BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. PUGET SOUND ENERGY, INC. Respondent.	DOCKET NO. UE-031725 PUBLIC COUNSEL ANSWER TO PSE PETITION FOR RECONSIDERATION AND CLARIFICATION OF ORDER NO. 14

I. INTRODUCTION

Pursuant to the Commission's Notice of May 25, 2004, Public Counsel files this Answer in opposition to PSE's Petition for Reconsideration and Clarification of Order No. 14 ("Petition"). The Commission should deny PSE's request for reconsideration. Public Counsel's pleading is directed to the reconsideration issues only. We will defer to the Commission Staff on clarification matters.

II. APPLICABLE STANDARD

WAC 480-07-850 permits the filing of a petition for reconsideration if a party wishes to request a change in the outcome of the order, but the petition must clearly identify which portions of the order are "erroneous or incomplete" so as to warrant relief. Reconsideration is a fairly limited remedy. *See e.g., WUTC v. Puget Sound Power & Light Co.*, UE-920433 et al, Fifteenth Supplemental Order on Clarification and Reconsideration, p. 8. It is "not a second opportunity to litigate issues that were fully developed prior to entry of the final order….The mere fact that a party disagrees with a final order does not state a basis for reconsideration." *In the Matter of the Application of Avista Corporation, PacifiCorp, and Puget Sound Energy, Inc.*

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for Approval of Sale of Interests in the Centralia Power Plant, UE 991255; UE 991262, Fourth Supplemental Order, p. 9.

III. ARGUMENT

A. PSE's Petition Does Not Meet The Standard For Reconsideration and Attempts To Introduce New Evidence.

PSE's underlying theme in its petition is simply a reargument of its position at the hearing. Although reconsideration is not meant as a vehicle for parties to simply repeat arguments they have already made during the adjudication, PSE nevertheless begins by asserting that the Commission order "unfairly punishes" the company, and that it "continues to believe that these decisions were reasonable when made…" Petition, p. 1. This undoubtedly was PSE's position throughout the case, but the evidence is in and the record closed. The Commission has ruled. PSE's petition does not establish any factual error, and, as argued below, its assertions of legal error are not well-taken. The standard for reconsideration is not met.

PSE's petition also appears to offer new evidence not previously in the record. The chart on Page 14, that in Attachment A, and the Power Cost Adjustment (PCA) Mechanism Forecasts presented in Attachments B-D contain new material not previously presented to the Commission. A petition for reconsideration is not the appropriate vehicle for submitting new evidence. The Commission's rules provide for a motion to reopen prior to entry of a final order by parties who wish to present evidence that is "essential to a decision and that was unavailable and not reasonably discoverable with due diligence at the time of the hearing or for any other good and sufficient cause." WAC 480-07-830. PSE has not filed such a motion here, nor met the requirements of the rule.

The motion to reopen rule also permits other parties an opportunity to respond to the new evidence if the Commission decides to admit it. Public Counsel believes, for example, that Attachment A is incomplete and therefore misleading, and would request the opportunity to cross

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examine as to the chart, and to submit responsive evidence, should the Commission decide to admit the Attachment to the record and consider it. A complete examination of areas addressed in Attachment A would confirm that the Commission's Order reflects a compromise position between the Company's original proposal and that submitted by Staff and ICNU. Indeed this decision is very close in net effect to that presented by Public Counsel, and reflected in Exhibit 271C, p. 2, line 19, in this proceeding.

B. PSE's Petition Misconstrues Order No. 14 – The Commission Does Not Abandon The Prudence Test.

PSE's primary argument on reconsideration is that the Commission has somehow employed an impermissible "economic test" in order to reach its conclusions in the case. PSE asserts that this "new test eclipses the long-standing prudence standard [.]" Petition, p.2. This is a misreading of Order No. 14.

The Commission's order in its initial "Standards and Regulatory Principles" section, beginning at ¶ 65, quotes the long-standing prudence rule employed in Washington: "The test this Commission applies to measure prudence in Washington is what would a reasonable board of directors and company management have decided given what they knew or reasonable should have known to be true at the time they made a decision." Id.[1] The Commission expressly notes that it "applied this standard in its original consideration of PSE's Tenaska and Encogen contracts, has consistently applied it in other proceedings, *and will apply it here*." Id. (emphasis added).

The Commission takes pains to observe that it has an adequate record upon which to make the prudence evaluation. Id., ¶ 67. After reviewing that record, measured against the prudence standard, the Commission concludes that PSE "did not have a prudent [gas] purchasing strategy in place," Id., ¶ 91, and that the company "failed to demonstrate that it followed prudent

[1] Quoting *WUTC v. Puget Sound Power & Light Co.*, Cause No. U-83-54, Fourth Supplemental Order, at 32.

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practices to mitigate risk even following the events of late 2000 and early 2001." In its ultimate Findings of Fact, the Commission states:

> PSE failed to carry its burden of proof to demonstrate its management of fuel gas acquisition for Tenaska was prudent through the PCA and PCORC periods under consideration in this proceeding. Puget's mismanagement of gas purchases for Tenaska was imprudent resulting in the incurrence of costs that are not reasonable considering the total costs of gas, return of, and return on the Tenaska regulatory asset.

Id. ¶ 109 (FOF 5).

PSE's suggestion that the Commission has substituted a new standard in place of prudence is belied by a review of the order and the citations above. The Commission has quite clearly evaluated the facts and reached a conclusion about prudence, using its previously articulated standard.

The prudence finding is the first step of what is in effect a two-step analysis. Once prudence is determined, the second step measures the burden of that imprudence that the Company must bear (and the portion to be shifted to consumers) using a multi-attribute analysis. The references to the "used and useful" standard which PSE points to as a new standard, in fact serves this second analytic purpose, acting as measure, by analogy, for how to determine a reasonable disallowance once prudence has been determined. This approach in effect, uses a principle of matching costs and benefits. Order, ¶68. Put another way, as the Commission explains: "we will use a hybrid analysis to determine recovery in rates *that are fair just and reasonable*." The Commission discusses this regulatory standard in the context of determining an appropriate remedy *after* imprudence has been found.[2] The matching principle of the used and useful rule, as well as the other regulatory concepts discussed in the order act as "useful guidance (but not a straitjacket)" for the Commission in determining remedies.

[2] Operating expenses have commonly been subjected to a "lower of cost or market" test. This Order simply adopts a variation on that theme.

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PSE's petition asserts that the Commission has adopted a new test, "under which it is no longer sufficient for an asset to be prudently acquired and physically used to serve load. PSE must also show that the asset produces net economic 'benefits' during every period of the asset's before PSE can recover the related costs in rates." Petition, p. 2. This is an inaccurate description of what Order No. 14 does with respect to disallowances. The Order does not find costs to be prudent, but then disallow them anyway. On the contrary, with respect to Tenaska, the Commission found that PSE did not establish the prudence of its practices, stating "[i]t is clear to us that during the test year PSE did not have a prudent purchasing strategy in place. Order, ¶91, and in addition that "PSE failed to demonstrate that it followed prudent practices to mitigate risk even following the events of late 2000 and early 2001." Order, ¶92.

As a direct result of the failure to prudently manage the Tenaska gas supply, the Commission makes a disallowance that is not tied to any "economic test" but which is explicitly tied to Puget's ability to earn a return on the asset. Order, ¶93.

Even in its application of the prudence test for going-forward Tenaska costs, the Commission is careful to ensure that prudently-incurred costs are eligible for recovery. The Commission's application of the "hybrid" test for assuring fair just and reasonable rates, when Puget has demonstrated that costs are prudent is: "PSE will recover fully its actual costs of gas and return of the regulatory asset even if the benchmark is exceeded." Order, ¶95. On a going-forward basis, the Commission has merely articulated a sharing of the risks of prudently-incurred costs, a regulatory tool common to regulation and well-known to Puget. *In the Matter of the Petition of Puget Sound Energy, Inc., For Approval of its 2003 Power Cost Adjustment Mechanism Report*, UE-031389, Order No. 04; In *the Matter of the Application of Avista Corporation, PacifiCorp, and Puget Sound Energy, Inc. for Approval of Sale of Interests in the Centralia Power Plant*, UE 991255; UE 991262, Second Supplemental Order, p. 21. Indeed, Puget's entire request for reconsideration in this proceeding is premised on an argument that the

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Commission's chosen risk-sharing methodology is in some fashion unfair to the company, and not that such a sharing of risks is inherently impermissible.

Puget further ignores the record in the case on a remedy based on risk-sharing. Public Counsel's witness, Jim Lazar, proposed an alternative remedy which would disallow all carrying costs – both return of and return on the regulatory asset. Ex. 271C, p. 10, line 14. PSE would be allowed to recover its investment from the savings it created. Mr. Lazar's remedy was a symmetrical approach in which imprudent costs would be disallowed, but any future benefits Puget could have secured would be reserved to shareholders.

C. The Commission's Order Provides A Fair Balance Of Rewards And Penalties.

PSE asserts that Order No. 14 "imposes asymmetric risks that are inequitable." Petition, p. 2. This is not accurate. Puget is merely focusing on the going-forward allocation of costs and benefits between customers and shareholders, and the company fails to include in its analysis the allocation of costs and benefits to date. The first 12 years of the Tenaska contract have been wildly and disproportionately unfavorable to consumers. Only after 2007 is there a possibility that ratepayers will see any benefit at all from this contract.

The Commission's allocation of risk for the remainder of the Tenaska contract must be examined in the context of the entire contract period, as PSE itself suggests. In Public Counsel's view, however, the order produces a moderately balanced result (though less favorable to ratepayers than Public Counsel would have preferred). This is true because the Commission properly disallows the recovery of some, but we would argue not all, imprudent costs in the most recent period, and then provides that consumers will reap the benefits of prudent management, if any materialize, in future periods in which the company beats an established benchmark.

PSE's petition argues that the Commission's "test ignores the economic notion of analyzing a resource's cumulative costs and benefits over the *entire contract term* using the net present value." Petition, p. 15, l. 17. If the Commission is persuaded by Puget to reconsider its

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order, it can turn to the one place in the record where it has a net present value calculation of costs and benefits of the full term of the contract. Mr. Lazar's testimony, Exhibit_271C, p. 2, line 20, identifies a specific dollar amount disallowance using that approach. The record is also clear that this gas assumption was too low, and at a higher gas price, the disallowance would be higher. Under Mr. Lazar's proposal, of the $219 million regulatory asset, Puget would receive a return of and on the portion remaining after PSE absorbed the specific disallowance stated at Ex. 271 C, p. 2, line 20**.** Adopting Mr. Lazar's recommendation, therefore, would be one solid alternative approach, consistent with PSE's theories.

Another option would be the approach taken by Commissioner Oshie. Indeed, as Commissioner Oshie's opinion points out, the Commission could have gone further based on the record in the case. There is a strong case to be made that "so long as the ratepayers receive no benefit in terms of cost savings relative to the benchmark, PSE should not receive the benefit of a return on the investment, the approval of which turned entirely on the promise of significant savings for customers." Order , ¶ 146 (Commissioner Oshie, concurring and dissenting opinion). We believe that the Commission would be on sound policy and legal footing to adopt Commissioner Oshie's recommendation.

D. The Commission's Order Does Not Set Bad Public Policy.

PSE's petition argues that the order creates a list of disastrous policy results. Petition, p. 10. These concerns are unfounded. As noted above, the Commission has strongly reaffirmed its long-standing prudence test, not superseded it as the company asserts, thus sending a sign of stability in the state regulatory arena. The fact that recovery of company expenditures may be denied after a prudence review is hardly a new consideration for the utility industry. Instead it is a well-known and long-standing aspect of rate regulation in Washington and throughout the country. As we argued on brief in this docket, this disallowance has far less impact on Puget

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than that faced by Nevada Power, for example, which suffered a $400+ million prudence disallowance for its short-term power purchasing practices.[3]

Given this fact, it is hard to see how the Commission's decision in this case will negatively impact the least-cost planning process, or result in the other dire consequences the company predicts. PSE's argument that the result here creates uncertainty is an arguments that could just as well be made against any prudence disallowance – prudence review without doubt introduces an element of uncertainty -- but this decision does not add anything new to the level of uncertainty inherent in prudence review. The record in this case indicates that the financial markets had indeed already taken the risks of the disallowance of some costs in this proceeding into account. Ex. 271C, p. 11, line 5.

Public Counsel has found much to support in the Company's most recent and its current IRP process. Indeed, Puget's analytical efforts in those processes stand in stark contrast to the record on the Tenaska purchasing decisions, where tens of millions of dollars were wasted due to an imprudent gas purchasing and portfolio management system. We note further that the company's Fredrickson acquisition, the centerpiece of this proceeding, was built upon a careful foundation of competitive solicitation and rigorous analysis, including fuel-price risk, again notably missing from the Tenaska decision-making. Puget thus demonstrates that it can effectively and successfully navigate the Commission's long-articulated prudence standard. This order, however, rightly protects consumers from Puget's failure to do so in the case of Tenaska.

[3] Opening Brief of Public Counsel, p. 6. *See also,* Ex. 271C, p. 12 (addressing larger percentage disallowances faced by PSE in the Skagit and Pebble Springs proceedings).

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IV. CONCLUSION

For the foregoing reasons, PSE has failed to establish any valid basis for reconsideration of Order No. 14 under the Commission's rules. Public Counsel recommends that the Petition for Reconsideration be denied.

Respectfully submitted this 1st day of June, 2004.

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