

Exhibit ___ (JMR-4)
Docket No. UG-040640, et al.
Witness: James M. Russell

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY, INC.

Respondent.

DOCKET NO. UG-040640
DOCKET NO. UE-040641
(consolidated)

EXHIBIT TO TESTIMONY OF

JAMES M. RUSSELL

STAFF OF THE WASHINGTON UTILITIES
AND TRANSPORTATION COMMISSION

UE-032043 White River Accounting Petition

September 23, 2004

Agenda Date: April 28, 2004
Item Number: A4

Docket: UE-032043
Company: Puget Sound Energy

Staff: Merton Lott, Energy Industry Coordinator

Recommendation:

Enter an order consolidating the unresolved issues in this accounting petition with Puget Sound Energy's (PSE) general rate case in Docket UE-040641.

Discussion:

On December 10, 2003, PSE filed an accounting petition requesting ratemaking treatment of the costs associated with its White River Hydroelectric Project. At that time, PSE anticipated the project would be retired on January 15, 2004. This project is no longer in service. The Company's petition seeks treatment of three different categories of costs: 1) the undepreciated plant in service at time of the retirement on January 15, 2004; 2) operating expenses related to obtaining the water rights and other efforts to maximize the salvage of the facility; and 3) costs that had been capitalized in construction work in progress (CWIP) associated with PSE's effort to continue operating the project. The petition also addresses treatment of the salvage related to the project including the associated water rights.

At the time PSE filed the accounting petition on December 10, 2003, it had also filed its power cost only rate case (PCORC) (Docket UE-031725). In PSE's original presentation in that proceeding, PSE removed 100% of its investment in the White River Project from the rate base, and excluded the depreciation expense from its results of operations. After discussions with Staff, PSE agreed to revise its presentation and include the undepreciated plant in service in rate base as a power supply cost. The agreement, as testified to by Mr. Story and Mr. Russell in that proceeding, is to carry this undepreciated balance as a regulatory asset for purposes of the power cost adjustment (PCA). Amortization of this undepreciated balance was to continue at the level being incurred prior to plant retirement.

Staff and the company also agreed that the salvage and or sale of water rights would be treated as a credit to this balance, and that the costs incurred to maximize these credits after retiring the project should be netted against the salvage. While there was an agreement on these last two items, these issues did not call for resolution in the PCORC as they have no revenue impact in the PCORC.

Undepreciated plant in service

As indicated above, both PSE and Staff have proposed that the Commission order in PCORC should resolve the accounting treatment of the undepreciated plant in service of White River project. The treatment proposed by PSE and Staff is to include the unamortized portion of the plant in rate base as a regulatory asset and treated similarly in the PCA process as other regulatory assets, e.g. BEP, Tenaska, and Cabot. Amortization of the undepreciated balance would continue at the level being incurred prior to plant retirement.

Salvage

Mr. Story also proposed treatment of the salvage of the project in the PCORC, but no order concerning the treatment of salvage is required in that proceeding. As proposed by Mr. Story in the PCORC any benefits derived from salvage will be used to adjust the deferred undepreciated balance of the White River project. Staff agrees with the proposed treatment for the salvage. Staff notes that it is possible that the salvage may actually exceed the deferred balance of the project thus creating a deferred liability. Any such a liability would need to be addressed in a future rate proceeding. It is the responsibility of PSE to manage these costs in a prudent fashion in order to maximize the net salvage of the facility. The prudence of these actions will be reviewed in a future proceeding.

Cost to maximize the salvage of the retired project

As indicated in Mr. Story's testimony in the PCORC proceeding, the deferred balance of the facility would be adjusted not only by the salvage but also by the Commission approved costs associated with obtaining salvage or selling water rights. Staff would agree that it is appropriate to net the salvage with the direct uncapitalized costs, incurred after retirement of the project, to obtain that salvage. Thus subject to prudence review of PSE's efforts and assignment of

direct costs, it is appropriate to adjust salvage by the direct costs required to obtain the salvage.

Costs that had been capitalized in construction work in progress

In PSE's petition there is approximately \$21,200,000 associated with the Company's attempt to relicense or maintain the White River Project, which PSE booked into construction work in progress (CWIP). In response to an informal Staff data request, this amount is revised to \$20,500,000, which includes \$5,900,000 of allowance for funds used during construction (AFUDC). Since these costs were considered CWIP during the period of their accrual, the decision to cancel the project results in abandoned plant. Staff agrees that it is appropriate for PSE to propose recovery of any abandoned project costs in a general rate proceeding.

Staff's recommendation is that the Commission consolidate any remaining issues into the general rate proceeding, Docket UE-040641. In the general rate case, several issues will need to be addressed: 1) prudence of the costs incurred, 2) whether the costs were properly recorded in the financial statements, i.e. capitalized as opposed to expensed, 3) whether the expenditures capitalized are properly classified as CWIP, 4) whether it was appropriate or not to accrue any AFUDC included in the balance, and 5) assuming all else, what is the proper sharing of the costs between shareholders and ratepayers of this abandoned project.

It should be noted that there has been several different proposals and Commission decisions for the rate treatment of abandoned projects. Most notably the Commission treated the prudent portions of the abandoned nuclear projects by sharing the cost of the abandonment between shareholders and ratepayers in an approximately 50/50 ratio. This sharing was accomplished by amortizing the prudent portion of the costs over a ten-year period. In essence, the capital costs are returned without carrying costs. Other projects were written off with no recovery, while still other projects, usually small projects often booked in the preliminary survey account, are expensed in the test period.

The Company in consultation with its auditors will need to determine whether it should retain any assets fully or partially on its financial books and records.

There are several accounting statements including FAS 71, 90, and 144 impacting this decision by the Company.

Conclusion:

Staff recommends that the Commission enter an order consolidating the unresolved portions of this petition with the proposed general rate proceeding in Docket UE-040641.

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STATE OF WASH.
UTIL. AND TRANSP.
COMMISSION

**BEFORE THE
WASHINGTON UTILITIES & TRANSPORTATION COMMISSION**

In the Matter of the Petition of
PUGET SOUND ENERGY, INC.

For an Accounting Order Authorizing
Deferral and Recovery of Investment and
Costs Related to the White River
Hydroelectric Project

Docket No. UE-032043

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

I. INTRODUCTION

1. In accordance with WAC 480-09-420(7), and because of the impending early retirement of its White River Hydroelectric Project ("Project"), Puget Sound Energy, Inc., ("PSE" or the "Company") respectfully petitions the Commission for an order that authorizes:

- Deferral of the net book value of the Project plant and recovery of such amounts in PSE's rates and through continued inclusion in PSE's variable rate base and amortization, over ten years, in the Power Cost Adjustment mechanism; and

ORIGINAL

- Deferral of costs associated with PSE's efforts to obtain a FERC license for the Project, to fulfill safety and/or regulatory requirements, to obtain a water right to offset the cost of operating the Project or increase the potential salvage value of the Project, and related costs, for recovery of such prudently-incurred costs in future electric rates as determined in PSE's next general rate case.

Because PSE anticipates ceasing generation of electricity at the Project on January 15, 2004, and to ensure an orderly transition in PSE's books from plant asset to regulatory asset, PSE asks that the Commission issue the requested order by January 15, 2004.

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: John H. Story,
Director, Cost & Regulation
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 480-09-420(7).

II. BACKGROUND

A. Retirement of the White River Hydroelectric Project

4. The Project was built in 1911 and has been in continuous operation ever since. The Project diverts water from the White River to Lake Tapps, a man-made reservoir, and from this reservoir, water is released to generate electricity and is then discharged back into the White River. The Project generates electricity with an annual average output of approximately 35 megawatts.

5. The Project diverts water from the White River in quantities that are sufficient to fill and maintain the Lake Tapps reservoir. The reservoir is a regional resource, supporting a variety of public benefits. However, the reservoir would not and will not exist unless the hydraulic functions of the Project are maintained (i.e., diversion, storage and discharge).

6. For many years, the Project was believed to fall outside of the jurisdiction of the Federal Power Act. This question was litigated and resolved in the 1970s, establishing FERC's jurisdiction over the Project. PSE submitted a license application to FERC in December 1983.

7. In December of 1997, FERC issued a proposed license for the Project ("1997 License"). The Company did not accept, and appealed, the 1997 License because it contained terms and conditions that would render ongoing operations of the Project uneconomic relative to alternative resources. Various natural resource agencies also appealed the 1997 License, including NOAA Fisheries ("NOAA Fisheries" or "NMFS"), U.S. Fish and Wildlife Service, Washington State Department of Fish and Wildlife and Washington State Department of Ecology ("Ecology").

8. Subsequent to the appeal of the 1997 License, PSE, local citizens and state and local elected officials initiated a collaborative settlement process, inclusive of all interests concerned about preserving the Lake Tapps reservoir. To facilitate this collaborative process, FERC issued a two-year stay of the 1997 License order and related appeals.

9. One of the tasks that needed to be completed during the two-year stay was completion by NMFS of a biological opinion, in order to determine the measures that PSE would be required to undertake if a settlement were to be structured around a FERC

license. Unfortunately, NMFS did not complete its biological opinion during that two year time period, and the parties were also unable to complete other tasks related to potential settlement.

10. In 2001, the parties sought and FERC granted a second two-year stay of the litigation, through June 30, 2003. In October of 2002, NOAA Fisheries completed a preliminary draft Biological Opinion. In the view of PSE and many other stakeholders, this draft contained conditions that rendered the hydropower project uneconomic and proposed flow restrictions that threatened the very existence of Lake Tapps. In response to the preliminary draft biological opinion, stakeholders provided NOAA Fisheries with detailed recommendations for further consideration. In June of 2003, FERC granted a further extension of the stay, giving the parties until January 15, 2004 to complete a settlement agreement. A copy of FERC's June 26, 2003 Order Granting Extension of Stay is attached hereto as Exhibit A.

11. PSE initially approached the collaborative with the purpose and expectation of licensing the existing hydroelectric project. PSE hoped that, through the collaborative, alternative conditions for a FERC license could be developed that would preserve the Project as an economic resource within its electric generation portfolio. However, PSE recognized that the existing infrastructure (e.g., dams, dikes, flowlines) also has value derived from the many benefits the Lake Tapps reservoir provides to the region. Moreover, the existence of the reservoir (and the continued operation of the infrastructure that maintains the reservoir), unlike operation of a hydroelectric project at the reservoir, is not dependent upon a FERC license.

12. As the collaborative process moved forward, water purveyors in the central Puget Sound area began expressing interest in the Lake Tapps reservoir as a potential

source of drinking water for the Seattle/Tacoma metropolitan areas. However, Ecology viewed the Project's existing water right as a "non-consumption" right that could not be changed to a consumptive use. Therefore, in order to realize the potential of the reservoir as a resource for drinking water, and to add another source of revenue to offset the cost of operating the Project, PSE applied for a new water right for municipal water supply purposes. PSE owns the reservoir, and therefore was the only party with a sufficient property interest to pursue this application. This allowed water purveyors to be brought into the collaborative and, in effect, become part of the solution to the economic problems threatening the existence of the Lake Tapps reservoir.

13. On June 30, 2003, Ecology issued a water right to PSE. With the new water right in hand, PSE was able to negotiate a Letter of Intent ("LOI") to sell the new water right to a consortium of municipalities, Cascade Water Alliance ("Cascade"), who wanted to develop the reservoir as a municipal water supply. A copy of the LOI, as amended, is attached hereto as Exhibit B. Cascade and PSE originally intended to finalize their negotiations before the end of 2003, but appeals of the water right must be resolved before a sale of the water right can be completed.

14. In November of 2003, NOAA Fisheries issued a revised Biological Opinion that does not differ materially from its prior draft. As with the preliminary draft issued in October of 2002, the collaborative concluded that the economic impacts of the conditions required in the Biological Opinion still rendered the hydropower facility economically infeasible. The collaborative concluded that the concerns they had previously raised with respect to the earlier draft had not been addressed or answered, and that its members would be better served by turning their attention to a settlement option that does not include generation of hydropower or a FERC license in the near term. The collaborative

has now turned its full attention to developing a non-power option that preserves the Lake Tapps reservoir.

15. In light of this development, the Company has concluded that it is unlikely that a settlement addressing the deficiencies of the 1997 License will be reached before the stay expires. As of January 15, 2004, PSE will be unable to generate hydroelectric power at the Project unless it begins to make significant and expensive investments in the Project consistent with conditions required in the 1997 License. PSE thus anticipates advising FERC in January that it intends to reject the 1997 License, withdraw its license application and discontinue the generation of electricity at the Project.

16. In order for the U.S. Army Corps of Engineers ("the Corps") to trap and haul endangered Puget Sound Chinook salmon above its Mud Mountain dam flood control project, PSE is working with the Corps, NOAA Fisheries and others to develop and implement a plan for interim non-power operations. PSE also advised the collaborative that it will take at least until January 15, 2004 to put such a plan in place.

17. The possible outcome of these various negotiations and discussions is uncertain at this time. The Company's goal is to maximize the value of the Project assets as an offset to costs that still need to be recovered. However, in any event, it is unlikely that the Project will be in service as a generation resource of the Company after January of 2004.

18. Although PSE's twenty-year effort to obtain an economic FERC license for the Project has now ended without the issuance of a license that will permit continued generation of hydroelectric power at the Project, PSE's efforts have enabled the Company to continue to generate relatively inexpensive power for its ratepayers many years longer than would have been possible without PSE's efforts and related investments. Moreover,

PSE's efforts to obtain a water right will likely result in continued value to PSE's ratepayers from the Project in the future and/or a significant increase in the salvage value of the Project.

B. Current Accounting and Ratemaking Treatment

19. The Project has been part of the Company's rate base for decades. The Company's net plant investment in the White River Plant at September 30, 2003 consists of \$47.7 million of net book value of plant in service, recorded in FERC Account No. 101, Plant in Service and FERC Account No. 108, Accumulated Provision for Depreciation.

20. In its Power Cost Only Rate Case ("PCORC") filed on October 24, 2003, Docket No. UE-031725, the Company assumed for purposes of forecasting its Power Cost Adjustment (PCA)-related power costs that the Project would be retired. For consistency, the Company also removed the book capital associated with the Project from its ratebase. At the same time, the Company indicated that it intended to petition the Commission for an accounting order in the fourth quarter of 2003 to request authorization for appropriate accounting and ratemaking disposition of this plant. See Docket No. UE-031725, Direct Testimony of William A. Gaines dated Oct. 24, 2003, at 25-26; Direct Testimony of John H. Story dated Oct. 24, 2003, at 8.

21. The Company has also incurred approximately \$21.2 million of costs associated with its efforts to obtain a FERC license for the Project, to fulfill safety and/or regulatory requirements to ensure continued operation of the plant through the licensing process, to obtain the water right discussed above, and related costs. To date, these costs have been recorded in FERC Account 107, Construction Work in Progress.

III. PROPOSED ACCOUNTING & RATEMAKING TREATMENT

A. Net Plant Investment

22. Regarding the Company's White River Project net plant investment, in FERC Account No. 101, Plant in Service, and FERC Account No. 108, Accumulated Provision for Depreciation, effective January 15, 2004, the Company proposes to:

- Defer, to FERC Account No. 182.2, Unrecovered Plant and Regulatory Study Costs, its net plant investment.
- Amortize the deferred balance to FERC Account No. 407, Amortization of Property Losses, Unrecovered Plant and Regulatory Study Costs, over ten years and include this amortization in the Power Cost Rate under depreciation – production plant (line 23). Such amortization shall commence no sooner than the implementation of the PCORC rate as determined in Docket No. UE-031725.¹
- Reduce the unamortized amount of the deferred costs by any recoveries and/or salvage realized relative to the White River Project plant investment.
- Include the unamortized balance in rate base in the Company's Power Cost Adjustment mechanism, as a regulatory asset; the return on which is considered to be a variable cost in the PCA mechanism.

23. Under the circumstances outlined above, the foregoing accounting and ratemaking treatment is reasonable and in the public interest and should be approved. Circumstances outside the Company's control will require the forced early retirement of the Project for hydroelectric generation by PSE. However, the Company has long been recovering its investment in and a return on the White River Project, and the plant has

¹ The Company has \$1,366,744 of fixed annualized depreciation/amortization expense in its current Power Cost Rate. As part of the current rate, this amount will be in effect until the Power Cost Only Rate Case rate is implemented.

substantially benefited the Company's ratepayers. Moreover, the plant will likely continue to provide benefit to ratepayers through the water right the Company has obtained or otherwise, depending on the outcome of ongoing negotiations.

B. Relicensing, Safety and/or Regulatory and Salvage Costs

24. Regarding its investment related to costs associated with PSE's efforts to obtain a FERC license for the Project, to fulfill safety and/or regulatory requirements, to obtain a water right to offset the cost of operating the Project or increase the potential salvage value of the Project, and related costs, the Company proposes to:

- Defer such costs, in FERC 182.3, Other Regulatory Assets, for review at the time of the Company's next general rate case, with prudently-incurred costs to be recovered in rates at that time. Such costs are approximately \$21.2 million at present. PSE also intends at that time to add these costs to its ratebase for treatment in the same manner as the net plant investment, described above.
- Include in the deferral future external costs related to the Company's effort to acquire and transfer a new municipal water right associated with the Lake Tapps reservoir.
- Reduce the unamortized amount of the deferred costs by any recoveries and/or salvage realized relative to the regulatory costs incurred associated with the White River Project.

25. The foregoing accounting treatment with respect to amounts currently accounted for as relicensing and salvage costs is also reasonable and in the public interest and should be approved. PSE's expenditure of these costs has allowed the Project to remain in service during the past two decades and has increased the potential salvage value of the Project. However, unlike the plant costs, the Commission has not yet had the opportunity to fully review these costs. PSE is proposing a deferral of the costs pending review of such costs in the next general rate case to be filed by the Company, so that the

Commission has the opportunity at that time to determine whether any such costs are unreasonable or imprudent such that they should be disallowed.

26. The Company provides illustrative journal entry examples of its proposed accounting and ratemaking treatment of the White River Project plant and regulatory costs outlined above in Exhibit C attached hereto.

IV. PRAYER FOR RELIEF

27. Based on the foregoing, PSE respectfully requests that the Commission issue an Accounting Order in the form attached as Exhibit D.

DATED this 10th day of December, 2003.

PERKINS COIE LLP

By 

Kirstin S. Dodge, WSBA #22039
Attorneys for Puget Sound Energy, Inc.

LIST OF EXHIBITS

**EXHIBIT A: FERC's June 26, 2003 Order
Granting Extension of Stay**

**EXHIBIT B: August 28, 2003 Letter of Intent
between PSE and Cascade Water Alliance**

EXHIBIT C: Illustrative Journal Entry Example

EXHIBIT D: Proposed Order

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Project No. 2494-028

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103 FERC * 61, 357
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

Puget Sound Energy, Inc

Project No. 2494-028

ORDER GRANTING EXTENSION OF STAY

(Issued June 26, 2003)

1. This order grants Puget Sound Energy, Inc.'s (Puget) June 13, 2003 request for a six-month extension of the current stay of Puget's original license for the White River Project No. 2494 in order to give participants to the license proceeding additional time to negotiate a settlement proposing revised license terms.

BACKGROUND

2. The Commission issued an original license for the existing 70-megawatt White River Project on December 13, 1997.[1] Puget filed a request for rehearing, asserting that the costs of operating the project under the terms of the license might cause it to retire the project rather than accept the license. Federal and state fish and wildlife agencies also filed rehearing requests, urging additional protection and enhancement measures.

3. After the license was issued, the Puget Sound chinook salmon and the Coastal-Puget Sound population segment of bull trout were listed as threatened species pursuant to the Endangered Species Act (ESA). These listings, added to Puget's concerns about project economics, led Puget to request a two-year stay of the license, and concurrent deferral of Commission action on the rehearing requests, to allow Puget to undertake settlement discussions with the participants to the license proceeding, with the goal of developing revised license terms to better accommodate developmental and environmental objectives. A key issue is the future of the project reservoir, the 2,700-acre Lake Tapps, which is the fourth most popular recreational resource in

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the State of Washington and a source for meeting the region's growing municipal water supply demands.[2] Puget stated that while the license was stayed it would take voluntary interim measures to protect the threatened species. NMFS, FWS, the Washington Department of Fish and Wildlife (Washington DFW), and the Muckleshoot Indian Tribe (Tribe) generally supported the stay.

4. On July 30, 1999, the Commission granted the stay, with a requirement that Puget file quarterly reports of its progress toward reaching a settlement.[3] In November 2000, the parties arrived at an Agreement in Principle. On June 28, 2001, the Commission granted Puget's May 3, 2001 request for a two-year extension of the stay.[4] As extended, the stay is in effect through June 30, 2003.

5. On June 13, 2003, Puget, with the support of the Lake Tapps Task Force,[5] filed a motion requesting extension of the stay through December 31, 2003. Comments in support of the stay were filed by the Governor of the State of Washington; members of the State and United States legislatures; Washington agencies, counties, municipalities, associations, corporations, and individuals; and NMFS and the U.S. Army Corps of Engineers (Corps).

6. Puget attached to its June 13, 2003 filing the outline of an overall settlement and the current draft of revised license articles, together with the parties' proposed schedule for resolving the three key issues that remain outstanding. According to Puget and the supporting commenters, an additional six months is needed to complete the agreement, which is now largely contingent upon actions expected to be taken before the end of the year by NMFS, the Corps, and the Washington Department of Ecology. Puget states that NMFS expects to issue a final biological opinion under the ESA on the relevant chinook salmon populations by the end of September 2003; the Corps will report on the extent of its participation in the repair of the project diversion dam, which is needed for the operation of the Corps' upstream fishtrap facility; and the Washington Department of Ecology will issue a water right for Lake Tapps water to be used for municipal water supply purposes.

7. Puget and the Lake Tapps Task Force argue that failure to extend the stay would undermine four years of hard work by the settlement participants, who would suffer irreparable injury, including the potential loss of Lake Tapps, were Puget to retire the project rather than operate it at a loss under the terms of the stayed license. On June 23, 2003, supporters of the motion

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and other interested entities participated in a public meeting at the Commission's headquarters on the status of completing a settlement agreement.

DISCUSSION

8. Puget and the Lake Tapps Task Force have demonstrated continued substantial progress toward reaching a settlement agreement on very difficult issues regarding the future use in the public interest of the significant water resources currently used by the White River Project. The settlement discussions continue to enjoy broad support among the participants, and Puget continues its voluntary measures during the stay on behalf of the listed species and other fish and wildlife resources. While we are loath to defer yet again the implementation of the license and all its conditions on behalf of environmental and other resources, we conclude that, on balance, the likelihood of a successful conclusion of a widely supported settlement agreement in this controversial case justifies extending the stay by another six months. [6]

9. In order that the Commission may be promptly informed of breaking developments in the settlement process, we are requiring Puget to file monthly progress reports, and in three months Commission staff will convene a meeting or teleconference with Puget and interested parties to discuss progress on the few remaining issues.

The Commission orders:

(A) Puget Sound Energy Inc.'s June 13, 2003 motion for a six-month extension of the stay of the license for White River Project No. 2494 is granted. The stay shall remain in effect through January 15, 2004, unless the Commission orders otherwise.

Project No. 2494-028

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(B) Puget Sound Energy, Inc., shall file monthly progress reports describing developments toward completion of a settlement proposal in this proceeding.

By the Commission.

(S E A L)

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Magalie R. Salas,
Secretary.

Footnotes

[1]81 FERC * 61,354 (1997). The project is located on the White River in King and Pierce Counties, Washington.

[2]Puget's June 13, 2003 filing at 4.

[3]88 FERC * 61,143 (1999).

[4]95 FERC * 61,453 (2001). The quarterly reporting requirement continued to apply.

[5]The Lake Tapps Task Force, while not a party in its own right, includes representatives of Puget, the Commission, various federal, state, and local government agencies, the Tribe, and other interested organizations and individuals who are participating in the settlement process.

[6]We are in fact extending the stay until January 15, 2004.



August 28, 2003

Grant Degginger
Chair of Board of Directors
Cascade Water Alliance
1309 114th Avenue SE
Bellevue, WA 98004

Re: Proposal to Acquire Certain Water Rights Assets

Dear Mr. Degginger:

The purpose of this letter (this "*Letter*") is to set forth certain nonbinding understandings and certain binding agreements between Puget Sound Energy, Inc., a Washington corporation, ("*PSE*") and Cascade Water Alliance, a Washington nonprofit corporation, ("*Cascade*") with respect to Cascade's possible acquisition of the Lake Tapps/White River water rights for municipal water supply and other assets needed to put those water rights to beneficial use (collectively, "*Project Assets*"), which rights and assets will be more particularly described in the fully integrated definitive written agreement to be negotiated and entered into by Cascade and PSE (the "*Definitive Agreement*").

1. Acquisition

It is anticipated that Cascade will acquire Project Assets from PSE. It is further anticipated that Cascade will assume certain specified contractual and operational obligations of PSE related to the Project Assets, which obligations (collectively, the "*Obligations*") will be more particularly described in the Definitive Agreement. With the exception of the Obligations, it is anticipated that Cascade will not assume any of PSE's debts, payables, lawsuits, obligations or other liabilities.

2. Consideration

As consideration for PSE entering into this Letter and granting the MOU term extension described in Paragraph 9 and subject to the satisfaction of the Condition Precedent described below in this Paragraph 2, Cascade shall pay to PSE Three Million Dollars (\$3,000,000) (the "*Extension Payment*"). Cascade's obligation to pay the Extension Payment is contingent upon Cascade entering into a wholesale water supply agreement whereby Cascade will acquire water for the benefit of Cascade's members and generate a rate-based revenue stream (the "*Condition*

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Precedent"). Upon the occurrence of the Condition Precedent, Cascade's obligation to make the non-refundable Extension Payment shall become irrevocable, and Cascade shall pay the Extension Payment to PSE on or before March 31, 2004, plus interest at the rate of four percent (4%) per annum accruing from September 1, 2003 to the date of payment to PSE. PSE shall have the right to terminate this Letter and the MOU (as defined below) upon ten (10) days' prior written notice to Cascade if the Condition Precedent has not occurred by November 30, 2003, unless by such date Cascade in its discretion has by written notice to PSE waived the Condition Precedent, thereby making its obligation to pay the Extension Payment irrevocable notwithstanding that the Condition Precedent was not then satisfied.

Separate from the Extension Payment, it is anticipated that the consideration for the acquisition of Project Assets pursuant to the Definitive Agreement will be comprised of (a) a cash component in an amount mutually agreed upon by the parties and specified in the Definitive Agreement (the "*Cash Purchase Price*") plus (b) assumption of the Obligations.

It is also anticipated that Cascade will pay the Cash Purchase Price to PSE through the issuance of a bond or bonds in the amount of the Cash Purchase Price. Alternatives being considered include (i) Cascade's private placement issuance to PSE upon Closing (as defined below) in early 2004 of a single, insured, tax-exempt, Cascade system-wide revenue bond in the principal amount of the Cash Purchase Price with payment terms providing for payment in one or more installments or (ii) Cascade or a Cascade member issuing one or more bonds after Closing through the public bond market in order to make payment of the Cash Purchase Price in one or more installments to PSE. The payment method and payment terms (and, if the single bond alternative is selected, the interest rate, maturity date and other terms and conditions of the bond) will be mutually agreed upon by the parties and specified in the Definitive Agreement.

3. Title and Condition of Property

It is anticipated that PSE will convey Project Assets to Cascade (a) free and clear of all liens and encumbrances arising by, through or under PSE other than the Obligations and (b) in their then-current condition "AS IS" and without any other warranty of any kind with regard to the condition of Project Assets or their suitability for Cascade's purposes.

4. Risk Management

It is anticipated that upon Closing and as to be more particularly described in the Definitive Agreement, Cascade will be responsible for all claims, damages and liabilities associated with Project Assets or any use thereof that accrue after Closing and will defend, indemnify and hold harmless PSE and its affiliates and their respective officers, directors, employees, contractors and agents from and against any and all actions, claims, damages and expenses, including reasonable attorneys' fees, arising out of or in any way related to such claims, damages and

August 28, 2003

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liabilities or any claim, damages or liabilities relating in any manner to the municipal water project or consumption of any water therefrom. It is further anticipated that the Definitive Agreement will include an obligation on Cascade's part to procure and maintain minimum levels of specified liability insurance coverages that are endorsed to name PSE and its affiliates as additional insureds.

5. Operation and Maintenance; Right of First Offer

It is anticipated that the Definitive Agreement or an ancillary operating agreement will address allocation, coordination and implementation of operation and maintenance activities and costs between the parties with regard to the operation and maintenance of the Lake Tapps and White River facilities and works of the parties. Further, it is anticipated that the Definitive Agreement will include a right of first offer for Cascade with respect to a PSE sale or retirement of certain tangible and intangible assets of the White River hydropower project works related to the operation and beneficial use of the proposed Cascade's Lake Tapps/White River municipal water supply project.

6. Conditions to Proposed Transaction

It is anticipated that the Definitive Agreement will provide that Closing (as defined in Paragraph 7 below) of Cascade's acquisition of Project Assets pursuant to the Definitive Agreement will be subject to satisfaction of the following terms and conditions:

- a. successful resolution (as will be defined in the Definitive Agreement) of all appeals, if any, to the State of Washington Department of Ecology's report of examination regarding the White River municipal water rights;
- b. Cascade having a rate based revenue stream upon which it is able to issue and support the above-described bond or bonds;
- c. receipt of all necessary federal, state (including, without limitation, the State of Washington Utilities and Transportation Commission) and local consents and approvals of governmental bodies and other third parties applicable to the parties or the consummation of the transactions contemplated in the Definitive Agreement;
- d. absence of any material adverse change in the Project Assets; and
- e. delivery of customary closing certificates and other documentation.

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7. Closing and Closing Costs

The parties intend that the execution of the Definitive Agreement will occur on or before November 30, 2003, and that, subject to the satisfaction of the conditions identified in Paragraph 6 by such date, the closing of the Project Assets acquisition transaction contemplated therein (the "*Closing*") will occur on or about March 31, 2004. At Closing, Cascade will pay for any excise, sales, use or other transfer taxes due on the sale of Project Assets and for the premium for any title insurance policy that Cascade requires. Any property taxes levied on the personal property and real property included in Project Assets will be prorated between PSE and Cascade as of the Closing. Any escrow fees will be shared equally by the parties.

8. Definitive Agreement

Cascade and PSE will promptly begin negotiating the Definitive Agreement. PSE and its counsel shall be responsible for preparing the initial draft of the Definitive Agreement. While both Cascade and PSE desire to arrive at a mutually acceptable Definitive Agreement at the earliest reasonably practicable date, nothing herein shall be construed as an "agreement to agree" or otherwise create an obligation or duty to negotiate, reach consensus on or execute such a Definitive Agreement.

9. Extension of Memorandum of Understanding

Contemporaneously with the execution of this Letter and subject to potential early termination of the MOU (as defined below) as provided in Paragraph 2 above, Cascade and PSE will enter into an amendment to that certain Memorandum of Understanding dated as of August 7, 2001, as amended, (the "MOU"), in substantially the same form as the prior extension amendments, extending the expiration date of the term of the MOU to March 31, 2004.

10. Access

PSE shall provide to Cascade and its employees, accountants, attorneys and other agents and representatives (collectively, "*Representatives*") access to PSE's facilities, books and records reasonably related to Project Assets and the Obligations for the purpose of conducting the studies and inspections of the same; provided, however, that PSE shall have no obligation to provide Cascade with access to any books and records that includes any (a) privileged attorney-client communication, (b) confidential attorney work product or (c) other confidential information that if furnished to Cascade may be treated as a public record of Cascade subject to public disclosure under applicable law.

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11. Communications

Cascade and PSE will coordinate their respective external communications regarding the subject matter of this Letter and their respective obligations arising hereunder. Except as and to the extent required by law, no public statements will be issued regarding this Letter or any matter covered under this Letter or the Definitive Agreement unless both parties consent to the substantive content of such statements, provided that Cascade may discuss matters related to this Letter or the Definitive Agreement that arise in the context of public meetings of the Cascade Board of Directors so long as none of the statements made by any officer, member or agent of Cascade are attributed to PSE without PSE's prior written approval. Without the other party's prior written consent, neither Cascade nor PSE shall, and each shall direct its Representatives not to, directly or indirectly, make any public comment, statement or communication regarding, or otherwise disclose or permit the disclosure of the existence of discussions regarding, a possible transaction between the parties or any of the terms, conditions or other aspects of the transaction proposed in this Letter except as provided otherwise in the immediately preceding sentence or in disclosures to governmental authorities. If a party is required by law to make any such disclosure, it must first provide to the other party the content of the proposed disclosure, the reasons that such disclosure is required by law, and the time and place that the disclosure will be made.

12. Confidentiality

Except as and to the extent required by law, Cascade shall not disclose or use, and it shall cause its Representatives not to disclose or use, any Confidential Information (as defined below) that was or is furnished by PSE or its Representatives to Cascade or Cascade's Representatives in connection herewith at any time or in any manner other than in connection with Cascade's evaluation of the transaction proposed in this Letter. For purposes of this Paragraph, "*Confidential Information*" means any nonpublic information of PSE; provided, that it does not include information that Cascade can demonstrate (i) is generally available to or known by the public other than as a result of Cascade's improper disclosure or (ii) was obtained by Cascade from a source other than PSE, provided that such source was not bound by a duty of confidentiality to PSE or another party with respect to such information. If Cascade is required by law to make any such disclosure, it must, at a reasonable time prior to such disclosure, provide to PSE the content of the proposed disclosure, the reasons that such disclosure is required by law, the time and place that the disclosure will be made, and cooperate with PSE as PSE requests in efforts to limit the extent and scope of such disclosure including, without limitation, establishing the applicability of any exemptions set forth in RCW 42.17.310 regarding any of the information otherwise subject to such disclosure.

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13. Costs

Cascade and PSE shall each be responsible for and bear all its own costs and expenses (including any broker's or finder's fees) incurred in connection with the proposed transaction, including its Representatives' expenses, incurred at any time in connection with pursuing the proposed transaction.

14. Entire Agreement

This Letter constitutes the entire agreement between the parties and supersedes all prior oral or written agreements, understandings, representations and warranties, and courses of conduct and dealing between the parties on the subject matter hereof. Notwithstanding the foregoing and except as expressly provided in Paragraphs 2 and 9 above, this Letter does not affect the MOU, the terms and conditions of which remain in full force and effect.

15. Governing Law; Jurisdiction; Venue

This Letter shall be governed by and construed under the laws of the State of Washington without regard to principles of conflict of laws. The parties irrevocably consent to the jurisdiction and venue of the state and federal courts located in King County, Washington, in connection with any action relating to this Letter.

16. Effect of Letter of Intent

Paragraphs 1-8 of this Letter reflect our current mutual understanding of the matters described in them, but each party acknowledges that such provisions (other than the terms in Paragraph 2 relating to the Extension Payment) may be subject to change, are not intended to create or constitute any legally binding obligation between Cascade and PSE, and do not contain promises upon which either Cascade or PSE may rely for purposes of establishing a claim for promissory estoppel. Upon execution by Cascade of this Letter or counterparts thereof, Paragraphs 9-16 of this Letter and the terms regarding the Extension Payment in Paragraph 2 will constitute the legally binding and enforceable agreement of Cascade and PSE (in recognition of the significant costs Cascade and PSE will bear in pursuing this proposed transaction and further, in consideration of their mutual undertakings as to the matters described herein). Except for Paragraphs 9-16 and the terms regarding the Extension Payment in Paragraph 2, if the Condition Precedent has been satisfied or waived, this Letter is intended only to constitute a list of proposed points that may or may not become part of an eventual Definitive Agreement, and the parties do not intend to be bound by any such other terms of this Letter unless and until such terms are included in the Definitive Agreement signed by both parties. Neither party may reasonably rely on any promises inconsistent with this Paragraph, and this Paragraph supersedes all other conflicting language and understandings.

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The binding provisions of this Letter identified above (other than the terms regarding the Extension Payment in Paragraph 2, which obligation, if the Condition Precedent has been satisfied or waived, is irrevocable and shall be payable notwithstanding any termination of the binding provisions of this Letter, failure of the parties to enter into the Definitive Agreement or any other event) may be terminated

- (i) by mutual written consent of Cascade and PSE or
- (ii) upon written notice by any party to the other party if the Definitive Agreement has not been executed by November 30, 2003;

provided, however, that the termination of such binding provisions shall not affect the liability of a party for breach of any of such binding provisions prior to the termination. Upon termination of such binding provisions, the parties shall have no further obligations hereunder, except as stated in Paragraph 2 (solely with regard to the Extension Payment obligation if the Condition Precedent has been satisfied or waived) and Paragraphs 11, 12, 13, 14 and 15; which shall survive any such termination. Except as otherwise provided herein, the binding provisions of this Letter as identified above may be amended or modified only by a writing executed by all of the parties.


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Please indicate your agreement to this Letter by signing and returning a copy of this Letter to the undersigned no later than September 10, 2003. This Letter and all the obligations set forth herein will terminate and become void if Cascade has not returned a signed copy of this Letter by that time.

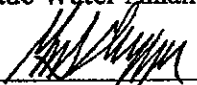
Very truly yours,

Puget Sound Energy, Inc.

By: 
Name: ERIC M. MARKELL
Title: SR. V.P. Energy Resources

Acknowledged and agreed:

Cascade Water Alliance

By: 
Name: GRANT DEGINGER
Title: CHAIR
Date Signed: OCTOBER 13, 2003

**PUGET SOUND ENERGY
WHITE RIVER RETIREMENT
PROPOSED ACCOUNTING ENTRIES
DOCKET NO. UE-_____
September 30, 2003**

**Exhibit C
Page 1 of 1**

The following journal entries are proposed to record the retirement of the White River Hydroelectric plant which is expected to occur on January 15, 2004; balances reflected below are as of September 30, 2003

<u>Account</u>	<u>Order</u>	<u>Description</u>	<u>Debit</u>	<u>Credit</u>
<u>Entry 1 - Property Accounting</u>				
18220000		Unrecovered Plant and Regulatory Study Costs	51,778,169.00	
10800001		Accum Prov for Depr - Regular	16,626,880.00	
11100201		Elec-Accum Amortization AMA (White R Fish Hatchery)	2,357,291.00	
10100001		Electric Plant In Service		70,762,340.00

To transfer White River Plant net of Accumulated Provision for Depreciation to FERC Account 182.2, Unrecovered Plant and Regulatory Study Costs in accordance with FERC Accounting Instructions.

<u>Entry 3 - Property Accounting</u>				
18220000		Unrecovered Plant and Regulatory Study Costs	17,161,835.00	
10700001		Construction Work In Progress-White River Licensing		17,161,835.00

To transfer costs related to FERC licensing and acquisition of water rights to FERC Account 182.2 to be deferred until the next general rate case.

<u>Entry 5 - General Accounting</u>				
18220000		Unrecovered Plant and Regulatory Study Costs	187,781.00	
18300111		Preliminary Survey		187,781.00

To transfer preliminary survey charges related to the White River plant to FERC account 182.2 to be deferred until the next general rate case.

<u>Entry 6 - General Accounting</u>				
407xxxxx		Amortization of Prop Losses, Unrecovered Plant & Study Cost	5,177,817.00	
18220000		Unrecovered Plant and Regulatory Study Costs		5,177,817.00

To record the amortization of the net plant balance in FERC Account 182.2 over 10 years.

**BEFORE THE
WASHINGTON UTILITIES & TRANSPORTATION COMMISSION**

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

For an Accounting Order Authorizing
Deferral and Recovery of Investment and
Costs Related to the White River
Hydroelectric Project

Docket No. _____

ORDER (PROPOSED)

MEMORANDUM

1. On December 10, 2003, Puget Sound Energy, Inc. ("PSE" or "the Company") submitted a Petition for an order regarding accounting and ratemaking treatment related to the early retirement of PSE's White River Hydroelectric Project ("Project"). According to the Petition, PSE anticipates ceasing generation of hydroelectric power at the Project on January 15, 2004, the date an existing Federal Energy Regulatory Commission ("FERC") stay expires, in order to avoid the need to make additional investments in the Project required by a contested hydroelectric license FERC issued in 1997.

2. In the Petition, PSE requested an order that authorizes:

- Deferral of the net book value of the Project plant and recovery of such amounts in PSE's rates and through continued inclusion in PSE's variable rate base and amortization, over ten years, in the Power Cost Adjustment mechanism; and
- Deferral of costs associated with PSE's efforts to obtain a FERC license for the Project, to fulfill safety and/or regulatory requirements, to obtain a water right to offset the cost of operating the Project or increase the potential salvage value of the Project, and related costs, for recovery of such prudently-incurred costs in future electric rates as determined in PSE's next general rate case.

Background

A. Retirement of the White River Hydroelectric Project

3. The Project was built in 1911 and has been in continuous operation ever since. The Project diverts water from the White River to Lake Tapps, a man-made reservoir, and from this reservoir, water is released to generate electricity and is then discharged back into the White River. The Project generates electricity with an annual average output of approximately 35 megawatts.

4. The Project diverts water from the White River in quantities that are sufficient to fill and maintain the Lake Tapps reservoir. The reservoir is a regional resource, supporting a variety of public benefits. However, the reservoir would not and will not exist unless the hydraulic functions of the Project are maintained (i.e., diversion, storage and discharge).

5. For many years, the Project was believed to fall outside of the jurisdiction of the Federal Power Act. This question was litigated and resolved in the 1970s, establishing FERC's jurisdiction over the Project. PSE submitted a license application to FERC in December 1983.

6. In December of 1997, FERC issued a proposed license for the Project ("1997 License"). The Petition states that the Company did not accept, and appealed, the 1997 License because it contained terms and conditions that would render ongoing operations of the Project uneconomic relative to alternative resources. Various natural resource agencies also appealed the 1997 License, including NOAA Fisheries ("NOAA Fisheries" or "NMFS"), U.S. Fish and Wildlife Service, Washington State Department of Fish and Wildlife and Washington State Department of Ecology ("Ecology").

7. Subsequent to the appeal of the 1997 License, PSE, local citizens and state and local elected officials initiated a collaborative settlement process, inclusive of all interests concerned about preserving the Lake Tapps reservoir. To facilitate this collaborative process, FERC issued a two-year stay of the 1997 License order and related appeals.

8. The Petition states that one of the tasks that needed to be completed during the two-year stay was completion by NMFS of a biological opinion, in order to determine the measures that PSE would be required to undertake if a settlement were to be structured around a FERC license. However, NMFS did not complete its biological opinion during that two year time period, and the parties were also unable to complete other tasks related to potential settlement.

9. In 2001, the parties sought and FERC granted a second two-year stay of the litigation, through June 30, 2003. In October of 2002, NOAA Fisheries completed a preliminary draft Biological Opinion. The Petition states that in the view of PSE and many other stakeholders, this draft contained conditions that rendered the hydropower project uneconomic and proposed flow restrictions that threatened the continued existence of Lake Tapps. In response to the preliminary draft biological opinion,

stakeholders provided NOAA Fisheries with detailed recommendations for further consideration. In June of 2003, FERC granted a further extension of the stay, giving the parties until January 15, 2004 to complete a settlement agreement. A copy of FERC's June 26, 2003 Order Granting Extension of Stay is attached hereto as Exhibit A.

10. PSE's Petition states that it initially approached the collaborative with the purpose and expectation of licensing the existing hydroelectric project. PSE hoped that, through the collaborative, alternative conditions for a FERC license could be developed that would preserve the Project as an economic resource within its electric generation portfolio. However, PSE states that it also recognized that the existing infrastructure (e.g., dams, dikes, flowlines) has value derived from the many benefits the Lake Tapps reservoir provides to the region. Moreover, the existence of the reservoir (and the continued operation of the infrastructure that maintains the reservoir), unlike operation of a hydroelectric project at the reservoir, is not dependent upon a FERC license.

11. As the collaborative process moved forward, water purveyors in the central Puget Sound area began expressing interest in the Lake Tapps reservoir as a potential source of drinking water for the Seattle/Tacoma metropolitan areas. However, Ecology viewed the Project's existing water right as a "non-consumption" right that could not be changed to a consumptive use. Therefore, in order to realize the potential of the reservoir as a resource for drinking water, and to add another source of revenue to offset the cost of operating the Project, PSE applied for a new water right for municipal water supply purposes. PSE owns the reservoir, and therefore was the only party with a sufficient property interest to pursue this application. This allowed water purveyors to be brought into the collaborative and, in effect, become part of the solution to the economic problems threatening the existence of the Lake Tapps reservoir.

12. On June 30, 2003, Ecology issued a water right to PSE. With the new water right in hand, PSE was able to negotiate a Letter of Intent ("LOI") to sell the new water right to a consortium of municipalities, Cascade Water Alliance ("Cascade"), who wanted to develop the reservoir as a municipal water supply. The Petition states that Cascade and PSE originally intended to finalize their negotiations before the end of 2003, but appeals of the water right must be resolved before a sale of the water right can be completed.

13. In November of 2003, NOAA Fisheries issued a revised Biological Opinion that the Petition states does not differ materially from its prior draft. As with the preliminary draft issued in October of 2002, the collaborative concluded that the economic impacts of the conditions required in the Biological Opinion still rendered the hydropower facility economically infeasible. The collaborative concluded that the concerns they had previously raised with respect to the earlier draft had not been addressed or answered, and that its members would be better served by turning their attention to a settlement option that does not include generation of hydropower or a FERC license in the near term. The collaborative has now turned its full attention to developing a non-power option that preserves the Lake Tapps reservoir.

14. The Petition states that in light of this development, the Company has concluded that it is unlikely that a settlement addressing the deficiencies of the 1997 License will be reached before the stay expires. As of January 15, 2004, PSE will be unable to generate hydroelectric power at the Project unless it begins to make significant and expensive investments in the Project consistent with conditions required in the 1997 License. PSE thus anticipates advising FERC in January that it intends to reject the 1997

License, withdraw its license application and discontinue the generation of electricity at the Project.

15. In order for the U.S. Army Corps of Engineers ("the Corps") to trap and haul endangered Puget Sound Chinook salmon above its Mud Mountain dam flood control project, PSE is working with the Corps, NOAA Fisheries and others to develop and implement a plan for interim non-power operations. PSE also advised the collaborative that it will take at least until January 15, 2004 to put such a plan in place.

16. PSE states that the possible outcome of these various negotiations and discussions is uncertain at this time. The Petition indicates that the Company's goal is to maximize the value of the Project assets as an offset to costs that still need to be recovered. However, in any event, it is unlikely that the Project will be in service as a generation resource of the Company after January of 2004.

17. The Petition states that although PSE's twenty-year effort to obtain an economic FERC license for the Project has now ended without the issuance of a license that will permit continued generation of hydroelectric power at the Project, PSE's efforts have enabled the Company to continue to generate relatively inexpensive power for its ratepayers many years longer than would have been possible without PSE's efforts and related investments. Moreover, PSE believes that its efforts to obtain a water right will likely result in continued value to PSE's ratepayers from the Project in the future and/or a significant increase in the salvage value of the Project.

B. Current Accounting and Ratemaking Treatment

18. The Project has been part of the Company's rate base for decades. The Petition states that the Company's net plant investment in the White River Plant at September 30, 2003 consists of \$47.7 million of net book value of plant in service,

recorded in FERC Account No. 101, Plant in Service and FERC Account No. 108, Accumulated Provision for Depreciation.

19. In its Power Cost Only Rate Case ("PCORC") filed on October 24, 2003, Docket No. UE-031725, the Company assumed for purposes of forecasting its Power Cost Adjustment (PCA)-related power costs that the Project would be retired. For consistency, the Company also removed the book capital associated with the Project from its ratebase. At the same time, the Company indicated that it intended to petition the Commission for an accounting order in the fourth quarter of 2003 to request authorization for appropriate accounting and ratemaking disposition of this plant. See Docket No. UE-031725, Direct Testimony of William A. Gaines dated Oct. 24, 2003, at 25-26; Direct Testimony of John H. Story dated Oct. 24, 2003, at 8.

20. The Petition states that the Company has also incurred approximately \$21.2 million of costs associated with its efforts to obtain a FERC license for the Project, to fulfill safety and/or regulatory requirements to ensure continued operation of the plant through the licensing process, to obtain the water right discussed above, and related costs. To date, these costs have been recorded in FERC Account 107, Construction Work in Progress.

C. Proposed Accounting and Ratemaking Treatment

Net Plant Investment

21. Regarding the Company's White River Project net plant investment, in FERC Account No. 101, Plant in Service, and FERC Account No. 108, Accumulated Provision for Depreciation, effective January 15, 2004, the Company proposes to:

- Defer, to FERC Account No. 182.2, Unrecovered Plant and Regulatory Study Costs, its net plant investment.

- Amortize the deferred balance to FERC Account No. 407, Amortization of Property Losses, Unrecovered Plant and Regulatory Study Costs, over ten years and include this amortization in the Power Cost Rate under depreciation – production plant (line 23). Such amortization shall commence no sooner than the implementation of the PCORC rate as determined in Docket No. UE-031725. Until the time that the PCORC rate is implemented the Company will continue its depreciation/amortization consistent with the existing Power Cost Rate.
- Reduce the unamortized amount of the deferred costs by any recoveries and/or salvage realized relative to the White River Project plant investment.
- Include the unamortized balance in rate base in the Company's Power Cost Adjustment mechanism, as a regulatory asset; the return on which is considered to be a variable cost in the PCA mechanism.

22. The Petition states that under the circumstances outlined above, the foregoing accounting and ratemaking treatment is reasonable and in the public interest and should be approved. Circumstances outside the Company's control will require the forced early retirement of the Project for hydroelectric generation by PSE. However, the Company has long been recovering its investment in and a return on the White River Project plant, and the plant has substantially benefited the Company's ratepayers. Moreover, the plant will likely continue to provide benefit to ratepayers through the water right the Company has obtained or otherwise, depending on the outcome of ongoing negotiations.

Relicensing, Safety and/or Regulatory and Salvage Costs

23. Regarding its investment related to costs associated with PSE's efforts to obtain a FERC license for the Project, to fulfill safety and/or regulatory requirements, to obtain a water right to offset the cost of operating the Project or increase the potential salvage value of the Project, and related costs, the Company proposes to:

- Defer such costs, in FERC 182.3, Other Regulatory Assets, for review at the time of the Company's next general rate case, with prudently-incurred costs to be recovered in rates at that time. Such costs are approximately \$21.2 million at present. PSE also intends at that time to add these costs to its ratebase for treatment in the same manner as the net plant investment, described above.
- Include in the deferral future external costs related to the Company's effort to acquire and transfer a new municipal water right associated with the Lake Tapps reservoir.
- Reduce the unamortized amount of the deferred costs by any recoveries and/or salvage realized relative to the regulatory costs incurred associated with the White River Project.

24. The Petition states that the foregoing accounting treatment with respect to amounts currently accounted for as relicensing and salvage costs is also reasonable and in the public interest and should be approved. PSE states that its expenditure of these costs has allowed the Project to remain in service during the past two decades and has increased the potential salvage value of the Project. However, unlike the plant costs, the Commission has not yet had the opportunity to fully review these costs. PSE is proposing a deferral of the costs pending review of such costs in the next general rate case to be filed by the Company, so that the Commission has the opportunity at that time to determine whether any such costs are unreasonable or imprudent such that they should be disallowed.

FINDINGS

25. PSE is engaged in the business of furnishing electric and gas service within the state of Washington as a public service company, and is subject to the jurisdiction of this Commission.

26. On December 10, 2003, PSE filed with the Commission a petition for an order regarding the accounting and ratemaking treatment related to the early retirement of PSE's White River Hydroelectric Project ("Project").

27. The accounting and ratemaking treatment requested in the Petition is reasonable and is in the public interest and should be approved. The Project has been generating electricity as part of the Company's power portfolio and rate base for decades. The Company has long been recovering its investment in and a return on the White River Project plant, and the plant has substantially benefited the Company's ratepayers. Circumstances outside the Company's control now require the forced early retirement of the Project for hydroelectric generation by PSE. Although PSE's twenty-year effort to obtain an economic FERC license for the Project is ending without the issuance of a license that will permit continued generation of hydroelectric power at the Project, PSE's efforts have enabled the Company to continue to generate relatively inexpensive power for its ratepayers many years longer than would have been possible without PSE's efforts and related investments. Moreover, PSE's efforts to obtain a water right will likely result in continued value to PSE's ratepayers from the Project in the future and/or a significant increase in the salvage value of the Project.

28. Regarding PSE's investment related to costs associated with its efforts to obtain a FERC license for the Project, to fulfill safety and/or regulatory requirements, to obtain a water right to offset the cost of operating the Project or increase the potential salvage value of the Project, and related costs, the foregoing accounting treatment is also reasonable and in the public interest and should be approved. PSE's expenditure of these costs has allowed the Project to remain in service during the past two decades and has increased the potential salvage value of the Project. However, unlike the plant costs, the

Commission has not yet had the opportunity to fully review these costs. PSE is proposing a deferral of the costs pending review of such costs in the next general rate case to be filed by the Company, so that the Commission has the opportunity at that time to determine whether any such costs are unreasonable or imprudent such that they should be disallowed. Granting the order requested by the Company will allow for recovery of in future rates of prudently incurred deferred costs associated with PSE's efforts to obtain a FERC license for the Project, to fulfill safety and/or regulatory requirements, to obtain a water right to offset the cost of operating the Project or increase the potential salvage value of the Project, and related costs.

ORDER

WHEREFORE, THE COMMISSION HEREBY ORDERS:

29. Approval is hereby given for the accounting and ratemaking treatment requested in PSE's Petition dated December 10, 2003, with respect to the retirement of PSE's White River Hydroelectric Project ("Project").

30. With respect to the Company's White River Project net plant investment, in FERC Account No. 101, Plant in Service, and FERC Account No. 108, Accumulated Provision for Depreciation, effective January 15, 2004, PSE is authorized to:

- Defer, to FERC Account No. 182.2, Unrecovered Plant and Regulatory Study Costs, its net plant investment.

- Amortize the deferred balance to FERC Account No. 407, Amortization of Property Losses, Unrecovered Plant and Regulatory Study Costs, over ten years and include this amortization in the Power Cost Rate under depreciation – production plant (line 23). Such amortization shall commence no sooner than the implementation of the PCORC rate as determined in Docket No. UE-031725. Until the time that the PCORC rate is implemented the Company will continue its depreciation/amortization consistent with the existing Power Cost Rate.
- Reduce the unamortized amount of the deferred costs by any recoveries and/or salvage realized relative to the White River Project plant investment.
- Include the unamortized balance in rate base in the Company's Power Cost Adjustment mechanism, as a regulatory asset; the return on which is considered to be a variable cost in the PCA mechanism.

31. With respect to PSE's investment related to costs associated with PSE's efforts to obtain a FERC license for the Project, to fulfill safety and/or regulatory requirements, to obtain a water right to offset the cost of operating the Project or increase the potential salvage value of the Project, and related costs, effective January 15, 2004, PSE is authorized to:

- Defer such costs, in FERC 182.3, Other Regulatory Assets, for review at the time of the Company's next general rate case, with prudently-incurred costs to be recovered in rates at that time. Such costs are approximately \$21.2 million at present. PSE also intends at that time to add these costs to its ratebase for treatment in the same manner as the net plant investment, described above.
- Include in the deferral future external costs related to the Company's effort to acquire and transfer a new municipal water right associated with the Lake Tapps reservoir.
- Reduce the unamortized amount of the deferred costs by any recoveries and/or salvage realized relative to the regulatory costs incurred associated with the White River Project.

The Company's actions in incurring the costs described in this paragraph are subject to review in future rate proceedings. Any costs determined to be unreasonable or imprudent in such proceedings are subject to disallowance.

32. This order shall in no way affect the authority of this Commission over rates, services, accounts, evaluations, estimates, or determination of cost or any matters whatsoever that may come before it, nor shall anything herein be construed as an acquiescence in any estimate or determination of costs claimed or asserted.

33. The Commission retains jurisdiction over the subject matter of the Petition and PSE to effect the provisions of this order.

DATED at Olympia, Washington, and effective this _____ day of _____,

MARILYN SHOWALTER, Chairwoman

RICHARD HEMSTAD, Commissioner

PATRICK J. OSHIE, Commissioner