Title 97/12/10 Puget Sound Energy
Description Tenaska gas contract - 971619 by Roland Martin

Agenda Date: December 10, 1997
Item Number: 2A

Docket: **UE-971619**
Company Name: Puget Sound Energy

Staff: Thomas E. Schooley, Revenue Requirements Specialist
Roland C. Martin, Energy Regulatory Consultant

Recommendation:

Staff recommends the Commission approve Puget Sound Energy's (PSE, the Company) revised petition for an Order regarding the accounting treatment for the purchase of a gas sales contract.

Discussion:

History

The subject of this accounting petition is the gas supply contract of a power sales agreement between Puget Sound Power & Light Co. and a cogeneration plant. In Docket UE-921262, the Commission ruled this power sales agreement was imprudent and disallowed a small percentage of the power costs. (19th sup.) This petition does not foreclose any future discussion of the prudence of the power sales contract, nor does it foreclose any review of power cost allowances in future rate cases. Puget Sound Energy, as successor to Puget Sound Power & Light Co., agrees with this assessment.

The Petition

On November 10,1997, PSE filed a petition for an order regarding the accounting and rate making treatment for the costs to purchase a natural gas contract from the owner of a cogeneration facility. Discussions with Staff on December 5, 1998, resulted in acceptable revisions to the petition. Staff commends PSE on negotiating an agreement which reduces the total costs over the life of this power contract.

PSE requests that the identities of the parties to the transaction (other than PSE) and the terms of the transaction remain confidential. Specifically, PSE requests confidential treatment for the following:

- Exhibit A-the identification of the gas contract owner and supplier;
- Exhibit B-the calculation of proposed re-bundled power costs;

•Exhibit C-the letter of intent between PSE and the supplier;
•Exhibit D-the allocation of power cost savings;
•Exhibit E-the table of forward market gas prices;
•Exhibit F-the graph showing re-bundled power costs;
•Exhibit H-the expected financial impact of the requested accounting order;
•and Exhibit J- the amendment to the existing agreement.

The Company also requests the Commission issue its order within 30 days because the transaction is scheduled to close on or before December 31, 1997. The terms of the letter of intent terminate the transaction unless it closes by this date.

PSE's stated objective in entering into the agreement was to buy-out the gas supply contract in order to drive the gas cost element of the purchased power contract toward market at a price and at a time that provides maximum overall benefit to the Company and its customers. Based on a filed supporting exhibit (Exhibit B, revised), PSE asserts that the savings in power costs resulting from this transaction are substantial and that delay of the transaction lessens the value to all parties, including customers. This transaction concerns only the gas supply costs of the facility. PSE continues to pursue other mitigation possibilities related to this cogeneration plant.

PSE's accounting and rate making proposal stems from its desire to ratably allocate the savings across the years. To accomplish this PSE calculated the 14 year total savings, subtracted the cost to achieve the savings, and compared the difference to the 14 year total power cost. The resulting percentage was applied to each year's power cost which was reduced accordingly. This method lowers each year's power cost by the same percentage. The cost of money is assumed to be 8%.

The Company requests an accounting order that obtains the desired distribution of savings over time and satisfies financial reporting and accounting needs. The Company seeks authorization to:

(a) Capitalize, for recovery in rates, the purchase price paid for the gas supply contract;
(b) Begin amortizing principal balance in 1998;
(c) Earn a return at a 8% on one half the deferred balance for the first five years;
(d) Flow through the straight line tax amortization of the purchase price.

The methodology set forth above and in Exhibit H (revised) would be used in filings with the Commission.

In the letter of intent PSE indemnifies shareholders of the natural gas supplier for 50% of any increased tax liability from unfavorable federal income tax rulings. The Company's accounting petition requests that future rates be adjusted and the accounting be revised accordingly if that event occurs.

Staff Analysis

The fundamental threshold issue confronting Staff is the Company's request to obtain reasonable assurance from this Commission that the capitalized costs constitute an asset and that future revenue requirements will include the costs as allowable for rate making purposes. In other words, if this Commission allows the creation of a new regulatory asset, PSE is assured of the asset's recovery. Considering the dynamic changes in the utility industry, the movement toward competition, and the uncertainty of the resulting future form of regulation, Staff believes it is inadvisable for the Commission to authorize new regulatory assets. Staff continues pursuing the goal of early retirement of regulatory assets already on the books. Creating regulatory assets for recovery in future rates also presupposes no change in the Commission's approach to setting rates on cost-based rate making principles.

In this situation, however, the savings in gas costs more than offset the regulatory asset. Recognizing the cost to buyout the existing contracts still allows for future rate reductions, all else being equal. One fact facing PSE is the contract to purchase natural gas for this plant at constantly increasing prices. For PSE to escape this burden, and for it to take control of purchasing it's own gas supply, PSE must buy out the parties of the existing contract. PSE has successfully negotiated that buyout, and it is fair to spread the cost to do so over time.

Staff had further concerns about the specific rate making treatment requested in the original accounting petition. PSE presented those concerns to its auditors and successfully reached a plan acceptable to Staff.

As stated above, PSE reflects the power cost savings over the life of the contract on a proportional basis. Each year's power cost is reduced by the same percent. The Company implements this concept as follows. Amortization of the principal begins in 1998, all be it at a low level. This level is determined as the principal's proportionate amount of the total interest plus principal. The concept is the same one used in mortgage payments. During the first five years one-half of the interest is capitalized and added to the principal.

PSE requests a future adjustment to the total in the event that the tax indemnification provision, as mentioned previously, is invoked. There is no need to confirm this section at this time. It may be addressed when or if it occurs.

Therefore, Staff supports the petition to create this regulatory asset, accepts the revised accounting treatment for the regulatory asset, and recommends Commission approval.

Additional Information