

**BEFORE THE
WASHINGTON UTILITIES & TRANSPORTATION COMMISSION**

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

For an Accounting Order Authorizing the
Appropriate Tracking of Treasury Grants
Received Under Section 1603 of the American
Recovery and Reinvestment Act of 2009
Associated with the Wild Horse Expansion
Project

Docket No. UE-09_____

PETITION OF
PUGET SOUND ENERGY, INC.
FOR AN ACCOUNTING ORDER

I. INTRODUCTION

1. In accordance with WAC 480-07-370(b), Puget Sound Energy, Inc. ("PSE" or the "Company") respectfully petitions the Commission to issue an order authorizing the appropriate tracking of grants that PSE expects to receive from the U.S. Treasury Department ("Treasury") under Section 1603 of the American Recovery and Reinvestment Act of 2009 ("ARRA") associated with the Wild Horse Expansion Project. Treasury grants are tax free grants that are

available in lieu of the production tax credit ("PTC") allowed under Section 45 of the Internal Revenue Code ("IRC").

2. PSE is engaged in the business of providing electric and gas service within the State of Washington as a public service company, and is subject to the regulatory authority of the Commission as to its retail rates, service, facilities and practices. Its full name and mailing address are:

Puget Sound Energy, Inc.
Attn: Tom DeBoer,
Director, Federal and State Regulatory Affairs
P.O. Box 97034
Bellevue, Washington 98009-9734

3. Rules and statutes that may be brought at issue in this Petition include RCW 80.01.040, RCW 80.28.020, and WAC 480-07-370(b).

II. BACKGROUND

4. The PTC is an incentive provided by the U.S. Government under section 45 of the IRC for the construction and operation of renewable energy resources such as wind generation facilities. The amount of the incentive is currently 2.1 cents per kilowatt hour for wind generation and is adjusted over time for inflation. This incentive can be claimed for wind generation from a qualifying facility during the initial ten years of commercial operation of the project. The qualifying facility must be placed in commercial service prior to January 1, 2013. The PTC is based on the actual generation from the qualifying facility.

5. The use of the PTC is restricted under IRC rules in that it can only be used to reduce a taxpayer's current taxes payable to either (a) 75% of the taxpayer's tax payable before considering the credit or (b) the level of the alternative minimum tax, whichever causes the taxpayer to pay more tax. To the extent that a taxpayer has excess PTCs (*i.e.* PTCs that cannot be utilized in the current year), the unused PTCs can be carried back one year and forward for up to twenty (20) years.

6. To flow the PTC benefit through to the customer, the Company uses Schedule 95A, a rate tracker that passes through to the customer the actual PTC benefits as they are generated by the Company. This tracker is used so that the PTCs are not subject to the sharing bands in the Power Cost Adjustment ("PCA") mechanism. The amount of PTC benefits passed through to customers is adjusted by the carrying costs of the PTC-related cash advanced to customers but that have not been utilized to reduce the Company's tax payment to the Internal Revenue Service ("IRS"). Since the customer receives the cash benefit of the tax credits when they are generated, even though the Company does not receive a credit from the IRS until the tax credits are utilized, the Company is reimbursed its carrying costs on cash advanced to customers through this calculation.

7. Through June 30, 2009, the Company has passed through to customers \$61.2 million of cash benefits and has only been able to use \$24.0 million as a credit to reduce tax payments with respect to the electricity generated from wind farms that qualify for the PTC. It is expected for the foreseeable future that the difference between the PTCs generated from the Company's existing wind projects will continue to be greater than the amount of PTCs that the

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Company will be able to utilize as a credit against its federal income tax liability. This difference is caused by the taxable income limitations described above.

8. The inability to use PTCs in a timely fashion has raised significant concerns in Congress as to how to encourage development of renewable energy facilities. This concern was heightened, particularly in light of the economic downturn that reduced the taxable incomes of many energy companies. Congress was concerned that the PTCs, as a tax subsidy, required taxpayers to have significant positive taxable incomes in order to stimulate their investment in alternative or renewable energy projects. Congress addressed this concern in the ARRA by, in relevant part:

- Allowing taxpayers the right to forego claiming the PTC and, in lieu thereof, to elect to receive (a) a nontaxable cash grant from the Department of Treasury or (b) an investment tax credit (“ITC”), in each case equal to thirty percent (30%) of the amount of their qualifying investment in eligible facilities, including wind farms, provided certain time deadlines can be satisfied in each case; and
- Reducing the amount of accelerated tax depreciation available for the renewable energy facility by an amount equal to one half of the cash grant received or the ITC claimed.

9. Upon review of these new incentives in relationship to the PTCs previously available, the Company concluded that claiming the ITC would have a similar problem to the PTCs as it could only be used if a taxpayer had sufficient taxable income. Since the Company was already experiencing a tax credit restriction, the ITC would have a limited benefit to the Company and its customers. The use of ITCs by a utility would require normalization of the ITC under Section 50 of the IRC which, taking into account application of the sections cross

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referenced therein, would require a utility to normalize the benefit of the ITC over the book life of the plant through either a rate base offset or amortization of the benefit to cost of service, but not both. Assuming no tax appetite restriction, this requirement reduces benefits to the customers of a utility claiming the ITC instead of the PTCs since the ITC is required by the IRC to be normalized over twenty-five (25) years in the case of wind plant, whereas (as noted above) taxpayers have been able to flow through the PTCs to customers over the ten-year period during which the PTCs are claimed.

10. The language in the ARRA relating to the rules pertaining to the normalization of Treasury grants is less restrictive than the existing rules pertaining to the normalization of ITCs. Section 1603(f) provides:

In making grants under this section, the Secretary of the Treasury shall apply *rules similar to the rules of section 50* of the Internal Revenue Code of 1986. In applying such rules, if the property is disposed of, or otherwise ceases to be specified energy property, the Secretary of the Treasury shall provide for the recapture of the appropriate percentage of the grant amount in such manner as the Secretary of the Treasury determines appropriate. (emphasis added)

The guidance subsequently issued by the Treasury to implement Section 1603 of the ARRA refers taxpayers to “see” former section 46(f) of the IRC (the ITC normalization rules, which are referenced by section 50 of the IRC) for guidance with respect to the normalization of the grant; it does not specifically require taxpayers to use the normalization periods set forth therein.

11. Representatives of the Company met with Treasury representatives shortly prior to the issuance of the foregoing guidance, and Treasury provided some informal and non-binding responses to PSE's questions regarding normalization of Treasury grants. The Treasury

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representatives indicated that some type of ITC normalization option would be required. The Treasury representatives did appear receptive to an interpretation of section 1603 that would permit a ten year normalization period as the grant is a substitute for a taxpayer claiming the PTCs as these are earned over the first ten years of a qualifying wind plant. While there is no conclusive authority on point, the view that the requirements of Section 1603 and the Treasury guidance permit a ten year normalization of the grant is reasonable, consistent with the policies of the ARRA, and this would be beneficial for customers. This view is supported by the fact that, even though the grant is determined in a manner substantially similar to the manner in which the ITC is calculated, the grant essentially acts as a substitute for the PTC since the taxpayer must elect to forego the PTC as a prerequisite to claiming the grant.

12. Attachment A to this Petition provides an analysis of the benefits associated with a Treasury grant versus the benefit associated with PTCs for the Wild Horse Expansion Project, assuming that the Treasury grant is normalized by either flowing through the benefit of the Treasury grant over ten years or offsetting the benefit of the Treasury grant against ratebase and restoring to rate base such amount on a ratable basis over a ten year period. These options are analyzed because under ITC normalization, a utility only has these two types of normalization available to choose from. As shown on this analysis, 96% of the cost associated with the Wild Horse Expansion is expected to be eligible to receive a grant. These are the costs that are directly related to the wind turbines and do not include infrastructure costs.

13. The Treasury grant is calculated at 30% of the eligible costs, which for the Wild Horse Expansion is equivalent to \$29.4 million dollars. As shown on Attachment A, the

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customer receives the most benefit by normalizing the grant and amortizing the benefit to cost of service over ten years. The net present value of this option is ~~\$30.2~~ 23.5 million, after taxes. This compares favorably to the ratebase offset benefit of ~~\$44.8~~ 12 million, after taxes, or PTCs of ~~\$23~~ 22.4 million, after taxes and before carrying costs.

14. Upon placing the Wild Horse Expansion in service in November 2009, the Company plans to apply for the Treasury grant. In the Company's application, the method of normalization--amortization of the grant to cost of service over ten years--will be explained to the Treasury. The Company hopes to include with its application a Commission order from this Docket accepting this normalization methodology, to show that the Company has Commission approval to apply this normalization methodology for the Treasury grant.

III. REQUESTED ORDER

15. The Company proposes that the Treasury grant received for the Wild Horse Expansion Project be amortized equally over the first ten years that the Wild Horse Expansion is in-service with no rate impact for the remaining balance of the deferred grant, as specified under ITC normalization rules. The customer benefit of this amortization will be included in Schedule 95A, the rate tracker that currently passes through to the customer the actual PTCs as they are generated. Please see Attachment B to this Petition for the proposed changes to Schedule 95A so that it properly describes the treatment of Treasury grants. By this Petition, the Company requests that the Commission approve the accounting and ratemaking treatment regarding

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Treasury grants received for the Wild Horse Expansion Project and the proposed changes to Schedule 95A.

IV. PROPOSED ACCOUNTING AND RATEMAKING TREATMENT

16. The Company proposes that upon receipt of the Treasury grant that a liability will be credited to Account 228.4, Accumulated miscellaneous operating provisions. For the first ten years of operation, one-tenth of the amount originally credited to Account 228.4 will be transferred to Account 242, Miscellaneous current and accrued liabilities. This transferred amount will be included in the Schedule 95A tracker calculation and passed through to customers on an annual basis.

17. The remaining balances in Account 228.4 and Account 242 will be included in the ~~nonoperating~~ Average Invested Capital section of the working capital adjustment for electric operations so that there is no ratebase offset for ratemaking purposes. This working capital treatment is necessary to comply with the ITC normalization rules that apply to the Treasury grants.

V. PRAYER FOR RELIEF

18. Based on the foregoing, PSE respectfully requests that the Commission issue an Accounting Order in the form attached hereto as Attachment C.

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DATED this 30th day of September 2009.

PUGET SOUND ENERGY, INC.

By Tom DeBoer
Tom DeBoer, Director, Federal and State
Regulatory Affairs

