

DEC 15 1997

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of)	
)	DOCKET NO. UE-971619
PUGET SOUND ENERGY, INC.)	
)	
For an Order Regarding the Accounting)	ORDER
Treatment for the Purchase of a Gas)	
Sales Contract.)	
.)	

MEMORANDUM

Petition: On November 7, 1997, Puget Sound Energy, Inc. (Petitioner or Company), filed a petition for an order regarding the accounting and rate making treatment of the Company's purchase of a gas sales contract and restructuring of the Company's existing power purchase agreement with the owner of a cogeneration facility (Owner). The Owner was identified in Exhibit A to the petition.¹ According to the petition, the transaction is scheduled to close on or before December 31, 1997, and provides the Company with the opportunity to achieve a restructuring of the power purchase agreement for the cogeneration project that will produce significant savings for customers. These savings were set forth in Exhibit B to the petition.

The petition states that the order requested is necessary to enable the Company to enter into the transaction. Because of the material loss in economic value related to timing, the terms of the Letter of Intent with respect to the transaction provide that it terminates unless the transaction closes by December 31, 1997. The Company therefore requested issuance of the requested Commission order within 30 days.

Background: In the early 1990s, the Company entered into an Agreement for Firm Power Purchase (Agreement) with the Owner of the facility to purchase the output of a cogeneration facility. The project is a Qualifying Facility under the Public Utility Regulatory Policies Act of 1978, or PURPA. Over the past year, the Company apparently has been in negotiations with the Gas Supplier (Supplier) regarding the restructuring of the Agreement to achieve a reduction in the power supply costs under the Agreement. The Supplier was identified in Exhibit A to the petition.

¹ Substantial information filed by the Company in support of its petition was designated confidential pursuant to RCW 80.04.095 and WAC 480-09-015. Therefore, this Order must incorporate some of that information by reference. However, at the Commission's December 10, 1997 open public meeting at which this matter was considered, it was disclosed that this matter involved the "Tenaska contract."

These negotiations included investigation of a possible purchase of the underlying gas contract from Supplier.

According to the petition, these negotiations resulted in the parties reaching agreement on a Letter of Intent (LOI) whereby the Company would purchase the underlying gas contract of Supplier and restructure the power purchase agreement. A copy of the LOI, including Exhibit A to the LOI, was included as Exhibit C to the Company's petition. The purchase price agreed upon by the parties (Purchase Price) was set forth in paragraph 1 of the LOI.

The Company's stated objective in entering into this agreement is to drive the gas cost element of a long-term fixed price escalating PURPA power contract toward market, at a price and at a time that provides maximum overall benefit to the Company and its customers. After the purchase of the gas supply contract, the Company will enter into new gas supply agreements at market prices. An Amendment to the Agreement was also executed reflecting the new pricing arrangement. This agreement was subsequently filed as Exhibit J to the petition. The petition states that the savings in power contract costs provided as a result of this transaction are substantial, citing the total shown on Exhibit B. The Company claims that while other forms of restructuring this PURPA gas supply contract were discussed with Supplier, a smaller level of overall savings would have been produced. The Company also indicated that delaying this transaction into a later time frame would materially lessen the value to customers and increase the purchase price for the gas supply contract due to tax consequences to Supplier, making it necessary to complete all elements prior to December 31, 1997.

The Company's notes that its proposal is structured such that the purchase price, financing costs, and new power costs are ratably spread forward in proportion to the original contract costs thereby achieving an equitable power cost savings in each of the remaining years of the Agreement. As a result, a proportionate percentage power cost reduction occurs in each year and approximately twice as much savings is delivered in the later years versus the earlier years.

Proposed Accounting Treatment: The purchase of the gas supply contract by the Company will result in effective future reductions in power supply costs under the Agreement. The Company proposed to reflect these reductions in cost of service proportional to the amounts in the Agreement. A restructuring of the power costs under the Agreement would be based on the contract price under the existing Agreement less gas cost savings, as measured by the current forward market gas price quotes. The rebundled power costs (including the cost to achieve the savings) would be spread over the remaining term of the Agreement.

According to the Company, this produces an equitable sharing of the power cost reduction benefits over the remaining term of the Agreement. The Company included as Exhibit F to the petition a graph depicting the effects of this proposal on the power costs paid by customers. For purposes of calculating the targeted amounts and to achieve an equitable spread of new power costs (i.e., ratable to the original contract), the Company's proposal balances the savings, based on forward-priced new power costs, with the restructuring costs. The Company proposed to use 8.0% as the cost of money for purposes of calculating the interest on deferrals, and included Exhibit G to the petition as support for using that rate.

The petition states that in order to achieve the targeted savings, an accounting order is necessary which obtains the desired effect for ratemaking purposes and satisfies the Company's financial reporting and accounting needs. The petition requested that the order authorize the Company to do the following for accounting and ratemaking purposes:

- (a) Capitalize, for recovery in rates, the purchase price paid by the Company for the gas supply contract;
- (b) Earn a return, at a rate of eight percent, on one-half the deferred balance for the first five years;
- (c) Commence amortization of the deferred balance (including the debt return and the capitalized purchase price) in the first year based on the proportionate amount of gas cost savings less interest expense in each year as compared to the total amount in all years as set forth in Exhibit H. The unamortized balance will be included for ratemaking purposes for recovery in any future proceedings;
- (d) Flow through the tax benefits of the straight line amortization of the purchase price.

The petition states that the requested methodology would be used in filings with the Commission.

The Company further proposed to adjust the recovery rates in the event the restructuring costs are increased by the consequence of the tax indemnification provision provided to Supplier as a result of the transaction. Paragraph 6 of the LOI obligates Petitioner to indemnify Supplier's shareholders for 50% of the actual increased tax liability in the event the gain resulting from this transaction is taxed at ordinary income rates rather than at capital gains rates. There is a maximum aggregate limit on such payments as set forth in paragraph 6 of the LOI. In the event that Petitioner makes any payments under this indemnification provision, the Company proposed that the recovery rates be subject to adjustment, consistent with the pro-rata pricing

methodology set forth above, over the remaining years at the time of such adjustment and that the accounting order be revised accordingly.

Regulatory Review of Restructured Agreement: Under previous orders issued by the Commission, the Company is required to file all cogeneration agreements with the Commission. Second Supplemental Order, Cause No. U-85-87. Commission Staff performs a preliminary review, and notifies the Company within thirty (30) days if there is any issue with respect to a particular contract. Seventh Supplemental Order, Cause No. U-85-87. According to the Company, the information and documents filed in connection with the petition give Commission Staff an opportunity to conduct its preliminary review with respect to the amendment to the Agreement.

FINDINGS OF FACT

Having thoroughly reviewed the instant petition and having been fully apprised in the particulars of that petition, and having heard the oral comments of Commission Staff, Company, and interested persons, the Commission makes the following findings.

1. The Washington Utilities and Transportation Commission is an agency of the state of Washington vested by statute with authority to regulate rates, services, facilities, practices, rules, accounts, and transfers of public service companies, including electric companies.
2. Petitioner Puget Sound Energy, Inc., 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 regulatory authority of the Commission as to its rates, service, facilities, and practices.
3. On November 7, 1997, the Company filed a petition for an order regarding the accounting and ratemaking treatment of the Company's purchase of a gas sales contract and restructuring of the Company's existing power purchase agreement with the owner of a cogeneration facility (Owner).
4. The transactions will provide the Company with the opportunity to achieve a restructuring of the power purchase agreement for the cogeneration project that will produce significant savings.
5. The Company's proposed treatment of the purchase price is reasonable. The Company should be allowed to: (a) capitalize, for recovery in rates, the purchase price paid by the Company for the gas supply contract; (b) record a return, at a debt rate, on one-half the deferred balance for the first five years; and,

(c) commence amortization of the deferred balance (including the debt return and the capitalized purchase price) in the first year based on the proportionate amount of gas cost savings less interest expense in each year as compared to the total amount in all years. The unamortized balance should be included for ratemaking purposes for recovery in any future proceedings.

6. The Company's proposal to flow through the tax benefits of the straight line amortization of the purchase price is reasonable and should be approved.

7. The Company also filed the draft amendment to Agreement with the Commission in accordance with the Second and Seventh Supplemental Orders in Cause No. U-85-87. The information and documents filed in connection with the petition provided Commission Staff an opportunity to conduct its preliminary review with respect to the amendment to the Agreement.

8. The Company's proposal regarding the treatment of any payments it may be required to make under the federal income tax indemnification provision of the LOI, which would adjust the recovery rates over the remaining years consistent with the pro-rata pricing methodology, is reasonable.

ORDER

THE COMMISSION ORDERS:

1. The Company's November 7, 1997, petition for an Order regarding accounting treatment with respect to the Company's purchase of a gas sales contract and restructuring of the Company's existing power purchase agreement with the Owner, is approved, except as limited by this Order.

2. The Company's proposed treatment of the purchase price is approved, and the Company is authorized to capitalize, for recovery in rates, the purchase price paid by the Company for the gas supply contract; record a return, at a debt rate of eight percent, on one-half the deferred balance for the first five years; and commence amortization of the deferred balance (including the debt return and the capitalized purchase price) in the first year based on the proportionate amount of gas cost savings less interest expense in each year as compared to the total amount in all years. The unamortized balance will be included for ratemaking purposes for recovery in any future proceedings.

3. The Company is authorized to flow through the tax benefits of the straight line amortization of the purchase price.

4. Commission Staff has performed its preliminary review of the draft amendment to Agreement pursuant to the Seventh Supplemental Order in Cause No. U-85-87, and the thirty day review period shall be deemed to have expired with respect to the amendment. The presence or absence of any such notification to the Company as to a particular contract shall not be construed or interpreted as a determination either of the prudence of such contract or of the rate treatment to be accorded such contract in any subsequent proceeding.

5. The Company's actions in purchasing the gas sales contract, managing the cost of gas, and restructuring the power purchase agreement is subject to review in future rate proceedings; the Company bears the burden of proof in any such proceeding regarding these matters. Any costs determined to be unreasonable or imprudent in such proceedings are subject to disallowance.

6. The Commission's approval of the instant petition does not in any manner modify or affect the Commission's prior orders regarding standards or burden of proof in determining whether costs of a utility were imprudent or unreasonable, *e.g.*, Washington Utilities and Transportation Commission v. Puget Sound Power & Light Company, Docket Nos. UE-920499, UE-921262 (September 27, 1994).

7. The Company's proposed treatment of any payments it may be required to make under the federal income tax indemnification provision of the Letter of Intent is approved. Given that an event triggering the indemnification provision may not occur for several years, however, the Commission reserves the right to reconsider this approval of the Company's proposal.

8. The Commission retains jurisdiction to effectuate the provisions of this Order.

DATED at Olympia, Washington, and effective this *10th* day of December 1997.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION



ANNE LEVINSON, Chair



RICHARD HEMSTAD, Commissioner



WILLIAM R. GILLIS, Commissioner