BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Proposal by

PUGET SOUND POWER & LIGHT COMPANY

to Transfer Revenues from PRAM Rates to General Rates
. . . . . .
In the Matter of the Application of

PUGET SOUND POWER & LIGHT
COMPANY and WASHINGTON NATURAL GAS COMPANY

for an Order Authorizing the Merger of WASHINGTON ENERGY COMPANY and WASHINGTON NATURAL GAS COMPANY with and into PUGET SOUND POWER & LIGHT COMPANY, and Authorizing the Issuance of Securities, Assumption of Obligations, Adoption of Tariffs, and Authorizations in Connection Therewith
. . . . . .

DOCKET NO. UE-951270

DOCKET NO. UE-960195

FOURTEENTH SUPPLEMENTAL ORDER ACCEPTING STIPULATION; APPROVING MERGER

SUMMARY

Proceedings: On February 20, 1996, Puget Sound Power & Light Company (Puget) and Washington Natural Gas Company (WNG) jointly applied for an order of this Commission, under the provisions of Chapters 80.08 and 80.12 RCW, authorizing the merger of WNG and its parent company, Washington Energy Company (WECo), with and into the surviving company of Puget Sound Power & Light Company in accordance with an Agreement and Plan of Merger by and among Puget, WECo, and WNG dated October 18, 1995. The surviving company will be renamed Puget Sound Energy (PSE). The plan of merger indicates that the subsidiary companies of Puget and WECo (other than WNG) will be subsidiaries of PSE; that the merger will be effected through an exchange of stock; that the corporate headquarters and principal executive offices of PSE will be located in Bellevue, Washington; and that PSE will operate as a combined gas and electric company.

Puget and WNG (Joint Applicants) seek authority to: (1) merge the assets of these companies into the surviving company; (2) issue common and preferred stock; (3) assume all obligations outstanding at the effective date of the merger and to continue and create liens in connection therewith; (4) adopt all tariff schedules and service contracts of WNG in effect at the time of the merger; (5) transfer to PSE all WNG certificates of public convenience and necessity; (6) implement a proposed rate stability plan; (7) implement certain accounting treatment for regulatory and ratemaking purposes for conservation expenditures, storm damage costs, environmental remediation costs, and proceeds from property transfers; (8) implement a proposed method of allocating costs between electric and gas operations; and (9) defer and amortize for regulatory and ratemaking purposes over the rate stability period of the merger any associated transaction and transition costs.

The Joint Application alleges that the proposed merger will: (1) result in reduced costs for administrative and general expenses; (2) result in maintenance of stable rates for customers with lower rates over the long run; (3) provide customers enhanced service and choice; and (4) result in less need for construction of new facilities.

Docket No. UE-951270 is a proposal by Puget to transfer to Puget's permanent rate schedules, currently-collected revenue of approximately $165.5 million authorized in the PRAM (Periodic Rate Adjustment Mechanism) under Schedule 100. On April 10, 1996, the Commission ordered Docket No. UE-951270 consolidated with the merger application.

Hearings: The Commission held hearings on August 5-9, 1996, October 11, 1996, and November 4-8 and 12, 1996, in Olympia. Hearings also were held on October 14, 1996, in Bellingham and Kent. The October 11 and 14 hearings included the opportunity for testimony by members of the public. The hearings were held before Chairman Sharon L. Nelson, Commissioner Richard Hemstad, Commissioner William R. Gillis, and Commission Administrative Law Judges Marjorie R. Schaer and John Prusia. The Commission gave proper notice to all interested parties.

Contemporaneous with the date for filing briefs, the Joint Applicants, Commission Staff, and Public Counsel jointly filed a Stipulation for Commission consideration. The Stipulation sets out those parties' agreement on contested issues. On December 18, 1996, the Commission held a hearing in Olympia for presentation of the Stipulation, for cross-examination of the proponents, and for additional testimony from members of the public. All parties were given until January 3, 1997, to file briefs to address the Stipulation and issues raised in direct testimony.

Parties: Joint Applicant Puget is represented by James M. Van Nostrand, attorney, Bellevue. Joint Applicant WNG is represented by Matthew R. Harris, attorney, Seattle. The staff of the Washington Utilities and Transportation Commission (Commission Staff) is represented by Robert D. Cedarbaum, Assistant Attorney General, Olympia. The public is represented by Robert F. Manifold, Assistant Attorney General, Public Counsel Section, Seattle.

The following intervenors appeared: Industrial Customers of Northwest Utilities (ICNU) is represented by Clyde H. MacIver, attorney, Seattle. Northwest Industrial Gas Users (NWIGU) is represented by Edward A. Finklea and Paula E. Pyron, attorneys, Portland, Oregon. Seattle Steam is represented by Frederick O. Frederickson, attorney, Seattle. Air Liquide America Corporation is represented by Anne D. Rees, attorney, Seattle. Washington PUD Association is represented by Joel C. Merkel, attorney, Seattle. Intervenor PUD No. 1 of Snohomish County is represented by Eric E. Freedman, attorney, Everett. Public Power Council is represented by Shelly Richardson, attorney, Portland, Oregon. Bonneville Power Administration (BPA) is represented by Jon D. Wright, attorney, Portland, Oregon. Natural Resource Defense Council (NRDC) and Northwest Conservation Act Coalition (NCAC) are represented by Deborah Smith, attorney, Helena, Montana. King County is represented by Sally G. Tenney, Chief Counsel, Seattle. The City of Seattle is represented by William H. Patton, Assistant City Attorney, Seattle. The City of Tacoma Department of Public Utilities is represented by Glenna Malanca, Senior Assistant City Attorney, Tacoma. The Washington Water Power Company is represented by David J. Meyer, attorney, Spokane. International Brotherhood of Electrical Workers Local 77 (IBEW) is represented by Lynn Ellsworth, attorney, Seattle. United Association of Plumbers and Pipefitters, Locals 32, 82, and 265 appears by Jeffrey J. Owen, Business Representative, Seattle. Teamsters Local 117 is represented by Spencer Nathan Thal, Staff Attorney, Seattle.

Interlocutory Order in Docket No. UE-951270: The Seventh Supplemental Order in these consolidated dockets, entered September 26, 1996, granted a joint motion of Puget and Commission Staff for authorization to transfer for recovery under Puget's general rate schedules the amounts currently collected under Puget's Schedule 100, other than PRAM deferral rate elements. The Seventh Supplemental Order resolved all outstanding issues in Docket No. UE-951270.

Commission Decision: The Commission authorizes the Joint Applicants to merge. The Commission authorizes the newly formed corporation to issue securities, assume obligations and adopt tariffs. The Commission accepts and approves the parties' stipulation resolving the issues presented in these applications, with clarifications set out in this Order.

MEMORANDUM

I. PROCEDURAL HISTORY

In this proceeding, two utility companies apply for Commission authorization to merge, under the provisions of chapters 80.08 and 80.12 RCW. Puget is an investor-owned electric utility headquartered in Bellevue, Washington. Puget furnishes electric service in a territory covering approximately 4,500 square miles, in nine counties in the Puget Sound region of western Washington. Puget's utility operations include the generation, purchase, transmission, distribution, and sale of electric energy on both a retail and wholesale basis. As of December 1995, Puget distributed electric power to 840,000 customers.

WNG is an investor-owned natural gas utility headquartered in Seattle, Washington. All outstanding common shares of WNG are owned by WECo. WNG distributes natural gas in a territory covering approximately 2,600 square miles in five counties in northwestern Washington, including the greater Seattle area. As of December 1995, WNG served 475,000 customers. Approximately 91% of those were residential customers who consumed about 44% of WNG's annual gas throughput.

Puget, WNG, and WECo have entered into a merger agreement. Under the terms of the merger agreement, WECo and WNG will merge with and into Puget as the surviving company, which will be renamed Puget Sound Energy (PSE). The subsidiary companies of Puget and WECo (other than WNG) will be subsidiaries of PSE. The merger will be effected through an exchange of stock. The corporate headquarters and principal executive offices of PSE will be located in Bellevue. PSE will operate as a combined gas and electric utility.

The shareholders of Puget, WNG, and WECo have approved the merger.

Fifteen days of hearings were held for resolution of preliminary matters and for the testimony of witnesses.

Contemporaneous with the date for filing briefs, the Joint Applicants, Commission Staff, and Public Counsel jointly filed a Stipulation for Commission consideration which sets out those parties' agreement on contested issues in this proceeding. The Commission held a hearing for presentation of the Stipulation and for cross-examination of the proponents by non-settling parties. A panel of three witnesses testified in support of the Stipulation. All parties were given an opportunity to file briefs subsequent to the presentation, to address the Stipulation and issues raised in direct testimony.

II. THE JOINT APPLICATION

The Joint Application of Puget and WNG alleges that the merger will be consistent with the "public interest," as that term is used in Washington law.

The Joint Application states that the utilities seek to merge because they believe that merging will produce benefits to the public, to investors, and to the companies' customers that cannot be realized through operation as separate utility systems. It alleges that the projected efficiencies and cost savings of the merger will result in rates for the companies' customers which are lower over the long term than they would be absent the merger. It claims that over the long term the merger also will allow the companies to meet more effectively the challenges of the increasingly competitive environment in the utility industry.

As a result of the merger, Puget and WNG expect to reduce their costs in several areas. Expenses will be reduced by combining operations and eliminating duplication in staffing and resources. The companies estimate that the surviving corporation could achieve merger-related cost savings of approximately $370 million, net of costs of achieving those savings and

transaction and integration costs, over the ten-year period following the merger. The Joint Application states that the merger offers the following strategic and financial benefits:

> *Maintenance of Stable Rates* -- NewCo The Joint Application uses the name NewCo to refer to the new company. The Joint Applicants later selected the name Puget Sound Energy (PSE). will be able to meet the challenges of operating successfully in the utility industry more effectively than either Puget or WNG standing alone. The merger will create the opportunity for potential benefits for customers in the form of lower rates over the long term than could be achieved if the companies operated independently and for shareholders in the form of greater financial strength and financial flexibility.
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> *Enhanced Customer Service and Operational Efficiencies* -- By coordinating and integrating certain operations of Puget's and WNG's utility businesses to take advantage of the companies' overlapping service territories, NewCo will be able to provide its customers enhanced service and choice. NewCo intends to assist its customers to manage their total energy service requirements in the most efficient manner without bias toward energy type, including the possibility of enabling customers to shift easily between gas and electricity to achieve savings. The merger should offer greater convenience to customers who, in most cases, will be able to conduct all their energy business with one company contact. In addition, NewCo will be able to respond more quickly to distribution interruptions with a combined workforce.
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> *Better Utilization of Resources* -- NewCo should be able to defer or avoid certain capital intensive projects, such as the construction of new service facilities and warehouses, which would no longer be necessary given the companies' overlapping service territories. In addition, joint engineering, siting and construction of facilities will reduce costs and minimize environmental disruption.
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> *Integration of Administrative and Operating Functions* -- NewCo will be able to consolidate certain corporate and administrative functions of Puget and WNG, thereby eliminating duplicative positions, reducing other non-labor corporate administrative expenses and limiting or avoiding capital expenditures for administrative functions and information systems. A joint transition task force is examining the manner in which to best organize and manage the business of NewCo. As a result of combining staff and other functions, NewCo will have fewer employees than Puget and WNG currently have in the aggregate. These work force reductions would be accomplished through severance programs (voluntary and involuntary), attrition, and strictly controlled hiring. Joint Application, pp. 8-9.

The Joint Application requests a Commission determination concerning the ratemaking treatment of merger costs and savings on PSE's customers. It proposes a five-year rate stability plan which would increase electric rates by 1% per year, and would provide stable gas rates through 2001 (other than purchased gas adjustments). It states that the Rate Plan uses the benefits of the merger to mitigate otherwise required general rate increases.

III. TESTIMONY

The Commission conducted a full set of hearings on the merger application prior to receipt of the proposed Stipulation. Thirteen witnesses testified for the Joint Applicants. Eight witnesses testified for Commission Staff, six witnesses for Public Counsel, and seven witnesses for the various intervenors. Eighteen public witnesses testified at the October 11 and 14, 1996, hearing sessions. In addition to the members of the public who testified at the hearings, many others wrote letters in which they expressed their views. Illustrative Exhibit 279 contains letters and materials sent by those persons.

A. Joint Applicants

The testimony of the Joint Applicants in support of the application contends that the proposed merger is good for customers, good for the environment, good for investors, good for employees, and good for communities.

The following witnesses testified for the Joint Applicants: Richard R. Sonstelie; William P. Vititoe; James P. Torgerson; Thomas J. Flaherty; Lori J. Wile; Paul M. Wiegand; John H. Story; Colleen E. Lynch; Ronald J. Amen; James A. Heidell; Jerry Lehenbauer; William A. Abrams, and William D. Steinmeier. The Joint Applicants' witnesses testified that customers will benefit in several ways: from more choice in their energy options; from increased availability of natural gas and increased promotion of customer awareness; from lower prices over the long term; from PSE's use of merger-related cost savings and savings from implementing best practices to avoid rate increases that otherwise would be necessary; from better quality of service; from better coordination and integration of operations; from having a company that is less dependent on rate relief and better positioned to deal efficiently with further evolution of the energy industry; and from lower capital costs which flow from a financially stronger company.

WNG witnesses testified that the residential market in its territory will continue to grow, and the company's costs will continue to rise, requiring general rate relief sooner than 2001, absent the merger.

Puget witnesses testified that Puget faces future rate pressures due to continued customer growth, power contract price increases, inflationary price increases related to transmission and distribution, and price increases in the capital budget. They testified that Puget has an immediate need for an additional $74.3 million of electric revenue requirement. They testified that estimated merger-related cost savings of $370 million over the rate stability period are not sufficient to allow PSE to meet its commitment to rate stability and earn a reasonable return on equity, but that by also implementing best practices and achieving other cost controls PSE can achieve both. They testified that adoption of their rate stability plan assures customers of receiving their share of merger benefits, while placing on management the responsibility to bring costs into line.

They testified that PSE will commit up to $1 million annually to low-income programs that will offer a new energy education program to assist low-income customers in reducing their energy bills, continue to fund weatherization of low-income households, and provide financial assistance for conversions of space- and water-heating load from electric to gas.

They testified that PSE will develop and implement a customer service guarantee for residential customers and will develop a customer satisfaction survey to monitor the quality of its service.

The Joint Applicants' witnesses testified that the merger will benefit the environment by: facilitating fuel switching; allowing the distribution systems for the two services to be designed and sized in an integrated manner; postponing some system improvements that would otherwise be necessary; enabling service facilities to be combined; and allowing joint resource planning to occur.

They testified that the merger will benefit investors in that it will result in a combined company that is financially stronger, with lower investment risk, than either Puget or WECo would be on a stand-alone basis. They testified that the merger will benefit employees in that it will assemble a strong management team and create a new enterprise that is more likely to succeed in the long run, and will provide a more stimulating workplace with greater opportunities for retained employees. They testified that the merger will benefit communities in that both companies have strong reputations for being active and involved in their communities, and PSE will be financially more flexible and a stronger partner in meeting communities' changing needs.

B. Testimony of Other Parties

The following witnesses testified for Commission Staff: Dixie L. Linnenbrink; Richard J. Lurito; Roland C. Martin; Thomas E. Schooley; James W. Miernyk; Frank J. Maglietti; Deborah L. Stephens; and Merton R. Lott. The following witnesses testified for Public Counsel: Jim Lazar; Neil H. Talbot; William B. Marcus; George Sterzinger; Barbara R. Alexander; and Michael Karp. Robert K. Schneider testified for IBEW Local 77. Tom Anderson testified for the Washington PUD Association. Carol Close Opatrny testified for Snohomish County Public Utility District No. 1. George Oakes testified for the City of Seattle. Dr. Thomas Michael Power testified for NCAC and NRDC. Donald Schoenbeck testified for NWIGU. Lincoln Wolverton testified for ICNU.

Of the parties who testified, none expressed opposition to the merger. However, most witnesses expressed concerns about the merger proposal, and recommended that the Commission authorize the merger only subject to various conditions.

Commission Staff witnesses disputed the Joint Applicants' estimates of cost pressures and estimates of savings related to the implementation of best practices and controlling power supply costs and other costs. They expressed concern that Puget presently is cutting rates for its largest industrial customers while proposing to increase rates for residential and other customers, and contended that if the merger is to be in the public interest, it must provide positive benefits to all customers. Commission Staff proposed an alternative five-year Rate Plan that would freeze electric rates and lower gas rates. It recommended that the Commission require PSE to amortize certain regulatory assets over the rate stability period to enable PSE to better position itself to meet future electric competition. Commission Staff supported a service quality incentive program proposed by Public Counsel. Commission Staff witnesses recommended that the Commission require PSE to implement measures to prevent negative impacts of the merger on competition, including reporting on market concentration.

Public Counsel's witnesses also testified that the Joint Applicants have overstated cost pressures and understated the likelihood of savings through the implementation of best practices and controlling power supply costs and other costs. They contended that the Joint Applicants' plan would impose excessive rates on consumers by shifting costs from industrial customers to residential customers through the plan's proposed 1% annual increases in electric rates, coupled with special contracts and Puget's market-rate tariff (Schedule 48) for the largest industrial customers. Public Counsel proposed a freeze on rates during the proposed five-year rate stability period.

Public Counsel's witnesses testified that under the Joint Applicant's rate proposal, residential rates could go up as much as 20% by July 1, 2001, rather than at 1% per year, primarily because of the loss of Bonneville Power Administration residential exchange benefits. The residential ex rates charged by BPA for the sale of electric power and transmission services. Residential and small farm customers of privately owned utilities receive the benefit in the form of a credit which reduces their monthly bills. Meanwhile, industrial rates could drop as much as 40% under Puget's proposed Schedule 48. They testified that PSE should be required to absorb any loss of BPA residential exchange benefits that occurs during the rate stability period, because Puget has the ability to influence this credit, and placing the burden on Puget will give it an incentive to protect the credit.

Public Counsel's witnesses testified that PSE will have an incentive to cut operations and maintenance expenditures under a multi-year plan to increase revenues and profits. They proposed a Service Quality Index which would incorporate ten measurable performance areas in three broad categories of performance: customer satisfaction, service reliability and safety, and business office performance. They proposed that PSE be required to annually report performance in each performance area, and proposed a total penalty amount of $7.5 million. Public Counsel's proposed index essentially is the same one proposed in the later Stipulation, and is discussed below in Section V.E.

Public Counsel's witnesses recommended that the Commission condition approval of the merger on implementation of a customer service quality index, funding of low income programs, and the launching of an open access pilot program for all customers.

Two public utility district witnesses testified that the merger could delay or impede retail competition, because it will result in unfair competition. They testified that a dual-fuel utility has an advantage over single-fuel PUDs in attracting new customers and competing for unified trench installation services, and may try to tie gas and electric service to each other in the guise of a combined energy service. They recommended that if the Commission approves the merger, it condition its approval on PSE undertaking measures to mitigate anticompetitive impacts.

One witness each testified for ICNU (representing large electricity customers) and NWIGU (representing large gas customers). ICNU does not oppose the merger so long as it does not impede competition. ICNU's witness testified that the 1% increases proposed in the rate stability plan should not apply to the energy component of Schedule 48, because if they did, the tariff would exceed market prices, violating the structure and underlying purpose of the tariff.

NWIGU's witness expressed the organization's concerns about electric stranded cost and service quality. He testified that it is critical to gas customers that any order entered by the Commission affirmatively state that gas customers of PSE will not pay any electric costs, including uneconomic costs, as a result of the merger, and further should say that any other cost shifts or revenue losses experienced by the electric utility will not be borne by gas customers in the future. The witness testified that a program to monitor industrial gas customers' satisfaction with service quality, and responsiveness of PSE, would be appropriate.

One witness (Dr. Power) testified for NRDC and NCAC, concerning possible adverse effects on conservation investment under the Joint Applicants' rate stability plan. He testified that the rate stability plan is a rate cap that has perverse incentives with respect to conservation investment or "demand side management" (DSM). He testified that there is cost-effective DSM that PSE could pursue but which a competitive market will not obtain. He proposed that the Commission remove the negative incentives that discourage investment in DSM by breaking the link between sales of kilowatt-hours and profits with a revenue cap linking recovery of transmission and distribution margins to growth in the number of customers rather than growth in sales volume. He proposed that the Commission require other conservation spending. NCAC and NRDC have continued to advocate, throughout this proceeding, the measures recommended by Dr. Power. Their position is discussed further in Section V.F, below.

One witness testified for the labor union intervenors. He testified that over the past five years, Puget has reduced staff levels, particularly maintenance and repair, and that system reliability has deteriorated during the period. The witness urged the Commission to require measures that address deterioration in system reliability.

One witness testified for the City of Seattle concerning the need for coordination between city utilities and WNG on construction projects.

C. Public Participation

Eighteen public witnesses testified at the October hearings. Nine testified on their own behalf as customers of Puget, WNG, or both companies. Six of the nine support the merger,

giving as reasons their past good experiences with the companies, a likelihood that the merger will result in efficiencies and savings that will be passed to customers, and rate stability. Several witnesses testified that the companies have been very public-minded and involved in their communities, have a good understanding of what businesses and residents in their territory need, and that the merger will give them the resources to be able to continue their local involvement. One supporter expressed concern about gas appliance safety, and recommended that regular inspection of WNG-leased equipment be required. Two customers opposed the merger, arguing that the merger will eliminate competition between electricity and gas, and in the long run will result in higher rates. One customer did not expressly oppose the merger, but argued that the proposed residential rate increase is out of line given the merger-related savings described, and expressed concern that competition between gas and electric will cease and that electric system reliability and the gas company's responsiveness in emergencies already are suffering.

Nine of the October public witnesses spoke on behalf of entities or constituencies. A representative of an industrial customer supported the merger, arguing that it will have important synergies that the companies can take advantage of to reduce costs, and arguing that one-stop energy shopping is convenient. An employee of the King County Housing Authority expressed concern that low income rate payers should share equally with industrial rate payers in the merger benefits, and argued that the Commission should require that some attention be paid to renewable resources, including the funding of experimentation with renewable resources. All seven witnesses in Bellingham were employees of Whatcom Opportunity Council. They expressed concern that: all customers should share any merger-related savings; expressed concern that large industrial customers are receiving rate decreases under Puget's Schedule 48, while low income customers will receive a rate increase; and that low income rate payers will be hurt by the low level of conservation funding that the Joint Applicants propose, which is lower than such funding has been and is less than a quarter of the level recommended for low income customers by the Comprehensive Review of the Regional Energy System.

More than 80% of the customer letters expressed opposition to the proposed merger. The principal concern expressed is that the merger will eliminate competition, and as a result rates for both electricity and gas will increase and service will deteriorate. Many WNG customers expressed a lack of confidence in Puget's management, concern that Puget's costs and rates are high, and a suspicion that Puget is seeking to merge with WNG in order to shift some of its electric costs to gas customers. There is a widespread perception among this group of customers that the only beneficiaries of the merger will be management and shareholders, and that residential rate payers will not receive any of the benefits of the merger. Other concerns expressed are that it is unfair that industrial customers will not also receive a rate increase, loss of consumer choice or opportunity to switch to a lower-cost fuel when competition between the two companies ceases, and loss of jobs. The letters in support of the merger cite opportunities for efficiency, elimination of duplication, and reduced costs that would result from the merger.

The Commission appreciates the breadth of the comments delivered at the public hearings and sent in by persons who did not attend the hearings. Each of the witnesses expressed thoughtful comments that have been valuable in assessing public sentiment.

IV. STIPULATION

A copy of the Stipulation of Puget, WNG, Commission Staff, and Public Counsel, is attached as Appendix A.

These four parties stipulate that the merger of WECo and WNG with and into Puget, and the transactions proposed in the Joint Application, are consistent with the public interest, if conditioned on the Terms of Approval set forth in Section III of the Stipulation.

The following is a summary of the recommended terms set out in Section III of the Stipulation:

There will be a five-year Rate Plan commencing on the date of merger approval and continuing through December 31, 2001 (the "Rate Plan Period"). During the Rate Plan Period, general rates for natural gas will remain unchanged until January 1, 1999. On January 1, 1999, general rates for natural gas sales and transportation service will be adjusted by reducing gas margin (revenues to cover costs other than commodity costs) by 1%.

During the Rate Plan Period, there will be immediate adjustments in electric rates which will have a net effect of lowering rates. Thereafter, general rates for electric service will be increased by 1% -1.5% (depending on customer class) annually, effective as of January 1 of each year through 2001. The stated basis for the annual increases is cost increases during the Rate Plan Period associated with purchased power, production, and transmission expenses over the period. PSE will pass through directly to eligible customers the residential exchange benefits received from BPA during the Rate Plan Period, and notwithstanding any reduction in the actual level of residential exchange benefits received from BPA during the Rate Plan Period, PSE will maintain the credits under Schedules 94 and 97 at their current levels. There will be changes in the treatment of specified regulatory assets during the Rate Plan Period. Details of the Stipulation's proposed Rate Plan are set out in Section V.B below.

The Stipulation provides that PSE may pursue specified regulatory initiatives during the Rate Plan Period.

The Stipulation provides that PSE may seek, under appropriate circumstances, interim rate relief during the Rate Plan Period, and specifies the process PSE must follow if it seeks such relief. It provides that such a request will be subject to the standard set out in Docket No. U-72-30, WUTC v. Pacific Northwest Bell Telephone Company, Second Supplemental Order (October 1972).

The Stipulation provides that PSE shall implement a service quality program including a Customer Service Guarantee and a Service Quality Index (SQI), as a mechanism to assure customers that they will not experience a deterioration in the quality of service. The SQI it proposes is essentially that proposed by Public Counsel at hearing. Details of the proposed SQI are set out in the Commission discussion, in Section V.E, below.

The Stipulation provides that during the Rate Plan Period, costs will be allocated between gas and electric operations in accordance with a four-factor allocation method.

The Stipulation provides that during 1997, Joint Applicants will work with Commission Staff to develop the following reports proposed by Staff in its testimony: annual market concentration studies; reports on joint utility services, such as unified design and trenching service with overlapping utilities; annual reports on merger costs and synergy savings; annual reports on allocation of merger savings between gas and electric operations; and annual reports on identification of best practice savings and power cost stretch savings.

Other provisions, described in greater detail in the Commission discussion below, address a reporting mechanism which will be developed for the purpose of monitoring the levels of gas conversions and line extensions to ensure that PSE is not acting to reduce or restrict gas availability, a comprehensive program to educate consumers about carbon monoxide (CO) and to promote CO detectors, and a commitment by PSE to maintain an effective vegetation management program.

Three witnesses, Ronald A. Davis for Puget and WNG, Kenneth L. Elgin for Commission Staff, and Jim Lazar for Public Counsel, presented the proposed stipulation at a hearing before the Commission on December 18, 1996. The Stipulation resolves all the outstanding issues that the four parties have with respect to the merger. They testified that there are substantial benefits from the merger, both to shareholders and rate payers, as a result of the Stipulation. The Rate Plan benefits gas and electric customers with known, stable rates. Removing uncertainty as to the effect on rates of changing power costs and changes in the BPA exchange rate is a benefit to electric rate payers. Each testified that in his opinion the proposed rate increases are cost justified and represent a fair sharing of the expected merger benefits between rate payers and shareholders. They testified that establishing some certainty with respect to rates during a period of transition to retail competition will assist PSE in managing its costs during the transition period.

The Commission heard from seven additional public witnesses on December 18, 1996, regarding the proposed Stipulation. The Commission also received into evidence an additional Illustrative exhibit, Exhibit 291, containing letters sent by persons who did not attend the hearing.

Five of the public witnesses at the December 18 hearing spoke on their own behalf. All are customers of one or both companies, and all testified in support of the proposed Stipulation. Among the reasons they gave for supporting the merger are: it probably will help keep rates under control; they have been happy with past service; the merger will make both companies financially stronger; and they like the idea of one-stop shopping.

Two witnesses testified on behalf of entities. A representative of the Washington State Association of Community Action Agencies expressed pleasure that the Stipulation includes a service quality index and a pledge by Puget to support the Comprehensive Review funding levels for conservation, but also argued that a shortfall of the Stipulation is a lack of a commitment to real numbers in conservation. The witness urged the Commission to send Puget a signal that real conservation in the future is important, especially during the interim before a

competitively neutral conservation funding mechanism comes into being. The witness urged the merged company to supply carbon monoxide monitors for free. A representative of Atmosphere Alliance, which is concerned about global warming, recommended that the merged company be required to meet the Comprehensive Review's final plan conservation spending recommendations, and expressed concern that the proposed rate cap will be a disincentive to continue energy efficiency programs.

V. COMMISSION DISCUSSION

A. The Public Interest Standard

1. The Legal Standard

Under RCW 80.01.040(3), the Washington Utilities and Transportation Commission is authorized to regulate, in the public interest, the rates, services, facilities, and practices of public utilities.

Chapter 80.12, RCW deals with transfers of property. Specifically, RCW 80.12.020 provides that:

> No public service company shall sell, lease, assign or otherwise dispose of the whole or any part of its franchise, properties or facilities whatsoever, which are necessary or useful in the performance of its duties to the public, and no public service company shall, by any means whatsoever, directly or indirectly, merge or consolidate any of its franchises, properties or facilities with any other public service company, without having secured from the commission an order authorizing it so to do [inapplicable proviso deleted].

Commission authorization is required in order for a public service company to merge or consolidate any of its franchises, properties or facilities with any other public service company. RCW 80.12.040, WAC 480-143-010. The Commission must be satisfied that the transaction is consistent with the public interest. WAC 480-143-050.

In order for a public service company to "merge or consolidate any of its franchises, properties or facilities with any other public service company," it must receive an order from the Commission permitting it to do so. The decision whether to issue an order approving such a transaction, and whether or not such an order requires conditions to be imposed, falls within the Commission's general authority and responsibility to "regulate in the public interest". The statute provides no specific statement about the criteria or standards to be applied when making this determination, although individual sections of the public service laws do provide statements of policy. Moreover, the relevant Commission rules do not establish specific review standards for determining consistency with the public interest.

Some precedent has been established in Commission orders in past merger or transfer of property application proceedings. None of these prior decisions (several of which

involved settlements) provide a specific enunciation of standards generally to be met when judging the public interest in cases of property transfer.

In Docket No. U-86-156, In re Pacific Northwest Bell Telephone Company, Second Supplemental Order (October 1988), the Commission cited consistency with legislative policy statements regarding telephone service as evidence of public interest, and stated that Washington rate payers should not be harmed by the merger. In the PacifiCorp merger, Docket No. U-87-1338-AT, In re PacifiCorp, Second Supplemental Order (July 1988), the Commission required positive benefits to be allocated to Washington rate payers in the form of rate reductions; but these rate reductions could be offset by future cost increases. In the Puget WNP-3 benefits assignment, Docket No. U-86-131, In re Puget Sound Power & Light, Order Denying Proposed Assignment (June 1987), the Commission rejected the property transfer due to lack of clear benefits and possible harm to rate payers. In the merger application of The Washington Water Power Company and Sierra Pacific Power, Docket Nos. UE-941053 and UE-941054, In re The Washington Water Company and Sierra Pacific Power Company, Seventh Supplemental Order (September 1995), the Commission approved a stipulated settlement based on a three part commitment which guaranteed: 1) no harm to Washington customers; 2) a fair allocation of benefits to Washington customers; and 3) that Washington customers would not subsidize benefits provided in other jurisdictions. Finally, in the GTE and Contel merger, Docket No. UT-910499, In re GTE Northwest Incorporated and Contel of the Northwest, Inc., Second Supplemental Order (September 1992), the Commission approved a settlement requiring rate reductions, and a temporary rate of return band with agreement to file a rate case to establish a new authorized rate of return.

2. Standards Presented

Five of the parties to this proceeding made arguments concerning the public interest standard.

The Joint Applicants argue that the proposal is in the public interest because it provides positive benefits for customers, the environment, investors, employees and communities. However, the Joint Applicants argue that:

> . . . to require an affirmative showing that customers are "better off" with the merger than without, and use that as a springboard for requiring Joint Applicants to reduce rates . . . seems to go far beyond what the Commission has required in previous merger proceedings. Steinmeier, Ex. 258, p. 4.

Commission Staff argues for the following standard:

> This requires both PSE to remain financially viable, and rate payers to be better off with the merger than without through an equitable sharing of the merger

benefits between the customers of the two companies and also between customer classes within the separate companies. Linnenbrink, Ex. T-78, p. 6.

Public Counsel argues:

> The public interest standard, simply stated, means that the general public must benefit compared with what would likely happen in the absence of Commission approval of this merger. Lazar, Ex. T-218, p. 8.

The apparent dispute between the Joint Applicants, Commission Staff, and Public Counsel regarding the standard was effectively resolved by the advancement of the Stipulation and the joint statement in it that the parties agree the merger is in the public interest if conditioned on the terms of approval included in the Stipulation.

The Washington PUD Association argues that the public interest no longer consists of ensuring just and reasonable rates and efficient service by monopoly providers. The PUD Association proposes in its brief that:

> In the simplest terms, the definition of the "public interest" has changed. No longer is the public interest served by protecting monopoly providers from competition. The broad "public interest" now lies in letting market forces work to produce lower rates for consumers.
>
> It follows that in order for the proposed merger to be "consistent" with the "public interest" it must advance the broad vision of a newly competitive electric industry. Brief, p. 1.

The PUD Association subsequently argues that, by improving PSE's competitive position relative to other energy service providers (PUDs in particular), the merger does not meet this test of the public interest -- unless conditioned as it requests -- and is not consistent with the Commission's principle that actions should not create an advantage or impose a disadvantage upon any group of competitors, or "inhibit" the natural evolution of efficient markets. See, Docket No. UE-940932, Policy Statement, Guiding Principles for Regulation in an Evolving Electricity Industry (December 13, 1995).

NCAC and NRDC derive their proposed public interest standard from statute:

> . . . the Washington legislature has declared the policy of the state to preserve affordable natural gas and electric services, and to maintain and advance the efficiency and availability of energy services. The Legislature also has enacted a variety of statutes that protect low-income customers and that encourage utility companies to invest in energy efficiency improvements and renewable resources. Brief, p. 5.

NCAC and NRDC subsequently argue that the merger fails to be consistent with this standard if conditions are not required that decouple revenues from rates for fixed cost recovery, and that

require minimum levels of expenditure for conservation, renewable resources, and low income programs. NCAC and NRDC also argue that not requiring such conditions would be inconsistent with the Commission's policy principle enunciated in Docket No. UE-940932 to preserve such public purposes. Id.

3. Commission Discussion and Decision

While there is no single statutory definition of the public interest to be considered in mergers and property transfers, specific statutes do provide direction regarding state policy concerning utility service. In particular, RCW 80.28.074 establishes state policy to:

(1) Preserve affordable natural gas and electric services to the residents of the state;

(2) Maintain and advance the efficiency and availability of natural gas and electric services to the residents of the state;

(3) Ensure that customers pay only reasonable charges for natural gas and electric service;

(4) Permit flexible pricing of natural gas and electric service.

These objectives constitute a clear statement in legislation of state policy as it applies to natural gas and electric utility service.

At the federal level, the Federal Energy Regulatory Commission (FERC) has recently established a new merger review policy which consists of three components: 1) effect on competition, 2) effect on rates and rate protections, and 3) effect on state and federal regulation.

Drawing on the statute cited above, and in consideration of the recently adopted FERC policy, we judge the public interest affected by the proposed merger using the following four standards.

1. The transaction should not harm customers by causing rates or risks to increase, or by causing service quality and reliability to decline, compared with what could reasonably be expected to have occurred in the absence of the transaction.

This component of the standard considers the consequences of the transaction for those customers directly served by the company(s) proposing the merger or property transfer.

2. The transaction, with conditions required for its approval, should strike a balance between the interests of customers, shareholders, and the broader public that is fair and that preserves affordable, efficient, reliable, and available service.

This component of the standard considers the way interests are indirectly, as well as directly, affected by the transaction. The broader public in this component includes state policies concerning environmental, low income, and gas and electricity resource issues.

3. The transaction, with conditions required for its approval, should not distort or impair the development of competitive markets where such markets can effectively deliver affordable, efficient, reliable, and available service.

Competition is entering the electric and natural gas industries, and its influence will likely continue to grow. However, competition is not, in itself, an enunciated state policy objective for utility service. Competition is an important tool, as is regulation, for accomplishing the policy objectives of affordable, efficient, reliable and available service. Consequently, a transaction's effects on competition must be considered not in isolation, but rather in light of the effect the transaction, and any conditions placed upon it, will have on these policy objectives.

4. The jurisdictional effect of the transaction should be consistent with the Commission's role and responsibility to protect the interests of Washington gas and electricity customers.

We are concerned that mergers and property transfers should not take place simply to accomplish a change in jurisdictional oversight for the companies involved. Any impact on the Commission's ability to continue to look out for the interests of Washington's customers must be considered carefully.

In this instance, we find that the Stipulation establishes appropriate rate protections and strikes an appropriate balance among affected interests. We clarify some requirements consistent with the Stipulation and emphasize the importance of other features of the Stipulation to address impacts on both competition and public purposes. Both companies involved are under the exclusive jurisdiction of the Commission and, therefore, this transaction does not raise questions concerning jurisdictional effects.

B. Cost and Rate Implications/Issues

1. Electric Rates and Rate Plan

The Stipulation proposes the following schedule of electric rate changes:

2-1-97 The Stipulation calls for the 1997 rate changes to occur on February 1, 1997. This order is being issued on February 5, 1997. Puget will need to file the rate changes as soon as possible, and no later than noon on February 10, 1997. The changes should bear an effective date which gives Commission Staff 48

hours to review the changes. If these revisions are ready to go and can be filed on the 5th, they could be effective as early as February 7.

	1-1-98	1-1-99	1-1-2000	1-1-2001	
Res Sch.7	-3.24%	1.5%	1.5%	1.5%	1.5%
Sch. 24	-4.19%	1.0%	1.0%	1.0%	
Sch. 25	-4.53%	1.0%	1.0%	1.0%	
Sch. 26	-4.97%	1.0%	1.0%	1.0%	
Sch. 31	-4.51%	1.5%	1.5%	1.5%	1.5%
Lighting	-1.9%	1.0%	1.0%	1.0%	
Sch. 49	-6.35%	1.5%	1.5%	1.5%	1.5%
All Other (incl. non-energy Sch. 48)	-4.1%	1.5%	1.5%	1.5%	1.5%

The 1997 decreases are the net of an average 5.6% decrease due to the expiration of PRAM deferrals, and stipulated increases of 1% to 2.47% depending on rate class. The 1997 rate decreases are not directly related to the merger and would have occurred at a later time in its absence.

The Stipulation recognizes cost pressures facing Puget during the five-year Rate Plan due to increases in purchased power, production, and transmission expenses, and is based upon recovery of various power cost components for 1997 -2001. Considering these cost pressures and the potential for savings associated with the merger, the Rate Plan reflects the implicit balance struck by the stipulating parties between five years of "rate certainty" for customers, and five years of opportunity for the company to manage its resource cost pressures. Within the five-year window, PSE's financial results will be a function of management's ability to achieve savings in order to provide shareholders with an opportunity to earn a reasonable return on investment.

If past rate changes are any guide to what rates would do in the next five years, the Rate Plan is beneficial to Puget's customers. The average annual rate increase for the period since 1990 was 5.18%. The residential exchange credit increased an average of 43.6% per year over the same period.

Neither the Stipulation nor the briefs of the Applicants and intervening parties explicitly address the issue of estimated merger synergy savings. All parties appear to agree, or at least not contest, that the merger will result in significant savings. In their merger filing, the Joint Applicants have estimated net merger synergy savings of nearly $370 million ($400 million savings less $30 million in costs to achieve) over the next ten years through the elimination of duplicate corporate and administrative programs and the integration of field operations and facilities. Commission Staff and Public Counsel have identified additional areas in which savings have been estimated by the Joint Applicants, including implementation of "best operation practices" and achieving certain "power stretch goals." These potential additional savings are significant. Exhibit TS-34, p. 5.

Consequently, the proposed Rate Plan is most accurately viewed as an implicit, rather than explicit, tradeoff between increasing costs that may be manageable, but that remain uncertain, and merger benefits which may be large, but are also uncertain.

The Stipulation also incorporates the risk associated with expected changes in Residential Exchange program benefits, by placing the company at risk for these changes. The Rate Plan calls for the BPA residential exchange credit to remain at the current level, regardless of the amount of credit actually received by Puget from BPA. Subsequently, BPA and Puget have reached a settlement in which BPA will pay Puget specified yearly sums in exchange for Puget terminating its participation in the residential exchange program. Over the five year period, it is projected that Puget will credit customers roughly $250 million more than it will receive from BPA.

2. Other Stipulation Provisions Concerning Electric Rates and Costs

In addition to the effect on electric rates during the Rate Plan period, the Stipulation addresses issues such as the treatment of regulatory assets, regulatory initiatives during the Rate Plan period ("carve-outs"), and interim rate relief.

Stipulating parties agree that the balance of deferred electric conservation costs as of December 31, 1996, shall be amortized during the Rate Plan period and that amortization of the current deferred balances of extraordinary property losses from storm damage will be accelerated so that the majority of these costs will be amortized prior to the end of the Rate Plan period. Environmental remediation costs will be amortized over five years, beginning at the point the costs (and insurance proceeds) become known. Gains from transfers of real property that are not a direct result of the merger will be deferred, as set forth in the Stipulation and Order of Dismissal dated May 26, 1992, Washington Court of Appeals No. 29404-1. Gains and losses from property transactions that are directly merger-related will be included in current earnings, rather than deferred.

The carve-outs that have been identified are principally aimed at enabling PSE to respond to future events or conditions, yet remain within the boundaries of the Rate Plan goals. The carve-outs are very general in nature and are followed by the conditions that nothing in the Stipulation shall be construed to predetermine issues to be resolved through these initiatives, the regulatory treatment associated with costs or revenues, or the information required in support of any initiative filed under this section of the Stipulation. In particular, the Stipulation provides for rate design changes to occur as made necessary by structural changes in the electricity industry.

3. Gas Rates and Rate Plan

The Rate Plan contemplates a freeze of non-commodity related natural gas service rates through January 1, 1999, at which point a one time reduction of 1% will occur to be effective through the end of the five-year Rate Plan period. A Purchase Gas Adjustment (PGA) mechanism would continue throughout the rate period. There has been little controversy regarding the natural gas side of the Rate Plan. The only concerns raised have been related to accounting and competition. Except for those costs that are truly joint and common, the gas and electric operating divisions should not subsidize each other's operations. The Stipulation proposes that common costs be allocated between the divisions by a multi-factor allocation formula. This formula is to be reviewed and approved by Commission Staff, and regular reporting of these allocations will be required.

4. Rate Plan Issues Presented

The Joint Applicants argue that the Rate Plan included in the Stipulation builds upon the Rate Plans previously offered by Commission Staff, Public Counsel, and the Joint Applicants and should be approved as offered. They, together with Staff and Public Counsel, urge that the Rate Plan represents a fair balancing between customer interests and company/shareholder interests.

Commission Staff responded to concerns expressed at the December 18 hearing regarding the treatment of changes in state and federal tax laws that may occur during the five-year Rate Plan period. Commission Staff states that:

> Witnesses for the stipulating parties agreed that changes in state or federal taxes were overlooked in the stipulation as tariff "carve outs" during the Rate Plan period." Brief, p. 6.

While not objecting to revision of the Stipulation, Commission Staff believes that it can be left as is, and the Commission order can clarify the issue. Commission Staff goes on to argue that the Commission should not predetermine any rate-making treatment for future state and federal tax changes, and that any changes in these taxes should be handled in a later generic proceeding or rulemaking so that all affected utilities are treated uniformly.

Public Counsel made no further comment in regard to the Rate Plan except to say that it is not opposed to the proposal of Dr. Power on behalf of NCAC and NRDC, with caveats expressed in Mr. Lazar's oral testimony. Tr. 2082-2085. Snohomish PUD, Seattle City Light, BPA, and the IBEW make no clear statements one way or the other regarding the Rate Plan. As a gas customer only of PSE, Seattle Steam supports the Rate Plan as it pertains to the two-year gas rate moratorium and subsequent three-year 1% decrease, with no position regarding rates or services to electric customers. NWIGU argues that the two-year rate freeze and subsequent reduction for gas customers, coupled with assurances provided by company officials that gas rate payers will not bear any financial consequences due to electric restructuring, gives gas customers tangible benefits without imposing improper risks.

NCAC and NRDC argue that the addition of a revenue cap mechanism is consistent with the rate cap offered in the Stipulation, and that without such safeguards concerning fixed cost recovery and public-purpose investment the proposed merger should be denied. This issue is discussed further in Section V.F.

The Washington PUD Association argues that the Rate Plan does nothing more than allow PSE to automatically raise its already above-market rates by additional amounts over the five-year period. The PUD Association goes on to argue that the Rate Plan:

> . . . will not and cannot offer PSE's customers as much economic benefit as could be achieved by giving them prompt direct access to other energy suppliers that may be able to offer significant rate reductions instead of rate increases. Brief, p.18.

While not specifically making a recommendation about the Rate Plan, the PUD Association argues that the Commission must take the initiative and set a schedule for implementation of direct access as a condition to merger approval. The specific conditions proposed by the PUDs are outlined under Section V.C, below.

5. Commission Discussion and Decision

With the exception of NCAC and NRDC, the parties generally support the major components of the Rate Plan, although some offer amendments or suggest additions to the Stipulation or Commission action to address their concerns. Along with the stipulating parties, Seattle Steam and NWIGU fully support the Rate Plan. BPA does not object, particularly since the Residential Exchange issue has been settled between BPA and Puget. See, Ex. 292. IBEW did not object to the Rate Plan. The PUD Association did not object to the Rate Plan specifically, even after criticizing its implications.

NCAC and NRDC did object to structural issues concerning the incentives the Rate Plan may produce for PSE. While the issue raised by NCAC and NRDC is relevant to the Rate Plan, we deal with this in the Public Purpose section of this Order. (Section V.F, below).

With the Rate Plan generally supported by the parties, the Commission must focus on whether the Plan, as offered in the Stipulation and supported by the parties, strikes a fair and reasonable balance between the estimated merger savings, future rates for customers, and investor needs. Much of this balance is implicit, rather than explicit, in the Stipulation. The Commission will clarify some key issues important to this balance, but only implicit in the Rate Plan, by addressing them explicitly.

First, the Commission concurs that fundamental changes in federal and state taxes should be recognized as a "carve-out" during the Rate Plan. Such changes, and their proposed regulatory treatment, will likely impact all Washington utilities, and should therefore be addressed in more generic proceedings.

Second, Section III.C.3. of the Stipulation addresses cost allocation methodology. A four factor allocation methodology is to be used to allocate common costs between gas and electric operations. Parties agree that there will be continued assessment of the reasonableness of such methodology. Commission Staff is to receive all relevant information to ensure a fair allocation of common costs to each service.

The Commission wishes to clarify two additional points in regard to Stipulation language in this section. The first point of clarification is to require PSE, in cooperation with Commission Staff, to establish a timetable for submitting information and reports. The second point of clarification is that the "fair allocation" standard established in the Stipulation should be defined to include the requirement that any allocation methodology for common costs of PSE shall not explicitly cause one fuel type (electricity or natural gas) to be advantaged over another. These clarifications add specificity and address the Commission's interest in minimizing

potential cost shifting, as well as the PUD Association's concern that PSE should not use its dual fuel capability and market power in a manner which is unfair, deceptive or anti-competitive.

Another point of clarification addresses the relationship between the rates that result from the Rate Plan and customer rates that might occur should the future see unbundled rates. The Stipulation acknowledges and provides the flexibility for rate design changes to respond to industry restructuring. To avoid any future ambiguity, the Commission wants to state clearly that the rate levels established in the Rate Plan are caps on rates for fully bundled utility service. If unbundling occurs, it may not be possible, or appropriate, to apply these caps to any specific unbundled service or any combination of unbundled and competitive services.

Finally, the balancing of consumer rate certainty against the company's opportunity to manage its affairs can only be considered fair if the company actually takes advantage of this opportunity. One of the likely benefits of the merger will be a strong management team equipped with experience from the management challenges presented by recent structural change in the natural gas industry. We fully expect PSE to pursue synergy savings and operating cost efficiencies aggressively during the five years of the Rate Plan, including but not limited to what have been identified by the Joint Applicants as "best operating practice savings" and "power stretch goals". The Commission concurs with the Joint Applicants that there are significant opportunities to achieve substantial savings in these areas.

The Commission finds, based on the representations of the stipulating parties and the general support from the other parties, that the Rate Plan is in the public interest. The Stipulation establishes suitable rate protections and strikes an appropriate balance between affected interests.

This finding is based upon the following clarifications:

- The Rate Plan rate levels are rate caps for bundled service.
- Rate design changes to unbundle services, or otherwise address industry restructuring and accommodate competition, may ensue during the Rate Plan period.
- The Rate Plan and Stipulation may be reopened to allow the Commission to consider fundamental changes in state or federal tax laws, or in the event that state or federal legislation dictating open access and unbundled service is enacted.
- The "fair allocation" standard shall be defined to include the requirement that any adopted allocation methodology for common costs of PSE shall not have the effect of artificially advantaging one type of fuel (electricity or natural gas) service over the other.
- A timetable for filing information or reports is to be established by PSE in cooperation with Commission Staff.

_ PSE shall aggressively pursue best operating practice savings, power stretch goals, and synergy savings during the Rate Plan period.

C. Competition

1. Merger Effects on Competition

A fundamental issue in this merger is the effect that the combination of the two companies will have on energy service competition, and on emerging structural changes in the electric and natural gas industries. The balance struck among the interests of customers, the company, and the broader public through rate protections, and tradeoffs between costs and savings, is certainly an important and necessary issue to be weighed. However, it is not sufficient to stop there if the consequences of the merger are to be considered and addressed. This merger raises issues and questions concerning competition that existed between the companies now to be merged, and competition between the newly created company and other utilities.

2. Actions Recommended by the Parties

Public utilities serving overlapping or adjacent service territories (Washington PUD Association, Snohomish County PUD, Seattle City Light, and Tacoma Public Utilities) were the principal parties to raise issues about competitive effects of the proposed merger. Commission Staff has evaluated competitive effects, and concluded that a number of reports will be necessary to monitor these issues over time. These reports are required by the Stipulation. In addition, as a result of questioning during the December 18 hearing, the stipulating parties agreed to include reports to monitor the cost-of-service basis of gas and electric line extensions to ensure that no cross-subsidies occur.

Beyond these reporting requirements, the PUD Association remains concerned that the merger will give PSE competitive advantages over the PUDs. It asks the Commission to impose a number of conditions. The centerpiece of the PUD Association argument is that, by becoming a dual fuel utility serving a wide area of western Washington, PSE will obtain significant market power and potential for anti-trust abuses that must be mitigated in the Commission Order. In particular, the PUDs argue that, because they lack the authority to provide natural gas service, PUDs will be placed at a competitive disadvantage by a dual fuel utility. The conditions the PUD Association requests include:

1. A finding of fact that PUDs will be competitively disadvantaged if not authorized by changes in state law to become natural gas providers;

2. Definition of key terms (primarily size) of an open access pilot program for Puget, and requiring alternative suppliers to be included in the collaborative aiding in the design of the program;

3. Establishing that PSE must make all of its customers eligible for direct access by July 1, 1999;

4. Establishing a program to monitor competitive impacts and to police PSE's business practices;

5. Requiring PSE to comply with applicable anti-trust laws and clarification of how these laws apply to PSE's activities in the context of the Supreme Court's recent holdings regarding Commission authority to achieve the purposes of RCW 19.86. (this anti-trust issue is addressed in Section V.G of this order); and

6. Initiating a docket to examine and establish Puget stranded generation costs.

The PUDs argue that these are necessary conditions to serve the public interest because the advent of competition for electricity service requires a broader public interest standard than that considered in the past. The PUDs note that these are appropriate issues for them to raise because the Commission admitted them to this proceeding while stating, in the Third Supplemental Order, that "competition is a basic issue in this case [and] must be examined in light of these market changes in order to decide whether the merger is in the public interest." Brief p. 6.

The PUD Association proposes that the merger "should, at a minimum, be required to enhance the public interests identified in the Guiding Principles and provide affirmative benefits which move customers and regulated utilities toward competition (their emphasis)." Brief, p. 7. It argues that the above conditions accomplish such affirmative benefits by charting a path for PSE's customers to have choice of providers, and by forming a basis for legislative removal of a competitive disadvantage alleged to be suffered by the PUDs.

3. Commission Discussion and Decision

We believe that the PUD Association raises some important points about competition and the transition toward more competitive electricity service markets. This Order will include the following conditions to address these issues:

- PSE shall establish a program to monitor competitive impacts of the merger for all services, not just distribution. The reports required in the Stipulation should be designed by Commission Staff with input from all interested parties, including overlapping and adjacent utilities. In addition to those reports required by the Stipulation, a report designed to monitor gas and electric line extensions will be required to ensure that cross subsidies do not occur in line extension policies or investments. All reports should be prepared on a schedule agreed to by Commission Staff, reviewed by Commission Staff, and presented annually to the Commission in an open public meeting.

- PSE shall file cost-of-service studies by December 31, 1997, that are of sufficient detail to support the unbundling of both electricity and natural gas transmission, distribution, and supply services.

- Proposals concerning stranded cost may be appropriate to take up at the time unbundled service tariffs are considered based on the above-required cost studies, if this is consistent with evolving industry trends and/or legislative direction. We will not require a study of stranded cost at this time.

These conditions chart a schedule for work necessary to accomplish a foundation for unbundling of services, without constraining flexibility to develop a restructuring schedule appropriate to conditions we may encounter over the next few years. Further, ordering this foundation work does not prejudge anything to be learned from the Open Access Pilot Program in Docket No. UE-961533. While unbundled tariffs may ultimately be appropriate to consider or require, it is too early at this point to establish a firm schedule for their development.

These foundation requirements do constitute "affirmative benefits which move customers and regulated utilities toward competition" that are proposed as necessary by the PUDs. Again, we view these requirements as making explicit the commitments that are implicit in the Stipulation's recognition and accommodation of regulatory initiatives during the Rate Plan.

The request of the PUDs for a finding of fact regarding PUD gas service should be denied. Public Utility Districts are independent from the jurisdiction and control of the Commission. RCW 54.16.040. Making a judgment about PUD authority and competitive circumstances is beyond the scope of this proceeding. The PUDs, or any other interested parties, may use the record developed in this proceeding when considering state policy concerning the PUDs.

The requested requirements and conditions to be imposed on the Open Access Pilot Program are appropriately left to the collaborative committee which has been convened in that docket. We will not prejudge the committee's work. Parties will have an opportunity to argue the merits of that work when the Pilot Program is filed.

E. Service Quality Issues

1. Service Quality Proposals

The Stipulation includes both a service quality guarantee initially proposed by the Joint Applicants (a $50 customer rebate for missed appointments), and the service quality index (SQI) initially proposed by Public Counsel and endorsed by Commission Staff. The purpose of these is to "provide a specific mechanism to assure customers that they will not experience a deterioration in quality of service." Stipulation, p. 11. The SQI would put PSE at risk for up to $7.5 million in penalties if service quality deteriorates significantly below benchmarks. The only difference between the SQI in the Stipulation and that originally proposed by Public Counsel

witness Alexander is the substitution of an "overall customer satisfaction" index (which will not incur penalties) for an index of lost-time accidents.

The SQI is still being developed. Five SQI benchmarks have yet to be determined: Overall Customer Satisfaction; System Average Interruption Duration Index (SAIDI); System Average Interruption Frequency Index (SAIFI); Field Service Operations Customer Satisfaction; and Missed Appointments. Company performance in three indices (Overall Customer Satisfaction, Telephone Center Transactions Customer Satisfaction, and Field Service Operational Customer Satisfaction Transactions) will be measured by the results of a customer satisfaction survey instrument which has not yet been developed. The survey will be conducted by an independent survey company which has not yet been selected.

After entry of the final Order, the parties will consult on the details of the service guarantee program and the unresolved details of the SQI. The customer satisfaction survey instrument, and the independent survey company that will conduct the survey, are to be mutually agreed upon by the parties.

The Stipulation provides that PSE will make a compliance filing with the Commission within 90 days of this order reflecting the parties' consultation on the remaining benchmarks and the service guarantee program. It specifically provides that the 90-day compliance filing will include a preliminary proposal regarding the Missed Appointments baseline, and that if the Missed Appointments baseline has not been resolved prior to the October 15, 1997, first service quality report filing, determination of that baseline will be submitted to the Commission for resolution as part of that filing. The Stipulation does not indicate how disagreements concerning other baselines will be resolved.

The Stipulation separately provides that PSE will make a filing reflecting the consultation of the parties on the customer survey issues. It does not specify when that filing will be made. It provides that if the parties are unable to agree on the survey instrument or the identity of the independent survey company, those issues will be resolved by the Commission as part of that filing.

2. Issues Related to the Service Quality Proposals

a. Employee safety. The IBEW proposes that the Commission modify the Stipulation by including employee safety ("lost time accidents", or LTA) as a penalty criterion in the SQI. The union contends that imposing penalties for system outages (i.e. the SAIDI and SAIFI criteria) may lead PSE to schedule long work hours to avoid penalties, potentially compromising employee safety. It points to a performance based rate making mechanism for Southern California Edison that includes a health and safety component (Exhibit 151), and cites a provision of the California Public Utilities Code that directs the California Public Utilities Commission to adopt standards for operation, reliability, and safety during periods of emergency and disaster. IBEW notes that there is no policy basis for limiting safety simply to emergencies. On January 10, 1997, IBEW submitted a portion of a

December 2, 1996, Massachusetts Department of Public Utilities decision relating to performance based rates for Boston Gas Company, including lost time accidents, as a "subsequent authority" for including a lost time accident criterion (Exhibit 293).

The IBEW also asks the Commission to confirm Local 77's right to participate in consultations on the details of the service quality index.

The Joint Applicants oppose IBEW's request to include a lost time accident index. They argue that the stipulating parties sought to include indices that were most closely tied to service quality. They claim, further, that lost time accidents should be excluded from the SQI because employee safety is already subject to a comprehensive regulatory scheme under OSHA and WISHA, and because there is no evidence in the record correlating accidents with service quality.

Commission Staff notes that inclusion of non-storm SAIDI in the SQI meets the recommendation of IBEW witness Robert K. Schneider. Commission Staff does not object to IBEW participating in discussions to establish the appropriate SAIDI benchmark. Commission Staff also notes that Mr. Schneider did not present a specific recommendation based upon lost time accidents. It emphasizes that Staff, Joint Applicants, and Public Counsel agree that the overriding goal of maintaining reliable service quality is achieved by the Stipulation even without the inclusion of an LTA index, citing Tr. 2447-48.

b. Vegetation management. IBEW notes PSE's commitment in the Stipulation to an effective vegetation management program, but suggests that there is no way to know whether "trees are being cut in an effective manner" without written standards or objective guidelines. Although it provides no suggestions about how such a program should be developed and monitored, the IBEW believes requiring such standards would not be an onerous condition.

3. Commission Discussion and Decision

The Commission will approve the customer service guarantee and the SQI included in the Stipulation. The role of regulation has been shifting from rate base/rate of return to a greater emphasis on consumer protection. The comprehensive service quality program should protect customers of PSE from poorly-targeted cost cutting. The Commission will not include the lost time accident criterion in the program at this time. Employee safety is already subject to a comprehensive regulatory scheme. We recognize, however, that increases in the level of lost time accidents could be a warning sign of excessive cost-cutting. We encourage IBEW Local 77 to continue to monitor worker safety, and to alert the Commission if there is a significant increase in the frequency of lost-time accidents.

The stipulating parties have agreed to work out the specifics of those portions of the SQI index which cannot be based on available information. IBEW Local 77 should be allowed to provide input in that process. The compliance filing for the SQI should also provide a detailed demonstration of how penalties are to be calculated. Requests for mitigation of future penalties, if any, should follow the procedures now used by the Commission to process requests for mitigation of transportation penalties.

Given the storms we experienced this winter, the Commission has a heightened awareness of the need to explore ways to improve the reliability of electric transmission and distribution facilities. While IBEW's suggestion about written standards has merit, vegetation management goes beyond merely "cutting trees". Long term reliability of the distribution system would seem to involve a comprehensive look at the causes of system outages, studying alternative ways of improving system reliability, and assessing the costs of different management alternatives against their benefits before making a decision on how to proceed.

Distribution system reliability and maintenance is of heightened importance, both because of recent breakdowns, and because of structural changes and competition in the industry. The Commission will soon be conducting hearings with both Puget and The Washington Water Power Company about winter storm damage. Follow-up to these hearings may require a more generic process to establish clearly enunciated guidelines and standards for a long-term sustainable vegetation management and distribution system maintenance program.

F. Public Purpose Issues

Public purposes issues discussed in this proceeding include:

1. Funding levels for demand-side management and low-income customer needs;

2. The need for carbon monoxide monitors for low-income customers; and

3. A proposal for a revenue cap.

These issues were primarily framed by the NCAC and NRDC and public witnesses. Much of the discussion centered on goals of the recently completed Comprehensive Review of the Regional Energy System. NCAC and NRDC argue that without Commission imposed safeguards for fixed-cost recovery and public-purpose investment, the proposed merger should be denied.

1. Safeguards to Ensure Appropriate and Timely Implementation of Public Purposes

NCAC and NRDC make the following proposals:

1. Require PSE to apply for a performance based system of rewards and penalties that equitably divides the net benefits of PSE's cost-effective demand side management (DSM) investments between shareholders and customers;

2. Modify Schedule 48 so that, as an alternative to rate reductions, customers may receive equivalent bill savings in on-site energy efficiency improvements;

3. Require PSE to submit a filing that allows for collection of funds equivalent to 3% of electricity sales revenues, and allocation of those funds to DSM, low-income weatherization, and renewable resources;

4. Formally recognize PSE's conservation collaborative, and charge this group to submit a proposal for DSM programs "that is in the public interest, fulfills UTC principle #5, and meets Comprehensive Review recommendations for conservation and low-income weatherization programs at a level of 2.43% of utility revenues"; and

5. Direct PSE to acquire at least 11 average megawatts of environmentally responsible wind, geothermal or solar power.

NCAC and NRDC ask that the Commission require condition three to be met by no later than April 1, 1997, and all other conditions by July 1, 1997.

The Joint Applicants argue that determining the level of commitment to, and methods of rate recovery for, DSM programs or public purposes funding in this proceeding is premature. They note that the Stipulation defers to a subsequent filing the development of an alternative recovery mechanism for DSM and related expenditures. Section III.A.4.a of Stipulation, p.8. PSE commits, in the Stipulation, to the funding levels for public purposes--including renewables--set in the Comprehensive Review if such funding is subject to a cost-effectiveness standard and is implemented in a competitively neutral manner. Id.

Similarly, the Joint Applicants argue that Dr. Power's recommendation that PSE be required to acquire at least 11 average megawatts of environmentally responsible wind, geothermal or solar power is premature and should be rejected. They argue that acquisition of renewable resources is an issue that will be considered in connection with PSE's least-cost plan.

2. Need for Carbon Monoxide Monitors for Low-income Customers

As a part of their testimony in support of merger approval, the Joint Applicants committed to spending $1 million annually on low-income programs that will offer a new energy education program to assist low-income customers in reducing their energy bills, continue to fund weatherization of low-income households, and provide financial assistance for conversions of space-and water-heating load from electric to gas.

The Stipulation provides that PSE will develop a comprehensive program to educate consumers about carbon monoxide and to promote carbon monoxide detectors. Mr. Davis of WNG expanded on this commitment at the December 18, 1996, hearing:

I think we could work something out to give away some of these as part of our commitment on low income. I don't see why we couldn't work to that. Tr. 2521.

3. Proposal for a Revenue Cap

NCAC and NRDC argue that these proceedings present the Commission with an opportunity to direct the outcome of a restructured utility industry in Washington and in the Pacific Northwest. They argue that among the issues presented is how PSE will recover payments from its customers for fixed costs. They submit that without Commission-imposed safeguards concerning fixed-cost recovery and public-purpose investment, the proposed merger would be detrimental to the public interest and should be denied.

NCAC and NRDC argue that two facts will operate to hinder PSE's commitment to pursue the public interest: 1) PSE will earn a greater margin with which to recoup fixed costs from sales of electricity than from sales of gas, thereby discouraging pursuance of fuel switching; and 2) under the rate cap, fixed costs will be recovered by commodity sales, making sales of electricity more lucrative than sales of natural gas and making throughput more lucrative than efficiency. They argue further that this reward for additional sales of electricity presents a powerful disincentive to invest in any measure that reduces electricity sales and, hence, profitability. They urge the Commission to eliminate the disincentives and corresponding incentives to augment sales of electricity by adopting the revenue cap proposed through the testimony of Dr. Power. This "revenue cap" would link the recovery of transmission and distribution margins to growth in the number of customers rather than to growth in volume of sales. They argue that no party has presented any testimony to rebut Dr. Power's proposal.

NCAC and NRDC argue that in a restructured electric utility environment, a utility's generation business will be separated, or unbundled, from its transmission and distribution businesses. The former will become competitive, and NCAC and NRDC have no conceptual problem with a rate cap applying to generation assets. However, transmission and distribution will continue to be regulated, and will be charged with implementing the public purposes identified by the steering committee of the Comprehensive Review of the Regional Energy System. These public purposes include investment in energy efficiency improvements, environmentally-responsible renewable resources, and low-income services. Given its publicly-charged nature and duties, it would be counter to the public interest for a transmission and distribution company to increase its profits by additional sales of output. NCAC and NRDC argue that failure to require a revenue cap would prevent achievement of Commission principle number 5 articulated in Docket No. UE-940932: "development of competitive electric markets should not undermine public policies favoring environmental protection, energy efficiency, resource diversity, and technological innovation. . . . Approaches that encourage development of markets for energy efficiency and renewable generation equipment should be emphasized."

Commission Staff argues that the Commission should reject NCAC and NRDC'S proposed revenue cap. It notes that the proposal is a decoupling mechanism similar to that in the PRAM "which the Commission abandoned recently as a controversial, complex and burdensome experiment." Staff argues, further, that the issues and principles that are involved should be considered, if at all, in a broader context for the industry in general. Finally, Staff argues that a

revenue cap would be incompatible with the Stipulation, which establishes specific rate levels for both gas and electric service for the five-year period 1997-2001.

Public Counsel noted that it is not opposed to the proposal of Dr. Power on behalf of NRDC and NCAC. Public Counsel did not specify to which of Dr. Power's proposals it referred.

The Joint Applicants argue that the revenue decoupling proposal should be considered, if at all, in a separate proceeding. They note that the proposal is in many respects similar to the PRAM decoupling mechanism. They also note that Dr. Power's testimony describes the process that would be necessary to implement the revenue cap, including a full cost of service analysis and development of a weather normalization process, citing Ex. T-216, pp. 24-25. The Joint Applicants conclude that the record in this proceeding is insufficient to allow these determinations to be made.

4. Commission Discussion and Decision

The public purpose elements of the Stipulation and Joint Applicant's proposal include a $1 million commitment to low-income programs, general commitment to the Regional Review recommendations if cost-effective and competitively neutral, and commitment to facilitate use of carbon monoxide monitors, including funding some for low income customers. We applaud these commitments, and commend the Joint Applicants in advance for following through on them.

We understand Puget has been working for some time with Commission Staff and other parties in its collaborative to fashion a DSM proposal to replace the tariff scheduled to expire in the near future. To encourage these discussions to produce a constructive product, the Commission believes it is important to set a time for filing a DSM proposal and cost recovery mechanism accommodated within the "DSM carve-out" in the Stipulation. The Stipulation provides:

> Electric conservation expenditures after December 31, 1996 (including those expenditures resulting from PSE's commitment to conservation or public purposes funding under the Comprehensive Regional Review) will be subject to recovery through an alternative recovery mechanism to be proposed by PSE in a separate filing subsequent to merger approval. Such recovery shall not include PSE's separate commitment to spend $1 million annually on low-income programs during the Rate Plan Period. PSE will commit to the funding levels set in the Comprehensive Regional Review so long as: (1) the program is implemented in a competitively neutral manner, and (2) expenditures under such program remain subject to a cost effectiveness standard. Section III.A.4.a of Stipulation, p. 8.

A target date of April 1, 1997, for filing the DSM proposal and cost recovery mechanism seems suitable, since we understand Puget and its collaborative have made progress. The Commission expects PSE will continue to work with, and consider the recommendations of,

this collaborative group in developing this and future DSM and public purpose program proposals.

The budget "level of effort" questions will have to be considered in the context of the DSM filing, since the merger record provides no basis for evaluating cost-effectiveness or appropriate levels of utility expenditure. We cannot simply "require" Puget to meet the budget prescriptions proposed in the Regional Review recommendations. We will require that Puget characterize its proposed programs in the context of the Review's recommendations. Puget's April 1, 1997, DSM filing should describe budgets and level of effort in the context of the Regional Review recommendations so that a determination can be made about where programs and efforts are, or should be, consistent with the Review's recommendations and where they should not.

The Commission has no interest at this time in pursuing NCAC and NRDC's request for a revenue cap. Substantial design and cost work would be necessary before such a cap could be implemented. The record in this proceeding is insufficient for this purpose. The rate caps established in the Stipulation are for bundled services, not unbundled transmission and distribution. Moreover, as Commission Staff notes, one of the benefits to PSE's customers of the Rate Plan is a substantial period of predictable bundled power rates. A revenue cap would require rate variations which could erode this benefit.

NCAC and NRDC's request that Schedule 48 be modified and that PSE be required to propose some form of incentive mechanism for sharing of DSM program benefits is similarly outside the record and scope of this proceeding. These are not issues associated with the merger of these two companies.

The Commission wants to emphasize its continuing commitment to the importance of public purpose issues raised by NCAC and NRDC and others in this proceeding. If these values are to be preserved, and the Commission believes they should, efforts should focus on finding methods, mechanisms and approaches that will be compatible with, and sustainable in, a more competitive industry. As competition comes to this industry, attention will focus on consumer values and on price. Methods to accomplish public purpose objectives and funding that rely on leveraging monopolies, and which assume that consumers will not be sensitive to price, will not be successful. The Commission does not take its responsibility to consider public purpose values and objectives lightly. However, our actions are confined by the limits of our statutory authority and by the realities of the emerging marketplace.

The Commission is disappointed by the lack of constructive detail and substance about new methods for accomplishing public purpose objectives in the Regional Review's recommendations, which seem to focus on finding the right dollar level rather than the right mechanism. We are prepared, and expect our Staff to be as well, to work with all parties to seek ways to preserve public purpose values and programs. We trust that mechanisms can be developed that will be consistent with changing market structures, and that will achieve these objectives in cost-effective and sustainable ways.

The Commission approves of the public purposes resolutions included within the Stipulation, and will not impose the additional requirements requested by NCAC and NRDC. The Commission will require the "separate filing subsequent to merger" for consideration of electric conservation to be filed by April 1, 1997. PSE should continue to work with its "collaborative" in the development of this filing. Moreover, it is the Commission's hope that this filing will begin to address the new methods and strategies that will be necessary if public purposes values and programs are to be preserved.

G. Local Jurisdiction and Anti-trust Issues

In its brief, the City of Seattle states that it supports the proposed merger if the following conditions are made a part of the Commission's order: 1) PSE is required to adhere to the replacement schedule in Seattle previously required of WNG; 2) PSE is required to coordinate with Seattle City Light, Seattle Public Utilities, and Seattle Transportation construction schedules and requirements in conducting such replacements; 3) PSE is required to comply with any other franchise conditions incorporated into a franchise with the City of Seattle; and 4) PSE is required to comply with both federal and state antitrust laws.

1. Infrastructure Replacement Schedule and Coordination

Seattle states that it assumes that PSE will succeed to all rights and obligations of its predecessors, including prior Commission orders on infrastructure replacement in Seattle, but it requests that the Commission make that continuing obligation explicit.

Seattle argues that there have been past problems with coordination of construction by WNG with Seattle's municipal utilities. It argues that it is imperative that the Commission require PSE to coordinate all construction with city utilities.

The Joint Applicants argue that the coordination relief requested by Seattle is beyond the scope of this proceeding, in that it is unrelated to the merger --it is requested whether or not the merger is approved. Joint Applicants also argue that the record demonstrates that the requested relief is unnecessary, in that the record shows that WNG has a strong history of construction coordination with Seattle and Seattle did not identify any problems that have occurred.

2. Compliance With Existing Franchise Conditions

Seattle argues that WNG does not presently have a franchise with the city, that Seattle expects to negotiate a franchise with PSE, and that Seattle expects that PSE may assert that the Commission's regulations and tariffs do not allow it to agree to or be bound by certain conditions in the proposed franchise. It states that such an argument was successfully advanced by General Telephone with regard to undergrounding requirements enacted by ordinance by Bothell four years after the Commission approved a conflicting undergrounding tariff. General Telephone v. Bothell, 105 Wn.2d 579 (1986). Seattle argues that while it would not expect to require PSE to violate existing conditions required by the Commission, it does expect to negotiate a franchise which is binding on PSE over the term of the franchise, whatever future

changes in Commission tariffs and regulations are implemented after the date of the franchise contract. In order to avoid later claims of a conflict between Commission regulation and franchise, Seattle requests that the Commission order PSE to comply with all franchise conditions of any local franchise agreement into which PSE enters.

No other party addresses this issue, which appears to have been raised for the first time in Seattle's brief.

3. Compliance With State and Federal Antitrust Laws

Washington's unfair business practices laws are found in Chapter 19.86 RCW. RCW 19.86.170 provides an exemption from those laws as follows:

> Nothing in this chapter shall apply to actions or transactions otherwise permitted, prohibited or regulated under laws administered by the . . . Washington utilities and transportation commission . . . .

The City of Seattle contends that there are antitrust considerations in this merger proceeding. It argues that the most likely type of antitrust violation in the proposed merger would be attempts to tie-in the service of natural gas, or the availability of various conservation programs, to the provision of electric services to the same customer or group of customers. It argues that a tie-in of one product or service for another is a violation of both state and federal antitrust law.

Seattle argues that an order approving the merger should include an order that PSE "comply with both state and federal antitrust laws, unless the company is explicitly exempted from such compliance by order of the Commission specifically authorizing a particular course of anti competitive conduct." Brief, p. 5.

Although Seattle requests order language that refers to both state and federal antitrust laws, its brief focuses on state law. Seattle contends that companies regulated by the Commission are not automatically exempt from antitrust scrutiny under RCW 19.86.170. It argues:

> The statute provides for exemption not from all actions but from ". . . actions or transactions otherwise permitted, prohibited or regulated under laws administered by . . . the Washington utilities and transportation commission. . ." Accordingly, the specific actions or transactions have to be "permitted, prohibited or regulated" by the Commission. Brief, p. 5.

Counsel for Public Counsel and Commission Staff stated at the December 18, 1996, hearing that the parties to the Stipulation did not specifically discuss questions on the antitrust laws. Counsel for Commission Staff stated that there were discussions with respect to the competitive impacts of the merger. Public Counsel stated that he consulted with the antitrust section of the Attorney General's office during the early phases of this case, and it is certainly aware of this merger. He stated that the consumer protection law of Washington under which the

state's antitrust laws are enforced provides a specific exemption for companies that are regulated by the Commission in RCW 19.84.170.

The Washington PUD Association is the only other party that addresses the question of the antitrust laws in its brief. The PUD Association expresses concern that the merger will give PSE increased market power which will sharply increase the potential for unfair, deceptive, or anti-competitive business practices. The PUD Association, however, interprets the state antitrust exemption differently than does Seattle. Citing the Supreme Court's decision in Tanner Electric Cooperative v. Puget Sound Power & Light Company, 128 Wn.2d 656, 911 P.2d 1301 (1996), the PUD Association argues that utilities such as PSE enjoy broad immunity from the state's unfair business practices laws. It notes that in so holding, the court at the same time held that the Commission has broad authority under its regulatory statutes and regulations to achieve the same purposes as chapter 19.86 RCW.

The PUD Association argues that the Commission must use its authority to establish standards for competitive conduct comparable to those applicable under chapter 19.86, and must pursue a vigorous reporting and oversight program which includes investigating and adjudicating complaints by customers and competitors who are aggrieved by unfair, predatory, or anti-competitive policies and conduct. Otherwise, it argues, such aggrieved parties will have no state remedy for unfair and anti-competitive conduct. The PUD Association generally endorses the Stipulation's provisions regarding reporting and monitoring, but urges the Commission to add a requirement for an opportunity for interested parties to comment on the format and content of required annual reports dealing with market concentration and joint utility services, and for the Commission to order changes to the reporting requirements based on the comments.

4. Commission Discussion and Decision

The Commission agrees with the Joint Applicants that the new construction coordination directions requested by Seattle are beyond the scope of this proceeding. The Commission confirms that its prior safety orders for WNG will continue in force and effect for the merged company. Thus, the merger will not affect any replacement schedule obligation that WNG already has. A requirement to coordinate all construction with city utilities is unrelated to the merger, and Seattle did not identify any problems that have occurred.

In addition, the Commission will not grant Seattle's request for order language requiring PSE to comply with all city-imposed franchise conditions. Seattle's position appears to assume, incorrectly, that the determinative factor when there is a conflict between a city ordinance and Commission decision is which body acted first. If state law makes regulation of an activity the responsibility of the Commission, the fact that a city has undertaken to regulate the activity by entering into a franchise agreement or enacting an ordinance before the Commission acts to regulate the activity does not preempt Commission regulation. Commission action may abrogate provisions of existing franchise agreements. How a conflict between a franchise agreement and a subsequent Commission-approved tariff would be resolved would depend upon the circumstances of the case. See Seattle Elec. Co. v. Seattle, 78 Wash. 203 (1914); Edmonds v. General Telephone, 21 Wn.App. 218, 584 P.2d 458 (1978); King County

Department of Public Works, Solid Waste Division v. Seattle Disposal Company, Rabanco Ltd., d/b/a Eastside Disposal and Container Hauling, Docket No. TG-940411, Third Supplemental Order (September 1994).

Finally, with respect to state and federal antitrust laws, the ordering language that Seattle requests is inappropriate. With respect to the state antitrust laws, Seattle reads the state statute too narrowly. Regulated utilities are not exempted only with respect to a course of conduct which the Commission has explicitly authorized. Rather, actions and practices which are subject to regulation under Title 80 RCW are exempt from Chapter 19.86. Commission regulation replaces the remedies for unfair competition and practices provided in that chapter. The Stipulation provides reporting mechanisms that will allow the Commission to monitor the activities that Seattle identifies as of concern. To the extent competitive markets develop in the electric industry, the Commission will continue to review its role in the policing of anticompetitive behavior.

This Commission has no role in enforcing federal antitrust laws. We cannot enter an order that purports to exempt a regulated utility from the Sherman Act. The federal courts have held that anti-competitive conduct that a state clearly sanctions and actively supervises is immune from federal antitrust laws. Parker v. Brown, 317 U.S. 341 (1943); California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980); Federal Trade Commission v. Ticor Ins. Co., 504 U.S. 621 (1992). However, the test for determining immunity involves case-specific factual issues. See, Cost Management Services, Inc. v. Washington Natural Gas, Ninth Circuit, No. 95-35566, decided November 7, 1996; Columbia Steel Casting Co., Inc. v. Portland General. Electric, Ninth Circuit, Nos. 93-35902 and 93-35958, decided December 27, 1996.

Seattle's proposed ordering language does not appear to serve any purpose other than to advise the Joint Applicants that anticompetitive conduct of Commission-regulated utilities is not necessarily immune from federal antitrust laws. We assume that the Joint Applicants are aware of the law.

V. SUMMARY

Upon review of the proposed settlement and the record in this matter, the Commission is satisfied that the merger, provided that the terms of the Stipulation are adopted, is in the public interest and should be accepted. The parties are to be commended for their cooperative efforts in reaching a consensus regarding the issues in this proceeding. Of particular interest to the Commission is the commitment of the Joint Applicants to customer service. In an era of increasing competition and cost cutting, the Commission will be called upon to ensure that customer service does not suffer. The Commission also applauds the continued commitment to assisting low income demand side management.

The Commission has certain specific concerns, which we have addressed in the discussion of the Stipulation specifics. We expect that those terms can be incorporated into the parties' agreement.

The Commission authorizes the merger of WNG and WECo with and into Puget. The Commission authorizes the newly formed corporation to issue securities, assume obligations and adopt tariffs. The Commission accepts and approves the parties' stipulation resolving the issues presented in these applications.

A matrix of filings required by the Stipulation, this order, and of other active Commission proceedings is attached to this order as Appendix B. PSE faces great challenges and great opportunities. We wish it well in its endeavors.

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 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, property transfers, and mergers of public service companies, including electric companies and natural gas companies.

2. Puget Sound Power & Light Company (Puget) is engaged in the business of furnishing electric service within the state of Washington as a public service company. Washington Natural Gas Company (WNG) is engaged in the business of furnishing natural gas service within the state of Washington as a public service company.

3. On February 20, 1996, Puget and WNG jointly applied for an order of this Commission, under the provisions of Chapters 80.08 and 80.12 RCW, authorizing the merger of WNG and its parent company, Washington Energy Company (WECo), with and into the surviving company of Puget Sound Power & Light Company in accordance with an Agreement and Plan of Merger by and among Puget, WECo, and WNG dated October 18, 1995. The application was given Docket No. UE-960195. Puget and WNG are referred to in this order as the "Joint Applicants."

4. The plan of merger indicates that the subsidiary companies of Puget and WECo (other than WNG) will be subsidiaries of the merged company, that the merger will be effected through an exchange of stock, that the corporate headquarters and principal executive offices of PSE will be located in Bellevue, Washington, and that the merged company will operate as a combined gas and electric company. The surviving company will be renamed Puget Sound Energy (PSE).

5. Puget and WNG (Joint Applicants) should be authorized to: (1) merge the assets of these companies into the surviving company; (2) issue common and preferred stock in accordance with the terms of the merger agreement; (3) assume all obligations outstanding at the effective date of the merger and to continue and create liens in connection therewith; (4) adopt all tariff schedules and service contracts of WNG in effect at the time of the merger; (5) transfer to PSE all WNG certificates of public convenience and necessity; (6) implement a proposed rate stability plan; (7) establish certain accounting treatment for regulatory and ratemaking purposes for storm damage losses, conservation expenditures, environmental remediation costs, and proceeds from property transfers; (8) implement a proposed method of allocating costs between electric and gas operations; and (9) defer and amortize for regulatory and ratemaking purposes over the rate stability period of the merger any transaction and transition costs associated therewith.

6. Docket No. UE-951270 is a proposal by Puget to transfer to Puget's permanent rate schedules currently-collected revenue of approximately $165.5 million authorized in the PRAM (Periodic Rate Adjustment Mechanism) under Schedule 100. On April 10, 1996, the Commission ordered Docket No. UE-951270 consolidated with the merger application. The Seventh Supplemental Order in these consolidated dockets, entered September 26, 1996, granted a joint motion of Puget and Commission Staff to transfer for recovery under Puget's general rate schedules the amounts currently collected under Schedule 100, other than

PRAM deferral rate elements. The Seventh Supplemental Order resolved all outstanding issues in Docket No. UE-951270. Docket No. UE-951270 should be closed.

7. The Commission held 13 days of evidentiary hearings on the merger application during August and October 1996. It received the testimony of 34 witnesses for the parties and 18 public witnesses. It received over 150 letters from the public commenting on the merger application.

8. On December 11, 1996, the Joint Applicants, Commission Staff, and Public Counsel jointly filed a Stipulation for Commission consideration. The Stipulation would resolve all outstanding issues among the statutory parties. The Stipulation sets forth a five-year Rate Plan, proposals for the treatment of deferred regulatory assets, a customer service guarantee, a service quality index, agreement regarding regulatory initiatives during the Rate Plan period, and other agreements of the parties. On December 18, 1996, the Commission held a hearing for presentation of the Stipulation, for cross-examination of the proponents, and for additional testimony from members of the public. At that hearing, the Commission heard testimony from three witnesses, one each on behalf of the Joint Applicants, Commission Staff, and Public Counsel. The Commission also heard the testimony of seven members of the public, and received an additional illustrative exhibit of written public comments.

9. The merger, as proposed in the Stipulation and as conditioned by this order, will not harm customers by causing rates or risks to increase over what they reasonably could be expected to be in the absence of the merger.

10. The Stipulation, as conditioned by this order, provides reasonable assurance that service quality and reliability will not decline as a result of the merger.

11. The merger, with conditions required for its approval, strikes a balance between the interests of customers, shareholders, and the broader public that is fair and that preserves affordable, efficient, reliable, and available service.

12. The merger is reasonably conditioned to mitigate the loss of existing competition between the merging companies. It is reasonably conditioned to allow the Commission to monitor the merger's effect upon emerging competition.

13. The jurisdictional effect of the merger is consistent with the Commission's role and responsibility to protect the interests of Washington gas and electricity customers.

14. The rate increases provided in the Stipulation's proposed Rate Plan are cost justified and represent a fair sharing of the expected merger benefits between rate payers and shareholders.

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 merger of Washington Natural Gas Company (WNG) and its parent company, Washington Energy Company (WECo), with and into the surviving company of Puget Sound Power & Light Company (Puget), as provided in the Stipulation of the Joint Applicants, Commission Staff, and Public Counsel, and as conditioned by this order, is consistent with the public interest and should be approved.

3. All outstanding motions made in the course of this hearing which are consistent with the findings, conclusions, and decision herein should be granted, and those inconsistent therewith should be denied.

O R D E R

THE COMMISSION ORDERS:

1. The joint Stipulation submitted by Puget Sound Power & Light Company (Puget), Washington Natural Gas Company (WNG), Commission Staff, and Public Counsel is approved and adopted, with the terms and conditions stated in this order incorporated by reference. A copy of the Stipulation is attached to this order as "Appendix A" and is incorporated by reference.

2. The Commission authorizes and approves the merger of WNG and its parent company, Washington Energy Company (WECo), with and into the surviving company of Puget Sound Power & Light Company, in accordance with the Agreement and Plan of Merger by and among Puget, WECo, and WNG, dated October 18, 1995, conditioned upon the Terms of Approval set forth in the Stipulation filed by the Joint Applicants, Commission Staff, and Public Counsel.

3. The Commission expressly authorizes and directs the following:

a. The surviving company, which will be renamed Puget Sound Energy ("PSE"), is authorized to issue a sufficient number of shares of common stock, so as to give effect to the conversion of the then existing and issued common stock of WECo outstanding on the effective date of the merger; and a sufficient number of shares of Series II PSE Preferred Stock to effectuate the conversion of all outstanding shares of WNG preferred stock, all in accordance with the terms of the Merger Agreement.

b. PSE is authorized to assume the first mortgage bonds of WNG.

c. PSE is authorized to adopt all tariff schedules and service contracts of WNG on file with the Commission and in effect at the time of the merger for service within all territories served prior to the merger by WNG.

d. All certificates of public convenience and necessity of WNG are transferred to PSE.

e. Upon the merger, PSE shall succeed to all of the rights and responsibilities of WNG under the public utility laws of Washington and the orders of the Commission.

f. The Rate Plan set forth in the Stipulation shall be implemented.

g. The accounting treatment for regulatory and ratemaking purposes for certain regulatory assets set forth in the Stipulation shall be implemented.

h. The method for allocating costs between electric and gas operations and for accounting for intra-company transfers of natural gas set forth in the Stipulation shall be implemented.

I. A Customer Service Guarantee and Service Quality Index as set forth in the Stipulation shall be established.

j. PSE shall amortize the transition and transaction costs associated with the merger over the Rate Plan Period for regulatory and ratemaking purposes.

k. Fundamental changes in federal or state taxes occurring during the Rate Plan Period, and their regulatory and ratemaking treatment, will be treated as "carve out" issues to be addressed in a separate proceeding.

l. Puget shall file the rate changes identified in the Rate Plan in the Stipulation as occurring on February 1, 1997, as soon as possible, and no later than noon on February 10, 1997. The changes shall bear an effective date which gives Commission Staff 48 hours to review the changes. The refiled tariff pages should bear the notation that the pages are filed by authority of the Commission's Fourteenth Supplemental Order in Docket Nos. UE-951270 and UE-960195.

m. No later than December 31, 1997, PSE shall file cost of service studies of sufficient detail to support the unbundling of both electricity and natural gas local distribution and supply services.

n. Within 90 days of the date of this Order, PSE shall submit a compliance filing reflecting the parties' consultation on unresolved SQI issues that are identified in the Service Quality Index section of Appendix A (the Stipulation). All SQI issues that are unresolved at the time of the compliance filing should be submitted to the Commission for resolution as part of the compliance filing. Missed Appointments shall be addressed as provided in the Stipulation.

o. No later than April 1, 1997, PSE shall file its proposal regarding conservation programs it will undertake during the Rate Plan Period, including its proposal for a cost recovery mechanism thereon.

p. No later than October 15, 1997, PSE shall file its first Service Quality Index Report on Penalties, as agreed to in the Stipulation.

4. The compliance filings required by this order are strictly limited in scope to effectuate the terms of the Commission decision and order.

5. The Seventh Supplemental Order in these consolidated dockets, entered September 26, 1996, granted a joint motion of Puget and Commission Staff for authorization to transfer for recovery under Puget's general rate schedules the amounts currently collected under

Puget's Schedule 100, other than PRAM deferral rate elements. The Seventh Supplemental Order resolved all outstanding issues in Docket No. UE-951270, and this docket is closed.

6. All outstanding motions consistent with this order are deemed granted. Those inconsistent with this order are deemed denied.

7. The Commission retains jurisdiction over the subject matter and the parties to effectuate the provisions of this order.

DATED at Olympia, Washington, and effective this 5th day of February 1997.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

SHARON L. NELSON, Chairman

RICHARD HEMSTAD, Commissioner

WILLIAM R. GILLIS, 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 and WAC 480-09-820(1).