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June 1, 2004

Via Facsimile and Federal Express

Carole J. Washburn
Secretary
Washington Utilities and Transportation Commission
PO Box 47250
1300 S Evergreen Park Drive, SW
Olympia WA 98504-7250

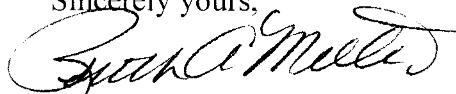
Re: In the Matter of Washington Utilities and Transportation Commission v. Puget Sound Energy, Inc.
Docket No. UE-031725

Dear Ms. Washburn:

Enclosed please find an original and seventeen (17) copies of the Answer of the Industrial Customers of Northwest Utilities to Puget Sound Energy's Motion for Reconsideration and Clarification of Order No. 14 in the above-captioned matter. Per my telephone conversation with Kippi Walker, she requested the document be faxed filed today rather than electronically, due to the State's email connection being down.

Please return one file-stamped copy in the postage-prepaid envelope provided. Thank you for your assistance.

Sincerely yours,



Ruth A. Miller

Enclosures
cc: Service List

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION	)	DOCKET NO. UE-031725
Complainant,	)	ANSWER OF THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES TO PUGET SOUND ENERGY'S PETITION FOR RECONSIDERATION AND CLARIFICATION OF ORDER NO. 14
v.	)	
PUGET SOUND ENERGY, INC.	)	
Respondent.	)	

INTRODUCTION

1 On May 24, 2004, Puget Sound Energy ("PSE" or the "Company") filed a Petition for Reconsideration and Clarification of Order No. 14 ("Petition"), which was issued by the Washington Utilities and Transportation Commission ("WUTC" or the "Commission") in Docket No. UE-031725, on May 13, 2004. Pursuant to WAC § 480-07-850(3) and the Notice of Time and Date for Answers, the Industrial Customers of Northwest Utilities ("ICNU") submits this Answer in Opposition to PSE's Petition. PSE has not established a valid basis for reconsideration of Order No. 14 (the "Order").

2 PSE argues that the Commission has articulated a new, "economic 'used and useful' test" in the Order. This argument misstates the Commission's analysis and overstates both the applicability and effect of the Commission's decision. The framework established by the Commission to evaluate the historic and future costs of the Tenaska gas supply did not represent an abandonment of the prudence standard or a deviation from Washington law and the

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Commission's prior decisions. Instead, the Order reflects a reasoned analysis that takes into account a multitude of factors, including the existence of a large regulatory asset related to the Tenaska gas supply. The Commission properly found that PSE did not prudently manage the Tenaska gas supply and then fashioned an appropriate remedy. Therefore, the decision was well within the Commission's discretion, and reconsideration is not warranted.

BACKGROUND

3 On October 24, 2003, PSE filed an Application for Adjustment of its Power Cost Rate pursuant to the Settlement Stipulation for Electric and Common Issues and the Settlement Terms for the Power Cost Adjustment ("PCA") Mechanism approved in the Company's last general rate case.[1/] PSE requested review of the Company's acquisition of the Frederickson plant ("Frederickson") and an update of the Power Cost Baseline under the PCA. As a result, PSE requested a $64.4 million revenue requirement increase.

4 In testimony submitted on January 30, 2004, ICNU, Staff, and Public Counsel proposed disallowances regarding a number of issues, including adjustments due to PSE's imprudent management of the Tenaska gas supply following the creation of a regulatory asset related to the 1997 buyout of a long-term Tenaska gas contract.

5 On May 13, 2004, the Commission issued Order No. 14, in which it made the following finding of fact:

> 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

[1/] WUTC v. PSE, WUTC Docket Nos. UE–011570, UG–011571, Twelfth Supp. Order (June 20, 2002).

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> reasonable considering the total costs of gas, return of, and return on the Tenaska regulatory asset.[2/]

The Commission ordered a $25.6 million adjustment to PSE's PCA deferral account balance and established a framework specifically designed to address the prudence of PSE's management of the Tenaska gas costs. In commenting on this framework, the Commission specifically noted the unique circumstances surrounding Tenaska, the lack of economic benefit of the Tenaska regulatory asset to customers, the function of the PCA, the balance of shareholder and ratepayer concerns, and the need to consider both historical and future conditions.[3/] The framework developed by the Commission resulted in a $9.9 million adjustment to power costs during the PCORC rate period.

6 PSE primarily challenges this framework for determining future cost recovery related to Tenaska in the Petition for Reconsideration. PSE argues that the incorporation of the "used and useful" concept into the discussion and decision in the Order is "unlawful, inequitable, and represents bad public policy for this state."[4/]

ARGUMENT

7 According to PSE, the Order suffers from a host of deficiencies: 1) it is inappropriate and inconsistent with Washington law; 2) it violates fundamental notions of fairness, due process, and ratemaking; 3) it supersedes the prudence standard; 4) it compromises utility resource planning; and 5) it will result in increased costs to customers. PSE's arguments rest largely on hyperbole. The effect of the Order is far less dire. The Commission did not

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[2/] Order at 51.
[3/] Id. at 46.
[4/] Petition at 2.

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announce a generally applicable, economic "used and useful" test in the Order that will apply to all Washington utilities; rather, the Commission established a framework to address the prudence of PSE's actions in managing the Tenaska gas supply. The Commission did not state that this standard would apply to any Washington utility or any resource decision other than PSE and its management of the Tenaska gas supply. As such, the fundamental premise upon which the Petition is based is faulty and the majority of PSE's arguments crumble around that faulty premise. The remaining arguments do not justify reconsideration.

A. The Commission Established a Framework to Address PSE's Past and Future Imprudent Actions in Managing the Tenaska Gas Supply, Not a New Economic Test

8 The fundamental flaw in PSE's Petition is that it hinges on the unreasonable belief that the Commission adopted a generally applicable new rule that applies to all Washington utilities. If the Commission does not agree with PSE that the Order announced a generally applicable new test, then it should deny the Petition because the Company states no other basis for reconsideration. As the Commission noted in the Order, PSE's imprudent management of the Tenaska costs was a unique situation with unusual facts that required a specifically tailored remedy—a hybrid approach that included elements of both the prudence test and the "used and useful" test.[5/] The fact that the Commission's analysis includes elements of both these concepts in no way affects the Commission's primary finding of imprudence. PSE's Petition ignores both the nature of the Commission's decision and all of the factors that contributed to that decision. Thus, there is no basis for reconsideration.

[5/] Order at 40-41.

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1. The Commission did not Adopt a Generally Applicable New Test

9 Most of PSE's arguments rely on the unfounded assertion that the Commission has established a new standard in the Order by which utility actions will be judged in the future. Based on this belief, PSE asserts a host of maladies to which Washington utilities will be subject as a result of the Order. PSE's claims are untrue. The framework adopted in the Order is limited to PSE only. In the Order, the Commission determined both that PSE was imprudent in its management of the Tenaska gas supply and that application of the used and useful concept to the Tenaska asset has "some merit."[6/] The Commission indicated that there were problems with the applicability of each test, however, due to the unusual facts of the case.[7/] As a result, the Commission fashioned a hybrid remedy that incorporated both the prudence standard and the used and useful test.[8/] The Commission specifically stated, however, that the test established "clear rules for *PSE's* future recovery of *costs related to the Tenaska power plant*."[9/] Thus, despite PSE's claims, the Commission did not establish a broad rule of general applicability. Because PSE's belief that the framework established in the Order applies outside of the Company's management of the Tenaska gas supply is erroneous, the following arguments in PSE's Petition are unconvincing:

1. Retroactive application of the new economic test, according to a cost "benchmark," violates fundamental notions of fairness, due process, and ratemaking principles;
2. The "new test" effectively supersedes the prudence standard;
3. The "new test" compromises the Commission's least cost standard and the

[6/] Order at 39.
[7/] Id. at 39-41.
[8/] Id. at 41.
[9/] Id. at 49.

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portfolio approach to least cost planning; and

4. The "new test" adds uncertainty to the electric industry and will increase costs for utilities and their customers.

If the Order is narrowly interpreted, as was obviously intended by the Commission, most of the arguments in the Petition fail due to PSE's faulty premise that the Commission announced a broad new test. The other arguments in the Petition, which are discussed below, also lack merit.

2. An Economic Remedy was Appropriate to Address PSE's Imprudent Failure to Manage the Tenaska Gas Supply for the Economic Benefit of Customers

10 PSE also complains that the Commission inappropriately made the used and useful standard into an "economic test."[10/] According to PSE, application of the used and useful standard as an economic test is inconsistent with Washington law and is bad public policy. PSE is mistaken.

11 The Commission was considering a regulatory asset in the case of Tenaska, not a physical asset. That regulatory asset was authorized specifically on the basis of the expectations created by PSE about future *economic benefits* as a result of savings in gas costs. In other words, the Commission was addressing an economic issue in the Order. It is entirely reasonable to apply an economic test under these circumstances, because PSE's imprudent actions lead to the elimination of that economic benefit. As the Commission noted, the used and useful concept was implicit in, or at least analogous to, the disallowances proposed by certain parties, which were based on the idea that it was inappropriate for the Company to recover all of its Tenaska costs, because the regulatory asset provided no benefit to customers.[11/] The Commission found

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[10/] Petition at 4.
[11/] Order at 35, 39.

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that application of this concept "does have some merit," but the Commission did not strictly apply the used and useful test in RCW § 80.04.250.[12/]

12 PSE's arguments are based on the presumption that the Commission's decision involved strict application of the used and useful standard only. This is incorrect. The Commission adopted a hybrid model that included elements of the prudence standard and the used and useful concept due to the unusual facts surrounding the Tenaska asset, but specifically found "that neither should dominate exclusively in this particular case . . . ."[13/] Although PSE initially acknowledges in the Petition that the Commission relied on the prudence standard, the Company ignores the prudence component of the framework in criticizing the Commission's decision. PSE cannot justify reconsideration by ignoring certain aspects of the Order.

13 The Commission explicitly determined that PSE was imprudent in its management of Tenaska gas costs and that PSE's imprudence affected both past and future periods.[14/] Based on this determination, the Commission concluded that the proposed rates were not just and reasonable and then exercised its statutory responsibility to set the just and reasonable rate.[15/] The remedy fashioned by the Commission reflected a balancing of the interests of ratepayers and shareholders.[16/] While the Commission considered the used and useful test by analogy, both its determination of prudence and its remedy clearly reflect application of a traditional prudence test. If anything, the Commission used the used and useful test to mitigate the impact of applying a strict prudence test. Under a strict prudence test, the

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12/ Order at 39.
13/ Id. at 41.
14/ Id. at 46.
15/ Id. at 51-52.
16/ Id. at 46.

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parties argued that rate recovery should be capped or that the regulatory asset should be removed from rate base. The Commission characterized these outcomes as unforgiving.[17]

14 PSE also maintains that the Commission has rejected the "economic 'used and useful' test" in the past; however, the Company does not explain the context of the Commission's decision.[18] In Cause No. U-85-36, the Commission allowed Washington Water Power ("WWP") to include Colstrip 4 in rate base despite a nine-month delay in putting the plant in service due to the unavailability of transmission capacity.[19] The Commission rejected proposed disallowances based on a number of different theories, including the sinking-fund depreciation method, rate base phase-in, trended rate base, the used and useful test, and the traditional prudence standard. Nevertheless, the Commission concluded that it might adopt such theories in a future proceeding.[20] Furthermore, in contrast to the decision at issue here, the Commission specifically found that WWP was not imprudent as a result of the delay.[21] The Commission also noted that determining what is used and useful requires consideration of a number of factors, including the utility's obligation to serve customers.[22] This is consistent with the Order, in which the Commission ordered a disallowance because "PSE managed gas acquisition primarily for the short-term bottom line for shareholders."[23] Application of the used and useful concept is appropriate when PSE does not act for the benefit of customers.

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[17] Id. at 40-41.
[18] Petition at 5 citing WUTC v. Washington Water Power Co., WUTC Cause No. U-85-36, Third Supp. Order (Apr. 4, 1986).
[19] WUTC v. Washington Water Power Co., WUTC Cause No. U-85-36, Third Supp. Order at 12-14 (Apr. 4, 1986).
[20] Id. at 13-14.
[21] Id. at 13.
[22] Id.
[23] Order at 42.

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15 Finally, PSE argues that other regulatory commissions and courts have identified significant problems with the "economic variant of the used and useful standard."[24/] However, the two primary cases cited by PSE are distinguishable. Unlike this proceeding, in which the Commission deemed PSE's actions imprudent, the Montana regulatory commission disallowed costs without any prior finding of imprudence or unreasonableness.[25/] The Montana district court overturned that decision.[26/] Similarly, the Massachusetts Department of Public Utilities ("MDPU") decision was not evaluating a remedy similar to the one the Commission adopted to address PSE's imprudence.[27/] Rather, the MDPU made a policy-based decision to abandon the practice of compensating utilities' generation investments based on a market surrogate price.[28/] Furthermore, the MDPU explicitly recognized that, in some cases, it had required a utility to demonstrate that its investment was prudent and "provide[d] net benefits to ratepayers" before allowing the utility to earn a return on the investment.[29/] The MDPU also determined that use of the prudence standard alone was inappropriate in that case.[30/] Thus, the MDPU's consideration of these two standards in concert with one another is consistent with the Commission's decision here.

24/ Petition at 11.
25/ Montana Power Co. v. Montana Dept. of Public Serv. Regulation, 68 P.U.R. 4th 251, 256 (1985).
26/ Id. at 527-28.
27/ Re Pricing and Rate-making Treatment for New Electric Generating Facilities Which Are Not Qualifying Facilities, 89 P.U.R. 4th 190 (1987).
28/ Id. at 216.
29/ Id. at 220.
30/ Id. at 219.

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3. PSE Was on Notice of its Burden to Demonstrate the Prudence of its Management of the Tenaska Gas Costs

16 The Company also argues that "[a]t no time has PSE ever understood that its management of the Tenaska asset could or would be judged by the new economic test set forth in the Tenaska Order."[31/] PSE maintains that it had no notice of the "new" test and, therefore, the Order is unlawful. The fundamental underpinning of the Order is that PSE acted imprudently. That decision was made according to the Commission's accepted prudence standard, based on the evidence presented in this proceeding. Thus, PSE's actions were evaluated according to the prudence standard of which the Company admits it had notice.[32/] Furthermore, the remedy chosen to address PSE's imprudence merely was one of a number of possible remedies, all of which were within the Commission's discretion to adopt. Adoption of that remedy did not mean, however, that PSE's costs were judged according to a different standard. The fact that the Commission also adopted a framework to assess the prudence of PSE's actions with respect to Tenaska in the future does not violate the Company's due process rights, nor is it fundamentally unfair.

B. PSE Complains About the Asymmetry of the Commission's Remedy but Proposes an Asymmetrical Alternative

17 PSE also argues that "[a]s currently written, the recovery rule for future Tenaska costs gives too great a benefit to customers at PSE's expense."[33/] PSE's complaints about the asymmetry of the remedy adopted by the Commission ignore significant aspects of the Order.

31/ Petition at 7.
32/ Id. at 8.
33/ Id. at 18.

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First, the Commission found that PSE has imprudently managed the gas supply for the benefit of shareholders since the buyout in 1997. PSE's imprudent actions cost customers substantial amounts from 1998 to 2003 and have eliminated any economic benefit.[34/] PSE is in no position to complain about asymmetrical treatment.

18 Furthermore, noticeably absent from PSE's "Attachment A" is data prior to PCA period 1, which reflects the asymmetrical sharing of the costs of the regulatory asset between the Company and customers to this point. It depicts no ratepayer costs prior to the first PCA period, which is the period when PSE was imprudently managing the Tenaska gas supply for shareholder benefit.[35/] The total cost to customers during this time cannot be recovered. In addition, PSE claims that customers will receive substantial benefits starting with PCA period 6, when the Company predicts the total contract charges will fall below the baseline.[36/] However, PSE ignores the fact that the total cost to customers above the benchmark in PCA periods 1 to 5 cannot be offset by the projected value in the later PCA periods. PSE's claim that "customers get 100% of the benefits when the costs are less than the benchmark" is untrue.[37/] PSE shareholders receive a direct benefit if the Company manages its costs below the benchmark, because the first $20 million in costs under the PCA is not shared with customers. PSE ignores the function of the PCA mechanism.

19 Finally, despite PSE's complaints about asymmetrical sharing under the framework adopted by the Commission, the Company proposes an asymmetrical alternative. PSE requests to defer any disallowance on the return on the asset over the remaining term of the

[34/] Exh. No. 231C at DWS/28-29.
[35/] Petition at Attachment A; Order at 42.

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contract and compare that deferral to the benefit at the end of the contract. However, application of this mechanism after PCA period 6, when there is very little carrying cost on the regulatory asset due to the non-levelized amortization scheme, will skew the results in the Company's favor. In other words, PSE's proposal does not consider all costs of the regulatory asset. Although the Commission should not alter the framework adopted in the Order, if PSE wanted a truly symmetrical sharing mechanism it would propose a mechanism that would compare the benchmark to total costs, including both the return on and the return of the regulatory asset over the life of the asset. PSE's disingenuous claims about desiring a "symmetrical" sharing mechanism provide no basis for reconsideration.

C. The Commission Should Consider the Impact of the Adjustment in Future Proceedings

20 PSE requests that the Commission clarify its discussion about the impact of the $25.6 million disallowance on future PCA periods. The issues surrounding interaction of the cost disallowances, the PCA, and changes to PSE's revenue requirement are complicated. It appears, however, that the Commission specifically reserved its right to review the impact of the adjustments in future PCA periods and that the Commission was aware that the recovery rule would impact PSE's revenue requirement in the near-term future.[38/] Under these circumstances, the narrow interpretation of the Order put forth by PSE is inappropriate.

36/ Petition at 18.

37/ Id. at 18-19.

38/ Order at 45 ("Because this adjustment may have consequences in later PCA periods, we will take it into account when reviewing those periods.") Id. at 47 ("In the near-future years some portion of the return on the asset will exceed the benchmark, and so only one-half of that portion will be included in the Company's revenue requirement.")

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21 Finally, the Commission should reject PSE's suggestion that the Order resolves all issues with respect to the fuel management issues for PCA period 2 and that the Company has a "clean slate" with respect to all fuel management decisions made before PCA period 2 began.[39] Such broad statements are unnecessary and will likely lead to future arguments about the Commission's intent. Furthermore, the Commission cannot predict what evidence may be discovered in future proceedings that may reveal that additional action is warranted.

CONCLUSION

22 PSE's request for reconsideration rests largely on the Company's exaggerated claim that the Commission adopted a generally applicable new test in the Order that fundamentally changes the way Washington utilities are regulated. The Commission's decision was reasonable and reflects consideration of the unusual circumstances surrounding Tenaska, equitable issues, and historic and future conditions. PSE ignores the Commission's consideration of these factors in an unconvincing attempt to justify reconsideration. The Petition should be denied.

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[39] Petition at 24.

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WHEREFORE, ICNU requests that the Commission deny PSE's Petition for Reconsideration and Clarification of Order No. 14.

DATED this 1st day of June, 2004.

Respectfully Submitted,

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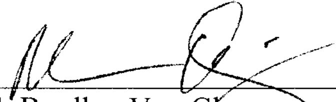

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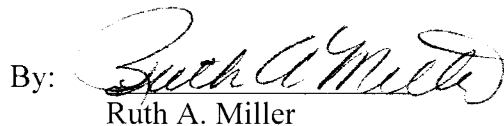
Of Attorneys for the Industrial Customers of Northwest Utilities

CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing Answer of the Industrial Customers of Northwest Utilities to Puget Sound Energy's Motion for Reconsideration and Clarification of Order No. 14 upon the parties, shown below, on the official service list for Docket No. UE-031725, by causing the same to be deposited, postage-prepaid, in the U.S. Mail.

DATED this 1st day of June, 2004.

DAVISON VAN CLEVE, P.C.

By: 
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