefit for the shareholders, who should therefore be required to share in the expense.

The company claimed that Puget's coverage is in line with other utilities. Puget argued that it is necessary to maintain the coverage in order to retain qualified directors.

The Commission notes that the company doubled its coverage level. The issue is not whether the company should have additional insurance, but who should bear the cost of the additional insurance. The Commission does not find Puget's Exhibit 921 persuasive. The exhibit does not show what

regulatory treatment is accorded the expense of insurance in each jurisdiction. The $50 million level is high when compared to gross revenue. The exhibit shows that companies larger than Puget have less coverage than Puget. As noted on cross-examination of Russel Olson, Puget ranks 11th in the comparison of D&O insurance as a percentage of gross revenues out of the 50 companies, but ranks 49th in size of gross revenues.

The Commission accepts the Commission Staff position. Only the first $25 million of coverage should be included in expenses for ratemaking purposes. If the company determines that a higher level is necessary, its management may certainly purchase additional coverage. Ratepayers should not have to pay for that additional coverage.

The resulting adjustment is $142,451.

11. 2.14 Wage and Salary

The purpose of this adjustment is to adjust test year wages and payroll tax amounts to reflect the levels that would be in effect during the rate year.

There are four differences between the calculations of the company and Commission Staff. Each of those differences will be discussed separately below. Intervenor FEA made recommendations on several issues.

a. Application of Increases to Bonuses

The company proposed a pro forma adjustment to increase wages for pay increases into 1993. The company on rebuttal also adjusted for the retirement of two officers, including Mr. Ellis. Commission Staff adjusted the company's calculation to remove bonuses prior to the application of increased pay rates and to remove salaries of the retired officers.

Most of the company's bonus plans are not directly affected by any pay increases granted by the company. The company on rebuttal removed some of the bonuses, but did not remove them all. The company brief does not discuss this difference.

FEA also rejected the company's pro forma adjustment. FEA agreed with Commission Staff's position on the removal of bonuses prior to the application of the pro forma pay increases.

Removal of bonuses before applying pay increases is proper pro forma treatment. The Commission agrees that increases should apply only to base wages; all of the bonuses first should be removed.

The Commission does not agree with removal of the salaries of retired officers in calculating the pro forma level of payroll. The Commission below accepts the Commission Staff's position on the proper level of management wage increases. Our understanding of the Commission Staff's method in calculating the effective management wage increase is that turnover (including officers) is already considered in the calculation. Removing the salaries of retired officers -- in addition to this calculation -- would be inappropriate.

b. Pay-at-Risk Program

The Pay-at-Risk program covers Puget's officers and directors. It sets a target bonus between 10% and 35% of base salary. The actual amount of the bonus is set by Puget's Board of Directors.

The company pro forma adjustment added an amount equal to the booked level of the Pay-at-Risk program for 1992 to executive compensation. The company contended that Pay-at-Risk is a part of total executive compensation, and that Puget should be allowed broad discretion in fashioning its compensation programs. Puget contended that its total executive pay (including bonuses) is not above market levels.

The Commission Staff adjusted the company's calculation to entirely remove the company's pro forma adjustment including the Pay-at-Risk incentive plan. This would treat the entire Pay-at-Risk plan below the line.

Commission Staff witness Andrea Kelley cited the goals that drive the plan. Many of the goals are directed to the bottom line, with the primary focus an earnings per share target. The officers earn the ability to receive bonuses based on the achievement of specific goals. Then, based on the company's earnings per share, a percentage of those bonuses is funded. Commission Staff argued that, at a minimum, $57,000 should be disallowed because Puget manipulated the payout at the end of the year. Commission Staff also argued it is inappropriate to treat a bonus plan as part of base salary.

FEA also proposed adjustments to this incentive plan. FEA argued that the company made payments under the Pay-at-Risk program that were totally discretionary.

The Commission agrees that the Pay-at-Risk plan should not be allowed as an operating expense. The Pay-at-Risk plan is undoubtedly a profit-sharing plan. The company has always treated this plan below the line, with shareholders bearing the costs. That treatment should continue below the line.

c. Energy Plus Program

The Energy Plus program allows every employee below the department head level to receive the same amount of bonus if company-wide goals are accomplished. The program was originally meant to pay for itself from realized savings. Since it has not, the company in 1993 budgeted for the entire bonus for the first time.

The company requested recovery of Energy Plus bonuses. The Commission Staff recommended treating approximately 73% of the Energy Plus program as below the line. Commission Staff witness Andrea Kelley argued that many of the goals are designed simply to benefit the shareholders and should not be a burden on the ratepayers. Ms. Kelley contended that the company has not measured offsetting benefits to the program. She also pointed out that one of the goals relates to the employees' donation of time to charitable concerns. Commission Staff contended that it is not appropriate for the ratepayers to be burdened with these costs. Commission Staff cited the court decision in Jewell v. WUTC[11] as indicating that shareholders should pay for charitable contributions.

The company argued that it should be within the company's prerogative to choose how to pay their personnel, so long as the total salary is within reasonable guidelines. The company argued that Commission Staff is particularly wrong on the Energy Plus program with respect to the budget target, the earnings per share target, and the community service target. The company argued that other public utility commissions have allowed regulated companies the ability to manage their wage packages without second-guessing them.

The Commission concludes that 73% of the Energy Plus program should be treated below the line. This program also has profit sharing components. The Commission is concerned that one of the goals represents payment for charitable service. Although management may at its discretion establish such plans, costs of the plans must not be borne by ratepayers.

d. Percentage Increase for Management Employees

Commission Staff also recommended an adjustment to the company's calculation to reduce the pay rate increase for management personnel to the average effective increase of management pay raises.

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[11] 90 Wn.2d 775(1978).

Commission Staff argued that the actual pay increases granted management personnel, as a percentage, do not represent the impact on management salaries. Commission Staff prepared an analysis of the average increase in management salaries as compared to the supposed percentage increases granted over the last seven years. The study showed that management employees average annual wage increase percentage was one-half the company announced figure. As a result, Commission Staff reduced the pro forma increase proposed by the company by approximately 50%, to a 2.86% increase. This is the same position that was adopted by the Commission in Puget's previous general rate case.

The company opposed the Commission Staff's adjustment. The company cited the last year of Commission Staff's study, which indicated an increase greater than 100% of granted increases. Finally, the company argued that in the previous rate case the wages were set below what actually was incurred during the rate year.

Intervenor FEA reduced the pro forma level of management wages to 3%. FEA argued that the company has not actually implemented the management wage increases as approved by its board for the last three years.

Commission Staff's position on management effective wage increases is consistent with the Commission Order in the previous general rate case. In that case, the Commission directed the company to present a study of "slippage" as part of the management wage adjustment in the next general rate case.[12] The company performed a study based on total wages. This has nothing to do with the issue of the average increase per employee, which is the relevant comparison.

The company's comparison total wages during the rate year to projected wages based on the Order in the previous general rate case would not consider the impact of anything other than growth, including the change in the construction budget, and the increase in conservation expenditures. It adds no helpful information.

The company did not comply with the Commission's directive. Its adjustment was not properly supported. The Commission accepts the Commission Staff's adjustment.

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[12] Third Supplemental Order, Docket Nos. U-89-2688-T, U-89-2955-T, January 17, 1990, pp. 39-40.

e. Summary

Bonuses should be removed before the pro forma adjustment is calculated, but the salaries of retired officers should be put back into the base salary amount with payroll taxes. The Pay-at-Risk and Energy Plus programs should be excluded. The Commission Staff's management wage adjustment of 2.86% should be applied.

With these parameters, and the remaining uncontested elements of the Wage and Salary calculation, the NOI effect is a decrease of $1,357,292.

12. 2.15 Investment Plan

This adjustment updates Puget's portion of investment plan expense to give effect to the pro forma increase in wages during the rate year. The company and Commission Staff adjustments differ according to their positions on the Wage and Salary adjustment above.

Since the Commission has accepted the Commission Staff position with modifications, this adjustment is a decrease of $79,723.

13. 2.16 Retirement Plan

The company proposed an adjustment to the pension expense based on the average contributions during the past four years. Puget also proposed to include in the reserve account a debit of over $900,000.

Commission Staff's original position was essentially the same. On rebuttal cross-examination, the Commission Staff indicated it had discovered that the company was accruing a reserve debit without previous approval by this Commission. Commission Staff therefore proposed that this reserve deficit not be approved for recovery.

The Commission is concerned with the company practice of only expensing levels approved in the last general rate case. However, in U-89-2688, the Commission adopted staff witness Parvenen's recommendation on this issue. That recommendation included an interim method of accounting which included deferrals. The method described how annual booked expense levels were to be determined. The Commission is not certain whether the company followed that proposed method.

The Commission will allow the deferred amount to be amortized over six years. If the company deferred this amount or should be corrected in the next general rate case. On a going

forward basis, the Commission agrees with staff in this proceeding and will not approve further deferrals from the date of this order. The adjustment is a decrease of $1,577,795.

14. 2.17 Bad Debt Expense

FEA witness Hugh Larkin proposed that the bad debt rate in this proceeding be set at the actual level from the test year, rather than the average of five years. He argued that the rate has been trending downward. He also contended that the downward trend is caused by specific steps taken by the company, including creation of a corporate credit department, the automation of active credit system functions, and the institution of the late payment/disconnection visit fee authorized in the previous general rate case. FEA also pointed to evidence that subsequent to the test period the bad debt rate has fallen further.

The following is a schedule of calculated rates:

Five-year average	0.29927%	(company position)
Test period average	0.25550%	(FEA position)
1992 average	0.18644%	
Year ended May 31, 1993	0.1725 %	

Company witness John Story argued on rebuttal that weather during the test period was exceptionally warm, lowering the level of bad debts. He also contended that the steps referred to by Mr. Larkin are already reflected in the five-year average. In response, FEA argued that the reason for the declining trend is the success of the steps taken to lower the level of bad debts.

The Commission accepts the FEA's adjustment. The company has apparently taken successful steps to reduce the level of bad debt. The figures graphically show a continuing decline in the level of bad debt, including our approval of a late payment charge. The Commission finds that due to the special circumstances in this proceeding, the test year actual level of bad debt is the best indicator of the level of bad debt during the rate year. The Commission notes the decline has continued since the end of the test year. The Commission notes that acceptance of FEA affects other revenue adjustments and the conversion factor.

15. 2.19 Creston

Creston was a planned coal-fired plant near the town of Creston, Washington. The plant has now been abandoned by its sponsor, The Washington Water Power Company (WWP). No actual construction ever commenced at the Creston site. In this case, the company requested that the costs it has accumulated be

amortized to rates over a five-year period and that the unamortized portion of the costs be included in rate base. The company included the costs it has accumulated in construction work in progress (an account which accrues AFUDC) rather than in preliminary survey and investigation costs (an account which does not accrue AFUDC).

Commission Staff did not agree with the proposed company treatment. Commission Staff proposed to remove the AFUDC accumulated by Puget, to amortize the costs over ten years, and not to include any portion of the costs in rate base.

Commission Staff argued that the company inappropriately accumulated AFUDC on the project. Commission Staff witness Roland Martin indicated that the project had never reached the construction stage and should have been booked in the preliminary survey account. Commission Staff also cited company witness John Story's testimony that WWP -- the project sponsor -- recorded these costs in the preliminary survey account and accrued no AFUDC on the project.

Commission Staff also argued that these costs are similar to other abandoned projects, although this is not a nuclear project. Therefore, as with other abandoned projects, it is appropriate to share the loss between ratepayers and shareholders. The method the Commission has previously used to accomplish such a sharing is a ten-year amortization period with no rate base inclusion.

The company argued that the shareholders have already shared, because the project was idled for the past ten years waiting for final disposition of the regional planning. The company also argued that AFUDC is appropriate, noting that recovery of similar costs has been accepted for other projects. The company contended that the project costs are not large, like Skagit, and claimed they do not deserve the same treatment. It argues that the Creston costs were prudent and, as such, could be recovered in rates over one year.

The key question is whether Creston was a "construction project" or simply a preliminary survey. The Commission concludes Creston was a preliminary survey. No construction was ever begun. The costs incurred were for the purpose of maintaining the license, should a decision be made later to begin construction. The Commission places some reliance on the characterization of this project by WWP, its project sponsor. WWP properly booked these costs in its preliminary survey account.

The Commission concludes Puget has been improperly booking Creston costs. No AFUDC is allowed on the preliminary survey and investigation costs, and the company may not recover AFUDC in this instance. Following the treatment allowed in recent Commission decisions, the company will be allowed to recover these preliminary survey and investigation costs in one year. To reflect the fact that the costs will be recovered in full in one year, they should be included on the resource side of the PRAM. To account for inclusion in the resource costs in PRAM and the growth anticipated to the rate year, these costs have been multiplied by the production factor. No Creston costs should be included in rate base.

The appropriate adjustment is therefore $2,900,886.

16. 2.20 Stone Creek
2.21 Black Creek
2.22 Small Hydro Write-offs

On rebuttal, Puget proposed the estimated gain from the sale of the Stone Creek project, minus the cost of small, undeveloped hydro projects, be offset against the costs of the Black Creek project. These adjustments are fully discussed in this Order's section on rate base. Because of the Commission's determination that inclusion of these projects is not appropriate at this time, there is no need for an adjustment to NOI.

17. 2.24 Working Capital

The parties contested several elements of the working capital calculation. The issues are fully discussed in the rate base section of this Order.

Following the Commission's rate base determination, the NOI effect is a decrease of $250,020.

18. 2.26 Rate Case Expense

The company proposed an adjustment to include its rate case costs for this proceeding. The company calculated the total cost of its presentation at $715,000. This total included $200,000 for outside consultants and $500,000 for legal services.

Commission Staff proposed to disallow substantial portions of these costs, leaving a net $285,000 as the level of rate case expense. The company also proposed to recover these costs over a two-year period, while the Commission Staff proposed recovery over a three-year period.

Commission Staff witness Kenneth Elgin testified that the company's use of consultants was unreasonable. He proposed to disallow all consultants' costs except Mr. Bertko's analysis of FASB 106. Mr. Elgin based his position on the in-house expertise of Puget. He noted that current executives are paid in excess of $1 million and have some 73 years of collective financial experience. Commission Staff indicated that the use of consultants can only represent the interests of Puget's shareholders and, thus, should not be paid by the ratepayers.

Mr. Elgin also expressed concern about the high legal costs. He cited Commission Staff witness Andrea Kelly's analysis of the Towers Perrin study, which questioned Puget's ability to control legal costs. Commission Staff contended that the company made no attempts to limit the contested issues.

The company disagreed with Commission Staff's disallowances. The company noted Commission Staff's use of Dr. Lurito and his predecessors for the past 17 cases. Puget claimed that it is unreasonable to maintain in-house expertise to respond in these specialized areas. With respect to legal fees, the company argued that it does not control the number or complexity of issues. Puget cited the number of data requests made, depositions taken, and the issues raised. The company cited court decisions on the issue indicating that the company has a right to recover a fair and proper expense of presenting its side to the Commission.

The company on brief opposed Thomas Schooley's calculation of the adjustment, stating that it is inappropriate to use prior year revenues to offset these costs. It should be noted that Commission Staff recalculated its adjustment to be consistent with its position on other issues such as self insurance and pension costs.

The Commission is very concerned about the high level of litigation expense on this case, both for legal counsel and for expert witnesses. The Commission notes it has at least once in the past disallowed costs for consultants it deemed not appropriate for ratemaking purposes.

This case is unique in the company's presentation of two witnesses from bond rating and investment agencies. While presented as independent experts, the witnesses were paid a fee by Puget for their testimony. At the very least, these witnesses represented the interests of company shareholders, not the interests of ratepayers. At worst, the witnesses' testimony has set the stage for problems with conflict of interest. If the Commission rejected the witnesses' testimony and set an equity component less than that urged by the witnesses, have they not forced themselves to "respond" by taking some action to rate the

debt differently? These witnesses can no longer take independent action in evaluating the Commission's Order for purposes of rating the company's debt, but have obtained some stake in the outcome.

For these reasons, the Commission has determined the costs attributable to Messrs. William Abrams, Terran Miller, and John Dell should be disallowed for ratemaking purposes. Costs of their participation in this case are properly the responsibility of shareholders, not ratepayers.

Although the Commission is troubled by the high level of legal costs in this case, it will not disallow those costs for ratemaking purposes. The Commission urges the company to follow-up the Towers Perrin study recommendation to evaluate use of in-house legal counsel to control costs.

The appropriate level of costs should be amortized over three years, which is the cycle of general rate case filings the Commission has herein ordered. The NOI impact is a decrease of 38,430.

19. 2.27 Non-recurring and Operating Expenses

This adjustment is a compilation of at least twelve adjustments. Several of the elements are not contested. The three which are contested will be discussed separately below.

a. 2.27(b) Corporate Dues

The company proposed an adjustment to corporate dues to remove dues to organizations to which Puget no longer belongs and to remove a portion of dues to certain organizations based on the amount the organization claims it spends on energy lobbying.

Commission Staff witness Thomas Schooley recommended removal or partial removal of dues to several organizations. The Commission Staff was particularly concerned with dues paid to the Association of Washington Businesses (AWB), because lobbying the state Legislature is its primary activity. Mr. Schooley presented Exhibit 734 listing each organization he disallowed, the percentage of disallowance, and the reason for disallowance.

There is no similar exhibit to support the company's calculation on rebuttal. The company's original position was based on a survey sent by Puget to each organization. The survey asked the organization to report the "amount spent during 1992 for lobbying, for efforts to influence state or federal legislation, or for advertising to influence public opinion with

reference to energy".[13] Company witness Corey Knutsen presented descriptions of each of the organizations in Exhibit 883. Commission Staff relied on the descriptions of various organizations as presented in Exhibit 626.[14] These descriptions are somewhat different than Mr. Knutsen's.

Intervenor FEA recommended disallowance of $41,953 of test year expense for membership dues. Exhibit 793, Schedule 31, itemizes the membership dues which FEA contended do not benefit ratepayers. FEA also removed dues of organizations of which Puget is no longer a member.

The company's survey did not provide information sufficient to determine the organizations' lobbying activities. "Energy" issues are not the only type of issues on which these organizations may attempt to influence government action. WAC 480-100-32 refers to ". . . any political information or political education activity . . ." in providing that such expenses not be allowed for ratemaking purposes.

The Commission is particularly concerned with the company's presentation about the Association of Washington Businesses (AWB). In the previous general rate case, the Commission ordered the company to "account for the lobbying activities of the Association of Washington Business in a manner similar to that used for expenses of the Edison Electric Institute".[15] The company has not presented such an analysis. The Commission therefore will disallow dues to the AWB for ratemaking purposes.

For other organizations, the Commission accepts the company's rebuttal recommendation. The company should revise its survey to solicit the amount of resources attributable to <u>all</u> lobbying activities, not just lobbying about energy issues.

Using as a basis the company's presentation in Exhibit 883, the NOI effect is $113,377.

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[13] The responses to many of the questionnaires are included as Exhibit 885. The questionnaires do not ask the percentage of resources used to lobby issues other than energy.

[14] John Story's deposition, particularly deposition exhibits 8 and 9.

[15] Third Supplemental Order, Docket Nos. U-89-2688-T, U-89-2955-T, January 17, 1990, p. 31.

b. 2.27(j) Conservation Advertising

Puget seeks recovery of $4.1 million in rate base and $520,000 in amortization for conservation advertising expenses. This adjustment is fully discussed in the rate base section of this Order.

Based on the Commission's determination that conservation advertising costs should be expensed in the future, the appropriate normalized amount for this case is a decrease of $1,340,674.

c. 2.27(l) Colstrip Interest Income

This adjustment to the test year pertains to Colstrip settlement income which was subject to deferral and amortization. The company and Commission Staff agreed on the adjustment to NOI. The contested rate base issues are discussed in the rate base section of this Order.

The NOI effect is a decrease of $203,108.

20. 2.28 Production Adjustment

This adjustment is the complement of the company's power supply and pro forma rate base (production) adjustments. The power supply adjustments adjust costs to a pro forma level based on the rate year, and then reduce them for the difference in load between the rate year and the test year -- this factor is known as the production factor. In this adjustment, the production factor is applied to the non-incremental costs of production, including pro forma adjustments for new resources.

In this proceeding, the only difference between Commission Staff and company can be traced to other adjustments, including the power supply adjustments. The major difference is the difference in the production factor used by the Commission Staff and the company. Puget used an updated production factor based on revised load forecasts.

The Commission notes that it adopted staff's suggestion to include WNP-3/BEP 10 year amortization in the resource costs in PRAM; these cost have been added to this adjustment. Skagit and Creston have been adjusted separately.

Based on the Commission's determination of the other issues, the production adjustment is recalculated to $2,121,296.

21. 3.03 Montana Corporate License Tax

This tax is charged by the state of Montana based on the portion of Puget's taxable income generated from its Montana

plant. The only difference in the calculation of this adjustment is the calculation of the pro forma interest adjustment.

Using the pro forma interest calculation found appropriate in the following section, the NOI effect is a decrease of $167,877.

22. 3.04 Pro Forma Interest

This adjustment provides the pro forma impact of interest on federal income tax. The two differences between Commission Staff and company on this issue involve weighted cost of debt, and pro forma rate base, as determined in each party's pro forma results of operation.

Based on the Commission's determinations in the rate of return and rate base sections of this Order, the pro forma interest adjustment is a decrease of $9,022,549, calculated according to the following table.

Table 3
PUGET SOUND POWER & LIGHT COMPANY
TAX BENEFIT OF PRO FORMA INTEREST
FOR THE YEAR ENDED 06/30/92

DESCRIPTION		
Pro Forma Rate Base		$2,002,480,268
Deductible CWIP		22,354,237
TOTAL		$2,024,834,505
Weighted Cost of Debt		3.56%
Pro Forma Interest		$72,084,108
Interest Expense Charged to Books		98,621,016
Increase (Decrease) Taxable Income		$26,536,908
Increase (Decrease) FIT	@ 34%	$9,022,549

23. 3.05 Montana Energy Tax

This tax is based on the net output from the generating plant owned by Puget in the state of Montana and a tax rate of $0.0002 per kWh. The adjustment depends on the coal production adopted in the power supply adjustments, and the decision on the level of Colstrip generation.

Based on the Commission's decisions on those issues, the appropriate adjustment is $78,460.

24. 4.02 Skagit Hanford

This adjustment was uncontested by the parties. However, because of the decision to move Skagit amortization to the resource cost revenue requirement, it is appropriate to apply the production factor to these costs. Similar adjustments have been made to Creston and WNP/BEP 10 year amortization. The NOI result is $528,736.

25. 4.03 Corporate Publications

Commission Staff recommended disallowance or removal of the cost of certain company publications. The company agreed that cost reductions related to two of the publications were appropriate. The company contended this Commission should not interfere with the company's determination of the appropriateness of an employee newsletter.

The Commission agrees with the company. The reduced production cost of The Outlet and the discontinued publication The Livewire are properly reflected by the company. The other publication costs should be allowed. They do not indicate imprudent or inappropriate costs incurred by the company.

The NOI effect is $84,337.

26. 4.04 Vegetation Management

This adjustment is contested only to the extent of application of the production factor. Using the production factor found appropriate by the Commission, the NOI effect is $3,425,985.

27. 4.05 Plant Held for Future Use

This adjustment is discussed in the rate base section of this Order. Consistent with the Commission's decision on rate base issues, the NOI effect is $28,653.

28. 4.06 Miscellaneous Adjustments

This adjustment has several parts, many of which are contested. Each of the contested adjustments will be discussed separately.

a. 4.06(a) Public Utility Tax Credit

The company accepted the Commission Staff's proposed adjustment, which the Commission Staff recalculated with updated data provided by the company. The only remaining difference is due to differing treatment of conservation advertising.

Consistent with the Commission's decisions regarding conservation advertising, the NOI effect is $214,520.

b. 4.06(c) Vehicles - Other

This adjustment reflects removal of displaced vehicles from rate base. The company adopted Commission Staff's original adjustment. On brief, the Commission Staff argued that another $109,657 should be removed from rate base. Commission Staff cited Exhibit 1010, which indicated that the company has been able to reduce its fleet with a reduction to year end rate base of $109,657. The exhibit also indicated that the company has been able to eliminate 21 leased vehicles.

In its discussion in the rate base section, the Commission accepted the Commission Staff's removal of the additional vehicles from rate base. The resulting NOI impact is $202,136.

c. 4.06(e) Tree Trimming Sales Tax

This adjustment is contested only to the extent of application of the production factor. Using the production factor found appropriate by the Commission, the NOI effect is a decrease of $321,429.

d. 4.06(g) Outside Services

Commission Staff witness Roland Martin proposed removing outside legal services for three contracts which he characterized as lobbying. These items included consultation with the company on legislative bills and proposed amendments, costs of a suit by Colstrip participants challenging Montana's taxation of a BPA transmission line, and review of draft legislation, discussions, and meetings in Washington, D.C.

Company witness John Story argued that the costs were not lobbying. He testified that the costs were either for interpretation purposes or relating to an actual lawsuit in Montana concerning the legality of a tax.

The Commission accepts Mr. Story's description of the costs. They should be allowed for ratemaking purposes. The Commission Staff's proposed adjustment is rejected.

e. 4.06(h) Nintendo/Tanner

Commission Staff witness Kenneth Elgin proposed an adjustment removing legal costs booked during the test period for a lawsuit relating to service to Nintendo. The Commission Staff also proposed that the Nintendo load be treated separately for PRAM purposes.

Commission Staff argued that Puget's nonrecurring legal costs for a lawsuit resulting from accepting the Nintendo load and defending a legal action brought by Tanner should not be borne by ratepayers. The Superior Court concluded as a matter of law that Puget violated its service agreement with Tanner. The Commission had previously ruled in Docket No. UE-901596 that Puget did not have an obligation to serve Nintendo. Commission Staff's treatment would hold other ratepayers harmless from Puget's unnecessary decision to serve Nintendo.

Commission Staff's proposed treatment in PRAM was to remove the highest-cost resources equal to Nintendo's load.

The company argued that the legal costs are recurring costs and should be allowed for ratemaking.

The Commission concludes these legal costs are clearly nonrecurring. The Commission agrees that this type of litigation is not common, and does not expect to witness such litigation in the future.

The proposed future treatment of the Nintendo load in PRAM is a more difficult question. The Commission views the company's actions in "chasing" load to be inconsistent with the decoupling element of the PRAM. The PRAM was intended to remove incentives for short-term sales that will increase the long-term costs for all ratepayers.

The Commission reluctantly rejects the Commission Staff's proposal to treat the Nintendo load separately in the PRAM by removing the highest-price resource at the level of the Nintendo load. The Commission expects the company's future actions to be consistent with the goals of decoupling.

f. 4.06(i) Account 930.24, Misc. General Expenses

Commission Staff witness Roland Martin proposed removing two items from the company's expenses. The first was a payment to a consultant to assist the 4th Corner Development Group, an organization which encourages companies to locate in northwest Washington. The second item was a contribution to Washington State University's engineering program.

The company argued that assisting this economic development company aids Puget's system planning. Further, the company explained that the contribution to WSU was to aid women in engineering and contended that such donations help Puget's customers by achieving diversity in the work force.

The Commission Staff agreed that programs such as women in engineering are worthy of support, but challenged the company's expectation that ratepayers should pay the costs. The Commission Staff expressed concern that assistance to economic development organizations in Puget's service territory might be a form of load building, which the Commission strongly objected to in the above section on Nintendo/Tanner, and which the Commission views as violating the decoupling compact.

The Commission agrees with the Commission Staff that the cost of hiring a consultant to help an economic development group should not be borne by the ratepayers. The company may benefit from an enhanced image, but ratepayers do not benefit.

The company has made a convincing argument with regard to its contribution to the WSU women in engineering program. The company is required to comply with affirmative action guidelines, and programs encouraging women and/or minorities to enter a variety of fields can help guarantee that qualified candidates are available to the company.

The NOI impact of these determinations is $14,190.

g. 4.06(j) OBC Relocation

This adjustment proposed by Commission Staff reflects the cost savings resulting from vacating a floor at the One Bellevue Center building. The savings were calculated by comparing the foregone lease savings to one-third of the relocation budget, assuming a three-year amortization period. The Commission Staff adjustment on brief goes beyond the adjustment reflected in Exhibit 978.

The Commission accepts the Commission Staff's revised adjustment. Such measures are consistent with the recommendations of the Towers Perrin study. Company measures to increase efficiency should be encouraged.

h. FEA Adjustment - Officers' Expenses/Employee Activities

Intervenor FEA witness Hugh Larkin proposed removing several items as not appropriate for ratemaking. FEA recommended disallowance of company subsidy of employee activities such as raft trips and bowling tournaments.

Company witness Corey Knutsen testified that it is important for the company to support such activities.

The Commission accepts the FEA's adjustment to remove these expenses. Company management certainly may decide to fund these activities, but ratepayers should not be forced to pay for them. There is no ratepayer benefit to such activities.

The effect on NOI is $12,540.

29. FEA Adjustment - Remove R&D Expenses

FEA witness Hugh Larkin indicated that the company has spent more than $1.5 million in excess of amounts paid to the Electric Power Research Institute (EPRI) for research and development (R&D). $900,000 of this amount is the company's 20% holdback from EPRI for local R&D. Mr. Larkin contended the company has not justified expending more than the EPRI holdback amount. Mr. Larkin recommended the extra costs should not be allowed for ratemaking purposes, because the company failed to demonstrate the benefits to ratepayers. Mr. Larkin listed some of the projects funded by Puget on page 70 of his testimony, indicating that the projects do not benefit the ratepayers.

Mr. Knutsen opposed FEA's position on rebuttal. In addition to defending the specific projects, he argued that the EPRI guideline is just that -- a guideline -- and not a maximum.

The Commission accepts FEA's proposed adjustment. The company's case already includes $4.5 million for R&D. Unless the company can justify additional amounts, those amounts should not be the responsibility of ratepayers.

The effect on NOI is $453,743.

D. Results of Operations Summary

Based on the Commission's determination of specific matters set out above, the Commission concludes the net operating income of respondent during the test period, as adjusted, is $155,351,571. Table 4 shows the effect of adjustments to respondent's actual income which have been found appropriate for ratemaking purposes.

Table 4
PUGET SOUND POWER & LIGHT COMPANY RESULTS OF OPERATIONS
For The 12 Months Ended 6/30/92

NO. Description	Commission
Per Books Actual	211,474,422
Total uncontested Adjustments	1,403,942
Contested Adjustments:	
2.01 General Revenues	(17,281,812)
2.02/.03 Power Supply Adjustments	(36,554,352)
2.04 Temperature Adjustment	16,159,284
2.05 Conservation	(7,704,875)
2.07 Property Sales	392,152
2.08 Storm Damage	(2,747,506)
2.09 Self Insurance	(320,855)
2.10 Environmental	919,220
2.11 Employee Insurance	(611,136)
2.12 SFAS 106	(69,000)
2.13 Company Insurance	142,451
2.14 Wage and Salary	(1,357,292)
2.15 Investment Plan	(79,723)
2.16 Retirement Plan	(1,577,795)
2.17 Bad Debts	(20,727)
2.19 Creston	(2,900,886)
2.20/21/22 Stone Creek-Black Creek-Small Hydro	0
2.24 Working Capital	(250,020)
2.26 Rate Case Expense	(38,430)
2.27:Non-Recurring & Operating Expense:	
2.27b Corporate Dues	113,377
2.27j Conservation Advertising	(1,340,674)
2.27l Colstrip Interest Income	(203,180)
2.28 Production Adjustment	2,121,296)
3.03 Montana Corp. Tax	(167,877)
3.04 Pro Forma Interest	(9,022,549)
3.05 Montana Energy Tax	78,460
4.02 Skagit Hanford	528,736
4.03 Corporate Publications	84,337
4.04 Vegetation Management	3,425,985
4.05 Future Use Plant	28,653
4.06:Miscellaneous Adjustments:	
4.06a Public Util. Tax Credit	214,520
4.06c Vehicles - Other	202,136
4.06e Tree Trimming Sales Tax	(321,429)
4.06g Outside Services	0
4.06h Nintendo	80,234
4.06i Miscellaneous General	14,190
4.06j OBC Relocation	72,011
4.06 (FEA) Employee Expenses	12,540
Research and development	453,743
Total Contested Adjustments	(57,526,793)
Total Adjustments	(56,122,851)
Pro Forma Results (NOI)	155,351,571

IX. RATE BASE

A. Legal Principles

As provided in RCW 80.04.250,

> The commission should have power upon complaint or upon its own motion to ascertain and determine the fair value for rate making purposes of the property of any public service company used and useful for service in this state . . .

The rate base shown on a company's books is adjusted to take into account known and measurable changes which will occur during the period rates will be in effect. Such pro forma adjustments correct what would otherwise cause a miscalculation of the value of property which is used and useful in providing utility service.

B. Uncontested Adjustments

The following table shows adjustments which are not contested among the parties.

Table 5
PUGET SOUND POWER & LIGHT COMPANY
RATE BASE
Uncontested Adjustments
For The 12 Months Ended 6/30/92
(In Thousands of Dollars)

NO.	Description	Company Position	Staff Position
2.06	Depreciation /Amortization	2,553	2,553
2.27:	Non-Recurring & Operating Expense:		
2.27d	Supplemental Pension	(155)	(155)
	Total Uncontested Adjustments	2,447	2,447

The Commission has reviewed the uncontested adjustments and finds they are proper for purposes of this case.

C. Contested Adjustments

Table 6 shows a comparison of the parties' presentations on contested issues regarding rate base.

Table 6
PUGET SOUND POWER & LIGHT COMPANY
RATE BASE
Contested Adjustments
For The 12 Months Ended 6/30/92
(In Thousands of Dollars)

NO.	Description		Company Position	Staff Position
Per Books Actual			1,976,594	1,976,594
Total Uncontested Adjustments			2,447	2,447
Contested Adjustments:				
2.05	Conservation	(3)	78,082	74,260
2.07	Property Sales		(1,025)	(1,025)
2.12	SFAS 106	(2)	898	0
2.19	Creston		3,541	0
2.20/21/22	Stone Creek-Black Creek-Small Hydro		6,807	0
2.24	Working Capital	(2)	13,873	(8,186)
2.27:	Non-Recurring & Operating Expense:			
2.27j	Conservation Advertising	(3)	0	(2,057)
2.27l	Colstrip Interest Income		273	(61)
2.28	Production Adjustment		(28,408)	(39,967)
4.05	Future Use Plant	(2)	(995)	(4,129)
4.06:	Miscellaneous Adjustments:			
4.06c	Vehicles - Other		0	(110)
Total Contested Adjustments			73,046	18,725
Total Adjustments			75,493	21,172
Pro Forma Rate Base			2,052,087	1,997,766

(1) Not contested by parties but adjusted by Commission
(2) FEA had an independent position
(3) Public Counsel had an independent position

1. 2.05 Conservation

The company included conservation expenditures from May 1992 through April 1993. Commission Staff and the company differed only with respect to the production factor used in the calculation of this adjustment. Several of the parties also objected to conservation advertising. Their proposed adjustments will be covered separately. Commission Staff witness Diane Sorrells testified that the company's conservation expenditures, other than those for advertising, were prudent.

Public Counsel recommended that the conservation amortization period be lengthened from the current ten years to twenty years, based on the actual life expectancy of conservation

measures. Public Counsel contended that the treatment used by the company creates situations where the current cost to the ratepayers is actually greater than the cost of the supply-side resource avoided. Public Counsel argued that it is unfair for current ratepayers to pay for benefits to future ratepayers.

The company opposed extension of the conservation amortization period to twenty years. The company argued that the nature of new conservation is changing and that the new expected lives are shorter than before. Puget stressed that conservation investment is not tangible property and thus only exists at the discretion of this Commission. Therefore, lengthening the life would only increase the risk perceived by investors.

The Commission discussed and decided the correct production factor in the power supply adjustment (2.02). The only remaining issue is the proper amortization period.

The Commission rejects Public Counsel's recommended change to the amortization period. Although some other companies do use periods longer than ten years,[16] the life proposed by Mr. Blackmon is longer than the anticipated life of the average investment. This is not appropriate. The Commission must also consider the cost to ratepayers of extending the amortization period. Due to the tax settlement entered by Puget, the company could not take the tax deduction until it takes the amortization for ratemaking. Therefore, by extending the lives we would actually reduce the present value of the tax benefits.

The amortization period should remain at ten years. The appropriate rate base adjustment is $74,260,000.

2. 2.07 Property Sales

This adjustment is discussed in the results of operations section.

The impact on rate base is a decrease of $1,025,000.

3. 2.12 SFAS 106, Post-retirement Benefits Other than Pensions

The Commission discussed this adjustment in the results of operations section. The Commission rejected the company's proposed rate base inclusion of the amortized balance of the five-year amortization of previously deferred amounts above the

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[16] The Commission is aware that WWP uses twenty to thirty years for some programs, and some Oregon companies use the actual life of conservation measures.

pay-as-you-go level. The Commission also indicated that in the future accruals and payments may be treated in working capital.

Because of these decisions, no rate base adjustment is appropriate.

4. 2.19 Creston

In the results of operations section, the Commission determined that Creston costs should be recovered in one year. Therefore, there will not be an unamortized balance of Creston costs.

Consistent with those decisions, no rate base adjustment is appropriate.

5. 2.20 Stone Creek
2.21 Black Creek
2.22 Small Hydro Write-offs

Puget asked for the recognition in rates of two small hydro projects which were projected to become operational during the rate year, Black Creek and Stone Creek. During the pendency of this case, Puget agreed to sell Stone Creek to the Eugene Water and Electric Board (EWEB). On rebuttal, Puget asked the Commission to recognize Black Creek in rates, after offsetting the gain on the sale of Stone Creek minus the costs of undeveloped small hydro projects. All projects involved were developed by Puget's HEDC subsidiary and are being built by an HEDC subsidiary.

The Commission Staff proposed removing Black Creek costs for three reasons. First, Puget failed to provide sufficient information for the Commission Staff to determine the reasonableness of the profit charged by the subsidiaries. Second, few construction costs have actually been incurred to date. Third, the projected commercial operation date has been delayed until December 1994, although even that date is uncertain.

Commission Staff recommended that Black Creek compete through Puget's RFP process before its costs are allowed for recovery. That would give ratepayers more assurance that the resource will be proven cost effective. Puget will be able to recover the cost of the resources through the simple dispatch model.

Commission Staff argued that the Commission should not accept Puget's rebuttal proposal because it would allow recovery of small hydro program costs which are not known, have not been evaluated, and have not been justified. The Commission Staff

noted that the competitive bidding process provides an opportunity to evaluate the reasonableness and cost-effectiveness of the individual elements of Puget's small hydro program.

Puget argued that use of the production factor makes it proper to include in rates generating projects that don't come on line until the rate year. Puget contended it is proper to use a subsidiary to license and construct small hydro projects for sale to Puget; that Puget will earn no more than a utility rate of return on its small hydro program; that HEDC's investigation costs are being improperly characterized as "abandoned plant costs"; and that failure to accept its proposal will cause the full gain on the Stone Creek sale to be booked in 1993 and not be available for use as an offset against the costs of the small hydro program.

The Commission rejects the company's proposed treatment of these projects. The Commission is concerned that Puget refused to provide information on subsidiary profits. The Commission must be satisfied that Puget's decision to use subsidiaries will not require ratepayers to pay increased or inflated costs. This information is absolutely vital. Chapter 80.16 RCW (particularly RCW 80.16.030) requires disallowance of payments to affiliated interests in the absence of satisfactory proof that the payment or compensation is reasonable. Here, the company has failed to provide such proof.

The company has the option of filing a single-issue case at the time Black Creek comes on-line, to explore the proper treatment of resources coming on-line from subsidiaries.

In this case, no rate base treatment is appropriate.

6. 2.24 Working Capital

Both the company and the Commission Staff used an investor-supplied working capital approach to measure the allowance for working capital which is added to rate base. Their calculations differed in several ways. The difference between Commission Staff and company is over $22 million in rate base.

Other parties also contested certain aspects of the calculation. Those issues will be discussed separately below.

a. Dividends Declared

Commission Staff and intervenor FEA excluded both common and preferred stock dividends declared from invested capital. Both parties contended that dividends declared are a current liability, and as such, represent zero-cost capital. The

company argued the declaration of dividends does not reduce the funding nor the requirement for funding.

In the previous general rate case, the Commission accepted the Commission Staff recommendation to exclude dividends declared from invested capital. The Commission notes that dividends when declared are a commitment from the company to its shareholders. There is no interest charge associated with this balance and the funds to be paid in dividends are simply a current liability.

The Commission affirms this evaluation. Dividends declared should be excluded from the invested capital.

b. BPA Residential Exchange Credit

This issue results from the petition filed by the company for an accounting order regarding the treatment of BPA residential exchange credits. The company included the residential exchange balance as part of the company's invested capital, consistent with its petition.

In its discussion of the petition in Section VI above, the Commission accepted the Commission Staff's preferred method of accounting for the balances. The account will be deducted from rate base. Exchange balances in the account will accrue interest monthly on actual account balances, at the short-term debt rate.

Because of this decision, BPA residential exchange balances should not be included in invested capital in the working capital analysis.

c. Other Work in Progress

The company has accumulated deferred amounts associated with minor work projects. The company claimed that the projects represent amounts that belong in working capital either as inventory or as items that were covered by the accounting Order on remediation.

The Commission Staff proposed removing amounts which represent items that have been expensed or are part of ongoing expense programs. Commission Staff argued that the ratepayer should not be required to pay a return on expense items.

The Commission accepts the company's position. These amounts are properly included in working capital.

d. Plant Held for Future Use

Commission Staff's allocation of working capital is affected by the reclassification of Plant Held for Future Use to non-utility. The company disagreed with Commission Staff's position on future use plant and, thus, disagreed with this modification to working capital.

The Commission in its discussion of Plant Held for Future Use (Adjustment 4.05) accepted the Commission Staff's position. The working capital allowance allocation to non-utility should be proportionately adjusted because the non-utility investment has been increased by the future use adjustment.

e. Depreciation Reserve

Commission Staff witness Roland Martin proposed that certain amounts originally booked to depreciation reserve instead be included in working capital. This adjustment to working capital is offset by a decrease in the depreciation reserve.

The company originally objected to Commission Staff treatment. Company witness John Story's testimony and exhibits seem to indicate the company removed its objection to at least the majority of this adjustment.

The Commission accepts the Commission Staff's treatment.

f. Extraordinary Property Loss

Commission Staff witness Roland Martin proposed adjustments consistent with the Commission Staff's proposed treatment of storm damage and insurance reserves. The company objected, based on its position on these subject matters.

Consistent with its decisions on Storm Damage (Adjustment 2.08) and Self Insurance (Adjustment 2.09), the Commission must recalculate this amount.

g. Working Capital Summary

As a result of the decisions on the above individual parts of the working capital calculation, the total working capital adjustment is a decrease of $4,876,000.

7. 2.27 Non-Recurring and Operating Expenses

a. 2.27(j) Conservation Advertising

Puget seeks recovery of $4.1 million in rate base and $520,000 in amortization for conservation advertising expenses.

Commission Staff and Public Counsel proposed that portions of the conservation advertising expenditures, brought before the Commission for the first time in this proceeding, be disallowed. The company has been allowed to capitalize all costs related to conservation since the late 1970s. Commission Staff and Public Counsel contended that the company has, with the inception of PRAM, taken advantage of this treatment and used the conservation advertising for image building. They argued that shifting advertising costs from the "normal" account to the conservation account between general rate cases has allowed the company to lower a cost in the base category and flow through increases in a resource category.

Commission Staff witness Diane Sorrells recommended that half of the conservation advertising be disallowed. Commission Staff contended that Puget has not demonstrated that the advertising campaign effectively contributed to the acquisition of conservation resources. Commission Staff cited company witness Gary Swofford's testimony that the company has not made an attempt to measure the specific energy savings resulting from the campaigns.

The Commission Staff also challenged the company's evaluation of the success of the advertising campaigns. Commission Staff noted that surveys identified who is aware of the advertisements, but failed to establish which customers had responded to the advertising by adopting conservation measures. Commission Staff questioned the fact that the tracking studies originally identified which customers had received assistance (15%), but later studies omitted the question.

The Commission Staff argued that the corporate communication plan was not carried out in a cost-effective manner. Commission Staff questioned the use of television as the most expensive resource and demonstrated that after the use of television advertising the response rates dropped.

Commission Staff also argued that the advertising was not limited to issues of conservation, noting that both Ms. O'Neill and Mr. Swofford conceded this point. Commission Staff indicated that some of the topics discussed in the advertising are not allowed under Commission rules.

Public Counsel also recommended that conservation advertising be disallowed, removing all expenditures in 1992 and 1993. Public Counsel stressed that the advertising portion of conservation receives less scrutiny than any of the direct costs. Public Counsel also argued that company advertising existed long before conservation, and the ability of the company to incorporate its image building spots into the conservation advertising should not be overlooked. Public Counsel agreed with

Commission Staff that the company has done little to justify the appropriateness and cost-effectiveness of this advertising. Public Counsel also argued that the advertising was not for the sole purpose of promoting conservation. Public Counsel's review of Exhibit 841 led to his conclusion that the advertising included within those pages is intended to bolster the company's image.

The company argued that advertising is an essential part of its conservation programs. The company stressed that it has tripled the level of conservation in recent years. Puget argued that advertising campaigns are designed to change peoples' attitudes towards conservation. The company contended the testimony of company witness Maura O'Neill establishes that the campaign was successful. The company also indicated that the conservation obtained during this period is cost-effective even considering the conservation advertising expenditures. The company contended that Ms. Sorrell's position of holding the advertising to historical levels could not have accomplished the results achieved during the ongoing campaign.

Finally, Public Counsel recommended that in the future conservation advertising should be expensed rather than capitalized. Public Counsel contended that establishing an approved level of advertising expense in a general rate case will provide the company with some incentive to make good decisions about advertising. Under this proposal, the level of advertising would only be adjusted in a general rate proceeding. This treatment would also allow the Commission closer scrutiny of these expenditures.

The Commission shares the concern of Public Counsel and the Commission Staff that the current system of capitalizing all conservation advertising gives inappropriate incentives to the company. First, it encourages the company to load as large a proportion as possible of its general advertising into the conservation category in order to earn a return on the amounts. Second, it encourages the company to spend more dollars on advertising without necessarily evaluating the cost-effectiveness or success of such advertising.

Compared to levels presented in prior cases, the company's "general" advertising budget has shrunk to nearly nothing. The type of advertising has not changed dramatically. The logical conclusion is that the company has shifted general advertising to the conservation heading to take advantage of the capitalization allowed. Such manipulation certainly does not benefit ratepayers.

A review of the types of advertising shows many instances of "ads" that do not relate to conservation. The Commission does not accept company witness' contentions that it must first catch the audience's attention with general ads and

"warm and fuzzy" themes in order to later induce customers to read and respond to advertising that carries conservation information. The company has not appropriately measured the effectiveness of its advertising campaigns and has not demonstrated its media are cost-effective.

In view of its many concerns, the Commission accepts Public Counsel's proposal to expense future conservation advertising, rather than continuing to capitalize it. Future conservation advertising should be put in the base side of the PRAM to reduce incentives for the company to include inappropriate expenditures. The level will grow with customer growth.

With regard to conservation advertising since the last case, the Commission concludes that some amount should be excluded from rate base, as a result of the concerns expressed above. Not all the advertising claimed was properly characterized as related to conservation. Using Exhibit 742, the Commission compared the eight year average of non-conservation advertising (1983 to 1990) to the two year average (1991 to 1992). The difference was considered a proxy for the amount of general advertising expenses shifted to conservation advertising. The resulting adjustment after applying amortization and the production factor is a reduction of $652,000.

For purposes of this case, the Commission must adopt a pro forma adjustment. Public Counsel did not suggest the proper level of this adjustment. The Commission deducted the disallowed rate base amount, then used the average of the company's 1991 and 1992 conservation advertising expenditures to calculate a pro forma expense of $2.1 million. The resulting NOI impact including a reduction in amortization is a decrease in NOI of $1,3414,000.

b. 2.27(1) Colstrip Interest Income

This adjustment removes from the test year items pertaining to the Colstrip settlement income which was subject to deferral and amortization.

The company and Commission Staff agreed on the income effects. The company disagreed with the Commission Staff rate base treatment, claiming the Commission Staff failed to remove deferred interest from rate base.

Commission Staff argued that a rate base change is not required because the working capital did not include this item. Removal would therefore lead to double counting.

The Commission accepts the Commission Staff position and rejects the company's adjustment, in order to prevent double counting.

8. 2.28 Production Adjustment

The Commission Staff and company adjustments differed on this issue primarily due to Puget's use of an updated production factor based on revised load forecasts. This adjustment was fully discussed above in the results of operations section.

Consistent with its decision above, the Commission decreases rate base by $39,967,000.

9. 4.05 Plant Held for Future Use

Commission Staff proposed that certain portions of the company's Plant Held for Future Use account be removed from rate base. Commission Staff analysis identified four groups of property to be removed. The company accepted only one of these groups for removal. Intervenor FEA recommended removal of this account in three pieces. FEA's third piece was a total removal, with an accrual of carrying charges similar to AFUDC.

The Commission Staff proposal included the removal of items that do not have specific plans as required by the system of accounts, and the removal of those items that have been held for longer than 20 years. The Commission Staff cited the system of accounts definition of Plant Held for Future Use (Ex. 760) as justification for removing a substantial portion of the costs.

Commission Staff also argued that it is inappropriate to include plant for long periods of time without substantiating the benefits. Commission Staff identified the property it intended to remove, excluding those agreed to by Puget, and indicated that these properties cost $3.1 million and have a current appraised value of $3.2 million. Commission Staff noted that the ratepayers have already paid $3.7 million in return requirement for these investments, not including property tax.

Commission Staff's four groups were shown in Exhibit 754. Group A represented those items Puget has agreed to remove. Group B represented those plants which have no specific dates on which they are expected to be placed in service. The Commission Staff therefore argued they do not have specific plans. Group C was those items that have been held for more than 20 years. Group D represented four items for which the plans have become indefinite, as evaluated by Commission Staff witness Roland Martin.

The FEA proposal was in three parts, as shown in Exhibit 793, schedules 3-6. The first group was the same as Mr. Martin's group A, and was accepted by the company. FEA's second group included those properties that will not be placed into service within ten years, or have no specific in-service date. The numbers in this group do not agree with the items that would fit this description in Mr. Martin's more comprehensive exhibit. The third part of FEA's proposal removed the entire balance of Plant Held for Future Use and to allow the company a carrying charge. The carrying charge would be reviewed at the time the plant is placed in service.

The company opposed both of these positions. The company contended that it is inappropriate to institute a new policy retroactively. Puget disagreed with Mr. Martin's position that a plan is not definite when no date is stated. Further, the company did not agree that the standard for including parcels in Mr. Martin's group D was appropriate, because Puget is attempting to place these items in service. Finally, the company opposed FEA's total exclusion with carrying costs.

The Commission notes that Puget does have a very large balance in its Plant Held for Future Use account. The company has stated that the reason for such purchases is to avoid high costs in the future. The Commission is aware that the price of land often increases, making earlier purchases arguably cost-effective if only the purchase price is considered. The Commission is also aware that the company needs to plan ahead for construction needs.

The numbers presented by Mr. Martin, however, are alarming. The properties to be removed under Mr. Martin's guideline have required a return of over $3.5 million, compared to the escalation in value of approximately $100,000. There has apparently not been much benefit for the ratepayers with respect to obtaining the land for a good price as claimed by the company.

The Commission is also concerned with the number of properties which have been held in this account for many, many years without action. Although litigation may cause some delays in a proposed use of property, some of the properties are apparently just "sitting".

The Commission therefore adopts the Commission Staff's proposal for treatment of this account, including Mr. Martin's twenty-year benchmark for exclusion of properties. If property has not been acted on within twenty years, the ratepayers should not continue to bear these costs. The Commission specifically rejects the company's claim that establishment of a benchmark would be retroactive ratemaking. If that were the case, the Commission would never be able to establish reasonable guidelines.

The properties should be removed from rate base, as listed in Mr. Martin's Exhibit 754. Exclusion of these items from rate base should not hurt Puget. The company would be allowed to keep the gain on the sale of these properties, based on the period they were excluded from ratepayer support. This treatment should allow Puget to acquire properties and formulate plans for their use with sufficient flexibility.

This adjustment reduces rate base by $4,129,000.

10. 4.06(c) Miscellaneous Adjustments - Vehicles - Other

This adjustment removed certain vehicles from rate base. The company adopted Commission Staff's original adjustment.

On brief, the Commission Staff argued that another $109,657 should be removed from rate base. The Commission Staff cited Exhibit 1010, which indicates that the company has been able to reduce its fleet with a reduction to year-end rate base of $109,657. The exhibit also indicated that the company has been able to eliminate 21 leased vehicles.

The Commission accepts the Commission Staff's adjustment as revised on brief to include the additional vehicles shown in Exhibit 1010. Although the company did not specifically agree to the revised adjustment, the rationale is the same: efficiency and elimination of inappropriate costs. This treatment is consistent with the recommendations of the Towers Perrin study. The company provided the revised numbers and may reasonably have expected the revised numbers to be used in the Commission Staff's case.

D. Rate Base Summary

The proper rate base for respondent for the test year as adjusted for ratemaking purposes is set out in Table 7. Total rate base is $2,002,481.

Table 7
PUGET SOUND POWER & LIGHT COMPANY
RATE BASE SUMMARY
For The 12 Months Ended 6/30/92
(In Thousands of Dollars)

NO.	Description	Commission
Per Books Actual		$1,976,594
Total Uncontested Adjustments		$ 2,447
Contested Adjustments:		
2.05	Conservation	74,260
2.07	Property Sales	(1,025)
2.12	SFAS 106	0
2.19	Creston	0
2.20/21/22	Stone Creek-Black Creek-Small H	0
2.24	Working Capital	(4,876)
2.27:	Non-Recurring & Operating Expense:	
2.27j	Conservation Advertising	(652)
2.27l	Colstrip Interest Income	(61)
2.28	Production Adjustment	(39,967)
4.05	Future Use Plant	(4,129)
4.06:	Miscellaneous Adjustments:	
4.06c	Vehicles - Other	(110)
Total Contested Adjustments		$ 23,440
Total Adjustments		$ 25,887
Pro Forma Rate Base		$2,002,481

X. REVENUE REQUIREMENT

A. Conversion Factor

Because the Commission accepted the FEA's recommended adjustment for bad debt expense, the conversion factor must be recalculated. The following table contains that calculation.

Table 8
PUGET SOUND POWER & LIGHT COMPANY
CONVERSION FACTOR
FOR THE YEAR ENDED 06/30/92
Docket No. UE-921262

DESCRIPTION			
BAD DEBTS			0.0025550
WUTC FEE			0.0018500
STATE UTILITY TAX		3.873%	0.0386310
SUB TOTAL			0.0430360
FIT	(1-LINE 5)	34.00%	0.3253678
CONVERSION FACTOR (1-[LINE 5 + LINE 7])			0.6315962

B. FERC Wholesale Firm Class

FERC firm resale customers are not under the jurisdiction of this Commission, thus, it is necessary to allocate a portion of the overall revenue requirement to these customers. All parties seem to be in agreement that the firm resale customers are not paying their cost-of-service, thus, the allocation of revenue to this class requires both an allotment for underpayment and an allocation of any rate increase. The company and Commission Staff have proposed different methods for this assignment.

The Commission believes that the revenues for this class should be adjusted to 100% parity with the overall rate of return. Review of the amounts proposed by Commission Staff and the company indicate that the Commission Staff's position appears to achieve this goal more closely. The method proposed by Mr. Hoff in Exhibit 1017 understates the increase required to bring firm resale customers to 100% parity.[17]

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[17] Mr. Hoff notes that the FERC firm customers are at 0.77 of parity. His proposed solution is to assign a 23% increase to their rates. 0.77 plus 23% of .77 equals 0.95, not 1.00.

In our revenue requirement calculation we have started with the assignment included in the Commission Staff's brief, adjusting it by the product of the difference in revenue requirement of this order and Commission Staff's brief, and 0.545%. This percentage is taken from the overall allocation percentage of operating and maintenance expenses to the firm resale class in the Commission Staff response to Bench Request 6 (Exhibit 81).

C. PRAM Offset

The Commission adopted the Commission Staff general revenues presentation in adjustment 2.01. In the revenue requirement calculation the Commission used Staff witness Roland Martin's PRAM offset.

D. Elasticity

The company proposed an elasticity adjustment that modifies the pro forma billing determinants for proposed rates due to rate design changes. Company witness David Hoff calculated the elasticity adjustment to be approximately $3.3 million.

Commission Staff and intervenor FEA recommended rejection of the elasticity adjustment.

The Commission rejects the elasticity adjustment. Such adjustments can be inaccurate and difficult to quantify. Finally, the PRAM mechanism should take into account any changes in customer use due to rate increases. An elasticity adjustment is unnecessary under the circumstances.

E. 35% Tax Rate

The company submitted a proposal for an approximately $4.2 million adjustment, based on the new federal tax law.

The adjustment is not sufficiently detailed for the Commission to adopt. Instead, the Commission will require that this adjustment be calculated after this Order is issued. The Commission urges the parties to work together toward developing an agreed number. The company should use the 35% income tax rate in its compliance filing.

F. Power Supply Rerun

Because of the decisions made by the Commission in the power supply area, the Commission in this Order is able only to estimate the appropriate adjustment. The company must immediately rerun its power supply model with the modifications adopted by the Commission.

G. Revenue Requirement Summary

Table 9
PUGET SOUND POWER & LIGHT COMPANY
CALCULATION OF REVENUE REQUIREMENT
FOR THE YEAR ENDED 06/30/92

Rate Base		$2,002,480,268
Rate of Return		8.94%
		$179,021,736
Pre '91 Conservation Investment	64,353,364	
Two Percent Equity Incentive	0.90%	579,180
Total Return Requirement		$179,600,916
Pro Forma Net Operating Income		155,351,571
Operating Income Deficiency		$24,249,345
Conversion Factor		0.6315962
Revenue Requirement Deficiency Before PRAM offset		$38,393,748
Assignment to Firm Wholesale		$ 1,494,815
Retail Revenue Requirement - Increase/(Decrease)		$36,898,743
PRAM Revenue Offset		100,963,409
Net Retail Increase/(Decrease)		($64,064,667)

XI. RATE SPREAD/RATE DESIGN ISSUES

Once the Commission has determined a utility's revenue requirement, the revenue requirement must be allocated among the various customer classes. The Commission for many years has required that rate filings be accompanied by embedded cost-of-service studies to assist in making rate spread and rate design decisions.

"Rate spread" refers to the manner in which any rate increases are allocated among customer classes. "Rate design" refers to the manner in which rates are structured within any particular tariff schedule.

The Commission considered cost-of-service issues, and some rate spread and rate design issues in the proceeding related to Docket No. UE-920499. The Commission's Ninth Supplemental

order in that docket was entered August 17, 1993. That Order reserved to this proceeding a determination of rate spread and the design of residential rates. Those issues will be discussed in the following sections.

A. Rate Spread

In discussing rate spread, it is first necessary to determine the starting point for any rate spread decision. Throughout this case, Puget has used the rates established after PRAM 2 (decided in September 1992) as a basis. Permanent rates were most recently established in a general rate case in 1989 in Docket No. U-89-2688-T.

Increased rates which are the result of PRAM filings are not spread with the assistance of cost-of-service studies. As a result, the rates in effect after two PRAM proceedings may have tended to move some customers away from parity.[18] The Commission is concerned that spreading rates from the level after PRAM 2 would further skew these relationships.

The Commission therefore finds the level of rates adopted in Docket No. U-89-2688-T to be the proper starting point for rate spread decisions. Compared to the level after the previous general rate case, under any party's proposal in this proceeding there would be a rate increase.

Using PRAM 2 rates as a basis, the company recommended a one-third move toward parity, based primarily on preventing rate shock. The Commission Staff and WICFUR also supported a one-third movement. Public Counsel made his recommendations as percentages of the entire increase. BOMA recommended immediate movement to 100% parity, to eliminate what it characterized as cross-subsidies.

The Commission decision in this matter will result in a rate increase of $38.1 million over U-89-2688-T rate levels. This amount is $62.8 million less than U-89-2688-T plus PRAM 1 plus PRAM 2 rate levels. The company should re-run its cost-of-service model to reflect the decisions made in this order. It should then spread rates to move all customer classes below parity one-third of the way to parity. No customer class should get a rate increase above the U-89-2688-T plus PRAM 1 plus PRAM 2 rate levels. After this spread has been made, the remainder of the decrease should be spread to reduce the rates of customer classes above parity an equal percentage move toward parity.

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[18] "Parity" means classes are contributing the amount of costs allocated to them under a particular approach, as a percentage of the company's overall rate of return.

PRAM rates should be spread in the manner indicated in the Commission's Ninth Supplemental Order in Docket No. UE-920499.

B. Rate Design

In its Order in the rate design portion of these consolidated cases, the Commission reserved part of its determination about the design of residential rates until this Order.

The Commission in that Order determined that a $5 per month customer charge was appropriate as cost-based. It adopted a summer/winter differential of 10%. The Commission noted the parties' proposals that the three-block rate structure be changed to a two-block structure. It listed the parties' recommendations for the proper break between the two blocks, ranging from 800 kWh (company), to 400 to 600 kWh (Commission Staff, depending on the level of revenue requirement approved).

The Commission finds that the two-block rate structure should be approved. No party objected to the change to a two-block structure. A two-block structure will be simpler and will send appropriate price signals.

The break between the two blocks should occur at 600 kWh per month, as proposed by Public Counsel. The level of 600 kWh will best reflect the actual cost of new resources in the end block, so customers can make economically efficient decisions at the margin. It will also equitably allocate the limited amount of low-cost power on Puget's system. The Commission notes that 600 kWh is consistent with the report of the Rate Design Task Force submitted in February 1992.

The increased customer charge will have an effect on all customers. The first block should be priced at the same level as it was in U-89-2688-T. The remainder of the rate increase to this class should be spread to the tail block.

XII. PUBLIC PARTICIPATION

The Commission held three hearings for the purpose of taking testimony from members of the public about these consolidated filings. There were 25 persons testifying on June 21 at Bellingham, 20 testifying on June 23 at Olympia, and 23 testifying on June 24 at Renton.

In addition, illustrative Exhibit Nos. 871, 873, and 874 contain statements and materials brought by witnesses to the three hearings. Illustrative Exhibit Nos. 872 and 1015 contain letters and materials sent by persons who did not necessarily attend the public hearings.

Witnesses reflected a variety of opinions. Many customers testified the company should cut spending or reduce costs before filing rate increases. Some witnesses contended company stockholders rather than ratepayers should bear the risk of drought conditions or declining sales.

Three witnesses were retired Puget employees. They opposed any reduction in company payments for retirees' medical benefits. One witness testified he had been told by the company that benefits might be curtailed, depending on Commission action in this rate case.

One witness proposed growth charges at the customer level as a means of making new customers pay for growth.

Views differed on the value of conservation. Many witnesses supported the company's conservation efforts. Other witnesses opposed recovery for conservation measures, characterizing the programs as "giveaways" which benefitted only the customer receiving the conservation measure. One Olympia witness contended the benefits of demand-side management measures like conservation were overstated due to inaccurate measuring techniques.

These public hearings were remarkable in the number of witnesses testifying from business and civic organizations. Many of those witnesses supported a rate increase so that Puget could continue to participate in their particular organizations. These organizations included chambers of commerce, economic development councils, and builders' associations. A number of the witnesses were not familiar with the rate filing itself, but generally supported Puget as a "good corporate citizen", providing education or sponsoring "community summits". Several witnesses supported in general Puget's educational activities.

It is not necessarily clear from this group of witnesses what effect they expect if some portion of the rate increase were denied. Would Puget stop paying organizations' dues? Would Puget employees stop volunteer work in the community? Would Puget stop collecting funds which the Salvation Army administers in the Energy Fund?

One Olympia witness testified company personnel had told him community activities would be curtailed if expenses of the activities were not allowed for ratemaking purposes. This Olympia witness supported passing these costs to ratepayers. Other witnesses stated that ratepayers should not be forced to pay for Puget's community activities. Still others took no position on the rate increase request, but commended Puget's community activities.

Several representatives appeared from organizations designed to assist low-income persons. Many of them asked the Commission to consider the impact of any rate increase on low-income and fixed-income customers. Surprisingly, at least four witnesses from entities designed to help low-income customers supported the rate increase so that Puget could continue to provide education and assistance for their organizations. The Commission questions whether this view would be shared by their low-income customers, if those customers were given the choice.

Finally, many of the people attending the Bellingham hearing addressed at least in part their opposition to Puget collecting a five percent utility tax levied by the Lummi Indians on owners of fee lands located within the reservation. Four witnesses spoke, representing two associations and many customers in the hearing room. They contended the five percent tax was "taxation without representation" and should not be collected. Speakers stated the Commission should either force Puget to challenge the tax in court, or the Commission should itself challenge the tax in court. In the meantime, speakers recommended any rate increase be reduced by five percent for owners of fee lands.

This issue is relevant to this rate increase filing only to the extent the five percent collected would be five percent of a greater amount of electric revenue generated within the boundaries of the Lummi Indian Reservation. The Lummi Indian tax is not included in any adjustment in this case. The tax is treated in the same manner as municipal taxes, that is, both the revenue and expense are removed from the results of operations.

In 1992, the Commission approved a tariff filed by U S WEST Communications, Inc., to collect a similar tax on telephone revenues.[19] The Commission agrees with several of the speakers that the proper forum to challenge this tax is the court system. It is not, however, the responsibility of the Commission to mount this challenge. Neither is it the responsibility of Puget Power. If the fee land owners feel the tax should be challenged, they are the proper parties to make such a challenge. In the meantime, Puget is collecting the tax and passing it through in the same manner as that approved by the Commission for U S WEST. The Commission does not feel it is appropriate to require a five percent reduction in the rate increase for fee land owners.

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[19] Docket No. UT-911306. The Commission's Second Supplemental Order entered on October 6, 1992, adopted the ALJ's initial order entered on August 25, 1992.

Letters received in Exhibit Nos. 872 and 1015 were received as illustrative of the opinions of the correspondents, under WAC 480-09-736(19). Five of the letters supported the rate increase. Two reflected that the companies had received conservation grants from Puget, which they felt had helped reduce their electric bills. One letter supported generally Puget's educational programs, but took no position on the rate increase request. The remaining letters (an approximately two-inch stack) opposed the rate increase request, in whole or in part.

As indicated in the rate design Order, the Commission appreciates the high level of input from customers. Discussion of the individual issues and recommendations is contained in the detailed sections above.

Based on the entire record and the file in this matter, the Commission makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

Having discussed above in detail both the oral and documentary evidence concerning all material matters, and having stated findings and conclusions, the Commission now makes the following summary of those facts. Those portions of the preceding detailed findings pertaining to the ultimate findings are incorporated herein by this reference.

1. The Washington Utilities and Transportation Commission is an agency of the state of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, accounts, securities, and transfers of public service companies, including electric companies.

2. Puget Sound Power & Light Company (respondent herein) is engaged in the business of furnishing electric service within the state of Washington as a public service company.

3. On October 30, 1992, Puget filed revisions to its currently-effective tariff sheets WN U-60, Tariff G. The filing would have increased rates by approximately $116.8 million above the levels after PRAM 2. The filing was given Docket No. UE-921262.

4. On April 17, 1992, Puget filed a petition for an order regarding the accounting treatment of residential exchange benefits. The filing was given Docket No. UE-920433.

5. On April 30, 1992, Puget filed proposed changes to its Tariff No. WN U-60. The changes were intended to revise rate spread and rate design aspects of those tariffs. The filing was given Docket No. UE-920499.

6. By order entered November 25, 1992, the Commission suspended the tariff revisions in Docket No. UE-921262. It also consolidated all three filings for hearing and decision, and instituted investigations of the company's operations. The Commission ordered public hearings be held on the reasonableness of the revisions.

7. The twelve-month period ending June 30, 1992, is the appropriate test year to examine for ratemaking purposes in these causes.

8. Respondent's rate base adjusted for its Washington electric operations is $2,002,480,268.

9. The appropriate capital structure for ratemaking purposes herein is 43% long-term debt, 4% short-term debt, 8% preferred stock and 45% common equity.

10. A rate of return of 8.93% on respondent's rate base will maintain its credit and financial integrity and will enable it to acquire sufficient new capital at reasonable terms to meet its service requirements.

11. Respondent's test year net operating income after all adjustments is $155,351,571 under the rates approved by the Commission's orders in Docket Nos. U-89-2688-T and U-89-2955-T.

12. A deficiency exists in adjusted test period gross annual revenues in the amount of $36,898,743 above the rates approved in the last general rate case, calculated on the rate of return herein found appropriate.

13. The Commission considered cost-of-service, rate spread and rate design issues in its Ninth and Tenth Supplemental Orders in these consolidated cases. Those orders reserved decision on certain rate spread and rate design issues to this order. The issues are discussed at Section XI above. Rate design and rate spread proposals accepted in the Ninth and Tenth Supplemental Orders and in Section XI of this Eleventh Supplemental Order will fairly apportion the burden of the additional rates among customers of the company and will result in rates that are fair, just and reasonable.

14. The tariff revisions filed by respondent on April 30 and on October 30, 1992, should be rejected in their entirety. Respondent should be authorized to file revisions which will not

exceed $36,898,743, as determined in the body of this order. The design of the tariff revisions shall conform with the directions and findings set out in the Commission's Ninth and Tenth Supplemental Orders and in this Eleventh Supplemental Order. The tariff revisions herein authorized will result in rates and charges that are fair, just, reasonable and sufficient.

15. The company's petition for accounting treatment filed April 17, 1992, should be rejected. The company proposal would overcollect from customers the proper level of residential exchange credit.

16. The company should accrue BPA residential exchange benefits in a separate account, which should be deducted from rate base. Exchange balances in the account should accrue interest monthly on actual account balances, at the company's short-term debt rate. Benefits should be passed through to qualifying residential and small farm customers only. This treatment will satisfy BPA's concerns as described on this record.

17. The PRAM has achieved its primary goal, the removal of disincentives to conservation investment. The PRAM/decoupling experiment should continue for at least another three-year cycle, as modified in this order. The base/resource split will be modified so that resource costs will include WNP-3 exchange power ten-year amortization, Skagit/Hanford nuclear amortization expense, Creston preliminary survey costs and production depreciation expense, the 500 kV transmission investment associated with the Colstrip coal plant, and certain operating expenses that were established in the previous general rate case which are integral parts of items already included in resource costs. All non-resource costs will be included in the base cost category. The Commission will not change the current procedure regarding normalization of hydro and temperature. In future rate filings, the company should specifically address the relationship between the PRAM and its required rate of return.

18. The parties should discuss further improvements to the PRAM/decoupling experiment within the framework of the collaborative process. The parties should present any refined proposals to the Commission during the next rate case.

19. The company should convene two collaboratives to study the issues listed on pages 17 and 18 of this order.

20. Because the Commission has modified the company's proposed power supply costs, the Commission is able only to estimate the appropriate numbers. The company must immediately re-run its Production Costing System (PCS) computer model with the adjustments the Commission accepts in this order.

21. The company shall modify the simple dispatch model to reflect differences in prices for purchases and sales of secondary power. Puget should develop price spread factors to project prices. Puget should true up secondary sales and purchases in the manner shown on pages 7 and 8 of Exhibit 782. Emergency backup power costs should not be included in the calculation of actual secondary purchase rates.

22. The company submitted a proposal for an approximately 4.3 million adjustment to net revenue requirement, based on the increase in the federal income tax rate from 34% to 35%, retroactive to January 1, 1993. The adjustment is not sufficiently detailed for the Commission to adopt. The parties should be directed to consult and recalculate the revenue requirement in this case using the 35% income tax rate, and try to develop an agreed number. In its compliance filing, the company should include a detailed portrayal of the calculation of the revised revenue requirement.

23. The company's rate moderation proposal is unnecessary because of the magnitude of the rate increase approved in this order. No phase-in of rates is required to prevent rate shock.

24. Prudence reviews of new resource acquisitions are properly conducted in general rate case proceedings unless otherwise provided. Puget has not carried its burden in this general rate case of demonstrating that its new resource acquisitions were prudent.

25. Total disallowance of recovery of these resources would not be in the best interests of ratepayers or shareholders. The company should therefore be allowed to file a PRAM 3 projection as a temporary rate subject to refund, as provided in this order. The company shall also file by November 1, 1993, a power supply case which demonstrates the prudence of its resource acquisitions since the last general rate proceeding. Puget is also directed to maintain all documents related to its decisions to enter into specific contracts.

26. In future cases, parties should reflect the impact of PRAM revenues by excluding the impact of PRAM revenues from the adjustment and using a PRAM offset.

27. The following parties filed motions to correct transcript: Commission Staff on July 27; WICFUR on August 5 and 10; and Puget on August 6, 1993. The parties were given the opportunity to comment on the motions. No party commented. The motions should be granted and the transcripts corrected as indicated in the motions.

28. On August 5, 1993, Puget filed responses to subject-to-check questions from the rebuttal case. On August 12, Puget filed an additional correction due to a transcription error. The parties were given the opportunity to comment on the subject-to-check responses. No party commented. The subject-to-check responses should be included in the record.

From the foregoing findings of fact, the Commission enters the following conclusions of law.

CONCLUSIONS OF LAW

1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of this proceeding and the parties thereto.

2. The rates for electric service in respondent's tariff established after the last general rate case are insufficient to yield reasonable compensation for electric service rendered in the state of Washington by respondent. Revision of rates and charges to its tariffs made in accordance with findings herein will yield a fair rate of return on respondent's rate base found proper herein, and, if filed pursuant to this authorization, will be fair, just, reasonable and sufficient.

3. The tariff revisions under suspension in Docket Nos. UE-920499 and UE-921262 name rates and charges which are excessive and inappropriate. They should be rejected in their entirety.

4. The petition for accounting treatment of BPA residential exchange benefits in Docket No. UE-920433 would result in the company inappropriately overcollecting from customers the proper level of residential exchange benefits. Under the accounting treatment approved by the Commission in Section VI of this order, interest will be accrued on actual monthly residential exchange balances and benefits will be passed through to residential and small farm customers only, in compliance with federal law.

5. Further study is necessary on some issues, as outlined in the body of this order. Some issues should be studied in a collaborative framework.

6. Puget should be directed to file the PRAM 3 projections and prudence review filing as described in the body of this order.

7. All motions made in the course of these proceedings which are consistent with findings and conclusions made herein should be granted, and those inconsistent therewith should be denied.

Based on the foregoing analysis of evidence, findings and conclusions, the Washington Utilities and Transportation Commission enters the following order.

ORDER

IT IS HEREBY ORDERED:

1. The tariff revisions filed by Puget on April 30 and on October 30, 1992, now under suspension, are hereby rejected.

2. Puget's petition for accounting treatment of residential exchange benefits, filed April 17, 1992, is rejected. The company is authorized to adopt the following accounting treatment: Prospectively from the date of this Order, the company is authorized to record interest on balances in the residential exchange account. The account should be deducted from rate base. Exchange balances in the account should accrue interest monthly on actual account balances. The interest rate used to record such amounts shall be equivalent to the interest rate received by or available to the company for its short-term investments of at least ninety days' term. Benefits shall be passed through to qualifying residential and small farm customers only.

3. Respondent is hereby authorized to file revisions to tariffs found appropriate in this Order and in the Commission's Ninth and Tenth Supplemental Orders in these consolidated dockets. Those revisions will produce no more than the additional gross revenue herein found to be proper for respondent's Washington operations.

4. Respondent shall re-run its Production Costing System (PCS) model with the adjustments the Commission accepts in this order. In its compliance filing, the company shall synchronize its power supply calculations using the level of return approved by the Commission.

5. The parties shall consult and recalculate the revenue requirement in this case using the 35% federal corporate income tax rate. In its compliance filing, the company shall include a detailed portrayal of the calculation of the revised revenue requirement.

6. The filings authorized herein shall bear an effective date which allows the Commission at least four working days following the date of the Commission's receipt thereof to consider them. The compliance filing shall be delivered to the Commission's office in Olympia no later than 8:00 o'clock a.m. on Monday, September 27, 1993. The filings shall reflect no retroactive rate treatment. The filings shall bear the notation on each sheet: "By Authority of Order of the Washington Utilities and Transportation Commission, Docket Nos. UE-920433, UE-920499 and UE-921262".

7. Material in support of the manner in which the additional gross revenues herein authorized for respondent's electric operations is obtained, shall be submitted simultaneously with the filing related thereto.

8. A notice of the filings herein authorized shall be posted at each business office of the respondent in Washington, on or before the date of filing with the Commission. The notices shall state when the filing is to become effective and advise that a copy of the filing is available for inspection at each such office. The notice shall remain posted until the Commission has acted on the filings.

9. Puget is directed to file the PRAM 3 projection as a temporary rate subject to refund, as provided in this order. The company shall also file by November 1, 1993, a power supply case which demonstrates the prudence of its resource acquisitions since the last general rate proceeding. Puget is also directed to maintain all documents related to its decisions to enter into specific contracts.

10. All motions consistent with this order are granted. Those consistent therewith are denied.

11. The Commission retains jurisdiction to effectuate the provisions of this order.

DATED at Olympia, Washington, and effective this 21st day of September 1993.

SHARON L. NELSON, Chairman

RICHARD D. CASAD, Commissioner

RICHARD HEMSTAD, Commissioner

NOTICE TO PARTIES:

This is a final order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-09-810, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-09-8920(1).

APPENDIX A

PUGET SOUND POWER & LIGHT COMPANY - DOCKET NO. UE-921262
OVERALL COST OF CAPITAL RECOMMENDATIONS FROM BRIEFS

A. Company Recommendation

	Ratio	Cost	Weighted Cost
Long-term Debt	45.00%	7.91%	3.56%
Short-term Debt	2.00%	4.42%	0.10%
Preferred Stock	8.00%	8.10%	0.65%
Common Equity	45.00%	12.25%	5.51%
Total	100.00%		**9.82%**

B. Staff Recommendation

	Ratio	Cost	Weighted Cost
Long-term Debt	46.50%	7.89%	3.67%
Short-term Debt	5.00%	4.00%	0.20%
Preferred Stock	7.50%	8.09%	0.61%
Common Equity	41.00%	10.80%	4.43%
Total	100.00%		**8.91%**

C. Public Counsel Recommendation

	Ratio	Cost	Weighted Cost
Long-term Debt	46.34%	8.10%	3.75%
Short-term Debt	4.12%	4.42%	0.18%
Preferred Stock	9.14%	7.91%	0.72%
Common Equity	40.40%	10.00%	4.04%
Total	100.00%		**8.69%**

Appendix A

D. FEA Recommendation

	Ratio	Cost	Weighted Cost
Long-term Debt	45.81%	7.91%	3.62%
Short-term Debt	2.04%	4.42%	0.09%
Preferred Stock	8.15%	8.10%	0.66%
Common Equity	44.00%	11.25%	4.95%
Total	100.00%		**9.34%**

E. WICFUR Recommendation

	Ratio	Cost	Weighted Cost
Long-term Debt	47.00%	7.91%	3.72%
Short-term Debt			
Preferred Stock	8.00%	8.10%	0.65%
Common Equity	45.00%	10.40-10.60%	4.66-4.78%
Total	100.00%		**9.03-9.15%**