Agenda Date: June 30, 2004
Item No.: A1

Docket: **UE-040926**
Company Name: Puget Sound Energy, Inc.

Staff: Doug Kilpatrick, AD Emergency and Risk Management
Thomas Schooley, Regulatory Analyst
Glenn Blackmon, Acting Regulatory Services Director

Recommendation:

Deny Puget Sound Energy, Inc's petition for an accounting order to defer for accounting purposes expenditures up to $2 million annually in order to continue the Tree Watch Program.

Background:

In mid 1998, Puget Sound Energy, Inc. (PSE or Company) came before the Commission with a proposal to establish a program, then called the Virtual Right-of-Way Program, targeting removal of certain trees growing beyond the limits of its dedicated right-of-way. The program, later termed the Tree Watch Program (the Program), was based on a study indicating that despite an active vegetation management program, some 60 percent of PSE's tree-related outages were caused by trees growing beyond the borders of its maintained right-of-way. The Program would target danger trees, most likely to cause damage to its system, and seek permission from landowners to remove them. The Company proposed to spend $43 million over five years, starting July 1998, and amortize those costs over a ten-year period. The benefits of the Program were expected to be realized over 15 to 20 years, hence the logic for creation of the regulatory asset. The Commission approved the accounting petition in Docket UE-980877, on July 8, 1998.

On July 1, 2002, PSE filed a petition for a one-year extension for Tree Watch Program expenditure deferred accounting treatment. The Company requested the extension in order to complete unfulfilled program work, without an increase to the total program budget. The Commission approved the one-year extension to June 30, 2004, in an order issued on July 26, 2002.

The Program was proposed as a one time, deferred asset program that would improve system reliability and safety. Each year since 1999, PSE has produced an annual report of Program expenditures and results. In its May 1, 2004 annual report, PSE stated that the Program has (a) reduced the levels of major storm damage expensed each year, (b) reduced repair costs from storm tree damage, and (c) reduced the level of expenditures per mile under the Company's traditional right-of-way vegetation management program.

In PSE's pending general rate case in Docket No. UE-040641, the Company has requested that the Tree Watch Program be continued indefinitely, at a reduced annual expenditure level of $2 million, with ongoing 10-year amortization. Since the existing program is due to expire on June 30, 2004, well before the issuance of an order in the rate case, the Company seeks an extension of the accounting treatment through this petition.

Discussion:

The Commission Staff recommends the petition be denied. Staff does not raise the issue of the prudence of PSE's plan to expend $2 million annually on the Tree Watch program. Nor does PSE's petition seek either a prudence finding by the Commission or Commission approval of the program itself. Indeed, generally speaking, Commission approval of a utility's routine maintenance activities such as these is not appropriate. Any concerns about the reasonableness of a utility's maintenance expenditures would best be addressed in a general rate case, complaint proceeding, or similar proceeding.

The basis for staff's concern is the proposal to use deferred accounting for the Tree Watch expenditures. While deferred accounting was appropriate when the program was structured as a large, one-time expenditure over a finite time period, it is not appropriate now that the Company has transformed the program into an ongoing activity of indefinite duration and at a steady-state level of expenditures. At this point, the Tree Watch Program is a preventative maintenance program that conceptually does not differ from other activities that are treated as operating expenses under generally accepted accounting principles (GAAP).

Regulators need to be careful when deferred accounting treatment is proposed and should not allow it in the absence of a serious mismatch in the timing of costs and benefits under GAAP. An important reason for this policy is that deferred accounting inevitably entangles regulators in the question of whether the expenditures themselves are reasonable. The Commission can attempt to minimize this problem by reserving its authority over ratemaking treatment, but the practical reality is that anything less than full recovery of a regulatory asset would likely be viewed unfavorably by investors.

As noted above, PSE has also requested deferred accounting treatment of the Tree Watch Program as part of its pending general rate case filing. If the Commission denies the petition in this case, PSE will still have the opportunity to show that deferred accounting is appropriate. In the alternative, the rate case provides an opportunity to consider inclusion of the ongoing Tree Watch expenditures as a part of the Company's normal maintenance expense level.

Staff argues that deferred accounting is not appropriate even as an interim measure while the issue is considered in the rate case. Staff notes that denial of the petition would not prevent PSE from continuing the Tree Watch program itself while the rate case is pending.

Conclusion:

PSE's request to use deferred accounting for its ongoing Tree Watch expenditures should be denied. The circumstances that justified deferred accounting treatment in 1998 no longer exist. If the Company demonstrates in the pending rate case that deferred accounting is still appropriate for this program, the Commission can approve such accounting in that case.