Agenda Date: April 28, 2004
Item Number: A4

Docket: **UE-032043**
Company: Puget Sound Energy

Staff: Merton Lott, Energy Industry Coordinator

<u>Recommendation</u>:

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

<u>Discussion</u>:

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 form 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.

<u>Undepreciated plant in service</u>

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.