I.INTRODUCTION

"Look mom, the King has no clothes." Hans Christian Anderson

"There are no savings." Jim Lazar

A. SUMMARY

Public Counsel recommends that the Commission reject the filing in this docket for several reasons:

- there are no savings, just a reshuffling: cost reduction now with increased risks and an expectation of increased costs in the future.
- there is no least cost plan.
- consumers are worse off with this proposal
- the balance is grossly unfair: stockholders gain $ 104 million and ratepayers lose $ 80 million (both present value).

If the Commission wishes to consider the sale of Colstrip, it is critical that ratepayers not be made worse off. To accomplish this, short run benefits (which Puget assigns to itself) must be provided to ratepayers to offset later increased risks and costs. The following options are available:

- approve the sale only with accounting treatment that defers the gain on the sale and the power cost savings, with a return, until the next rate case, at which time they should be distributed to ratepayers over an appropriate period of time.
- reject this application but allow Puget to resubmit as part of a comprehensive restructuring of its power supply resources.

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flow through to ratepayers now all benefits from the sale and the reduced power costs. The primary recommendation of Public Counsel is to reject this petition.

B. PARTIES

This brief is submitted by the Public Counsel Section of the Office of the Attorney General (Public Counsel), the statutory representative of the "people of the state" in utility hearings. RCW 80.01.100. The petitioner, Puget Sound Energy, will be referred to as Puget or Company. The Staff of the Commission will be referred to as Staff.

C. ANALYTICAL CONSIDERATIONS

1. There are two types of costs: power supply and gain on sale

Analysis of this proposal must include both the power supply costs and the gain on sale. The typical sale of surplus property only concerns the gain on the sale. Since Colstrip is an operating generating station, we must also consider the effect a sale would have on power supply costs. All parties agree on this. In fact the power supply costs and savings are much larger than the gain on sale. Tr. 367. Accordingly in this brief we will normally use the phrase "benefits" to include both the gain on sale and the effect on power supply costs. Our evidence shows that there are actually likely to be negative "benefits", i.e. liabilities from the transaction as proposed.

2. There are two types of equity considerations

Equity over Time. When considering Puget's proposal one must look at both the early years and later years. In the early years there are positive benefits from both the power supply savings and the gain on sale. However, in the later years there are negative effects from the

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purchase of replacement power at costs which are expected to increase over time. A sale of Colstrip would require Puget to acquire replacement power. To compare costs with and without Colstrip, one must compare the expected cost of Colstrip over its life with the expected cost of replacement power. After the first two years the replacement power is assumed to be at market price. Colstrip costs are currently above market, but are declining, due to depreciation and increasing market prices. Thus, there are system savings on power supply in the early years, with an expected system negative savings (i.e. increased costs) in later years. The cross over point is about 2004. Ex. 7, Ex. 20, Ex. 58, p.2,6,7., Tr. 103, 330.

Equity Between Shareholders and Ratepayers. When considering the effect on ratepayers and stockholders, one must consider the period of time during the current rate plan versus the subsequent period of time. Puget claims that it is entitled to keep all savings during the rate plan period, i.e. through the end of 2001. Thus one must look at the benefits that Puget would assign to itself in the first couple of years vs. the "benefits" that would fall to ratepayers in subsequent years.

Agreement. All parties agree that there are benefits from the proposal in the next few years, i.e. from the substitution of contract power and then market power in place of the cost of power from Colstrip and from the gain on the sale. All parties also agree that subsequently the economics of the replacement power are expected to reverse, and the cost of replacement power will become more expensive than Colstrip power. Public Counsel and Puget witnesses used the same power cost forecast and the same Colstrip cost forecast.

Disagreement. The important differences, especially between Puget and Public Counsel,

are the discount rate, carrying cost (both based upon capital costs) and end effects. This causes a difference in the power supply cost differential after the first few years, that is, in those years when ratepayers would be liable.

D. THE LEGAL STANDARD - THE PUBLIC INTEREST

In the 1997 order approving the merger of Washington Natural Gas into Puget Sound Power & Light the Commission reviewed the law, regulations and precedents to establish an appropriate standard for judging a massive property transfer. The Commission adopted a four part standard, Exhibit 27, Order p. 19-20. The most relevant are the first two:

> The transaction should not harm customers by causing rates or risks to increase, or by causing service quality and reliability to decline, compared with what could reasonably be expected to have occurred in the absence of the transaction.
>
> The transaction, with conditions required for its approval, should strike a balance between the interests of customers, shareholders, and the broader public that is fair and that preserves affordable, efficient, reliable, and available service.

As will be explained in greater detail below, the transaction as proposed, provides benefits to shareholders at the expense of increased risk and likely increased rates to consumers, compared with what can "reasonably be expected to have occurred in the absence of the transaction." In addition, Puget proposes to provide $104 million of benefits to stockholders and negative $80 million of costs to consumers. This does not strike a fair balance nor preserve affordable, reliable and available service.

II.ARGUMENT

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A. THERE ARE NO SAVINGS

We have first looked at the net benefits of the proposed sale for the entire Puget system, irrespective of who gets which benefits. The record shows at best a negligible benefit and more likely a large negative net detriment.

We then looked at the specific accounting treatment proposed by Puget. Since it proposes to keep all of the savings in the early years, Puget's proposal harms ratepayers.

1. A total system analysis shows a negative, or at best a negligible, net result of the sale

In this analysis, all of the costs and benefits of the sale are added together. The result varies from a small benefit per Puget to a large negative as calculated by Mr. Lazar. Using the Company's base case analysis with a few updated inputs changed results to a conclusion that there are in fact no "savings" from the sale of Colstrip, even when analyzed on a system wide basis.

This result does not support selling Puget's largest generating station, leaving supply to the open market. To move from being an owner to a "renter" deserves a clearer benefit than demonstrated.

Puget's result is demonstrated on Exhibit 20. It shows that during the first years Puget would get to keep about $86 million and in the post rate plan period ratepayers would be liable for about $308 million, for a net system detriment of $222 million, all in nominal terms. Adjusted by Mr. Story for present value, the benefit to stockholders is about $76 million and the liability of ratepayers is about $73 million, for a net total system benefit of just $3 million. Even

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assuming one accepted this result, that is a very small benefit in a transaction in which Puget receives $556 million for the sale, and the total nominal value of Colstrip power is $3 Billion. Ex. 17; Ex. 200, p.1, Ex. 58, p.6.

Mr. Lazar replicated the Puget base case analysis, using all of Puget's input assumptions. Ex. 58, p.6. He then adjusted the analysis by updating three factors and adding end effects: (1) the new, reduced, Montana property tax; (2) a lower discount rate to reflect the Company's current capital structure; (3) a lower carrying cost for Colstrip to reflect the Company's current cost of debt; and in addition, (4) he examined the value of end effects, i.e. the value of Colstrip after 2018, the end of the Company's analysis. Ex. T-57, p.12. The results are shown in a chart, sequentially, at Exhibit T-57, p.13, and calculated in Ex. 58. The first two changes by themselves lower the value of the benefits to less than zero. The first three changes result in a negative "benefit" of about $20 million. Combining all four adjustments results in a "benefit" of negative $70 million.

The new Montana property tax is a fact. Speculation about the political atmosphere in Montana and future changes is difficult to incorporate into an analysis. In response to a request from Public Counsel, Mr. Gaines updated his analysis in Ex. 7 to incorporate the new Montana property tax. His revised calculations, page 10 of Exhibit 15, show net benefits falling from $24 million to $6.5 million. Ex. T-57, p.6, Tr. 148.

Puget's analysis assumes that Colstrip is worthless after 2018. Mr. Lazar adjusted this to provide for a declining value over the next ten years. This longer plant life is consistent with the most recent depreciation study prepared by Puget. Ex. 15, p. 11. While that study is eight years

old, Puget provided it as the most current, has not presented any update, nor reasons that it is no longer valid. In 1996 PacifiCorp performed an analysis of the Centralia coal plant which used 30 years of remaining life. Since Centralia was built in 1972, this produces a useful life of 54 years. Ex. 61. This would indicate that Mr. Lazar's calculation for Colstrip was reasonable.

Puget argues that costs of keeping Colstrip could go up if a particular version of a carbon tax were to be enacted by Congress. The last time such a tax was proposed, it would have taxed all energy forms, not just carbon. Thus it would likely effect both sides of the keep/sell equation equally. While a carbon tax is possible, it does not appear likely at this time, and Puget has demonstrated a willingness to oppose such a tax. Ex. 15, pp. 17-30.[1]

2. Discount rate

Puget used its cost of capital as established in its last rate case in 1992. Its costs have changed since then and Mr. Lazar has simply used the best current numbers, as provided by Puget. Ex. T-57, p.12, Ex. 15, pp.3-4. This effects both the discount rate used for the present value calculation and the carrying cost of keeping Colstrip.

A lower discount rate means that the adverse effect of higher long run power costs is more severe on a present value basis. The lower cost of capital also means that the cost of holding Colstrip is lower. Taken together, these two corrections alone turn Puget's calculation of a net benefit into a net liability. Ex. T-57, p.13.

Public Counsel and Puget agree that a present value analysis is the proper way to compare

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[1] Note that the date request sought efforts that were funded by ratepayer contributions, Ex. 15, p.17.

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money in different years and both therefore used a present value calculation to compare the benefits in the early years with the detriments in the latter years. The choice of a proper discount rate is the key difference between the two perspectives. Puget originally used a discount rate of 7.69% based upon its cost of capital from the last rate case, and concluded the net benefit is expected to be $24 million in its base case. Ex. 7. Updating that for the Montana property tax reduces the net benefit to $6.5 million. Ex. 15, p. 10. At the hearing Mr. Story said that he preferred using a discount rate of 7.69%, based upon the Company's net of tax cost of capital from the last rate case. Tr. 89-90. At the request of Public Counsel he prepared a revised table which shows a net benefit of $3 million. Ex. 20, p.1.

Mr. Lazar used a discount rate of 7.16%, based upon Puget's current net of tax capital costs. The net of tax discount rate has been used widely by many entities. Puget Sound Power and Light's consultant Dr. Perl used it in Docket U-83-53. Washington Natural Gas, the other precursor firm to the current Puget Sound Energy, also used a net of tax rate in its last least cost plan. Tr. 80.

Mr. Lazar's discount rate is based upon actual known and measurable changes in Puget's cost of capital since the last rate case, as provided by Puget. Ex. 15, p.4. The Company, using information from its last rate case, 7 years ago, did not update its calculation to reflect that interest rates have declined and that Puget's actual cost of debt is lower.

3. Puget's proposed treatment results in a negative impact on the public

To properly evaluate Puget's specific proposal one must separately look at the effect during and after the current rate plan. During the rate plan Puget proposes to keep all of the gain

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and all of the power supply savings. Ex. T-57, p.5. There are assured power supply savings because Puget has contracted with the potential purchaser of Colstrip to buy back power at a favorable rate, compared to the current carrying and production costs, for this period of time only. After the plan, the remaining portion of the gain is provided to ratepayers and ratepayers begin being responsible for the difference between the cost of power from Colstrip and the market price of power. In the first three years, the power supply cost differential provides benefits. After 2004, as Colstrip costs drop due to depreciation and market prices continue to rise, the power supply cost differential becomes a liability.

Looking at the accounting proposal by Puget, the deal becomes a nightmare for ratepayers. Using the Company's own original Exhibit 7, for example, Puget takes all the benefit during the rate period, a total of $117 million, nominal; ratepayers get some benefit in the early years after the rate plan ends, but then suffer substantial negative effects after that. The total result is a negative for ratepayers of $319 million, nominal. On a present value basis, the result is a positive $104 million for shareholders, and a negative $80 million for ratepayers. Ex. T-57 (Lazar), pp. 5, 10; Ex. 7, p. 2, Ex. 58, p.6. Similarly Mr. Story's cross examination calculation shows that stockholders get a positive $76 million while ratepayers are stuck with negative $73 million. Ex. 20, p.1, line 28. Tr. 382.

The rate treatment as proposed must be rejected as harming ratepayers and therefore not being consistent with or in the public interest.

4. Even if Puget is getting a "premium" from Global, the transaction does not pass the public interest test

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Puget claims that it is getting a better sales price for Colstrip due to joining with Montana Power's sale of its share of the plants. Ex. T-6, p.15. Even if this is the case, the analysis in this case shows that the total deal is not a benefit to Washington ratepayers. Therefore the possibility that this represents a better deal than Puget can imagine getting at another time is not justification for taking a deal that harms ratepayers. Even with the premium, this deal is not very good on a system basis and is a horrible deal for ratepayers as proposed by Puget.

Puget claims that it does not want to be a minority owner in Colstrip. However, Puget has been a minority owner of Colstrip 3 and 4 for many years and a 50% owner of Colstrip 1 and 2 for even longer, yet has not previously indicated that this was a problem.[2] It seems to imply that Global is poised to be the majority owner. Yet, without Puget's share, Global does not obtain a majority of any of the plants. In other words, if Puget did not sell its share of the plants, it would remain a minority owner, just as it has been, and no single company would be a majority owner.

5. The Colstrip plants are due to become below market resources in 5 years

As utility held resources, the value of the Colstrip plants is calculated by accounting methods, not the market. The high initial capital costs gradually decline, resulting in more expensive power in the early years and relatively less expensive power in the later years. Most of the discussion in this case has treated the four plants as a single entity, even though the analysis has treated each under its own cost circumstances. There seems to be general agreement that as a

[2] Puget owns 50% of Colstrip 1 and 2. Colstrip 3 and 4 ownership is split as follows: Montana Power 30%, Puget 25%, PGE 20%, WWP 15%, and Pacific 10%.

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group they are currently above market. They are also above the price that Puget contracts to obtain power from Global for the next 2 years. After 2004 they become below market resources.

Whether they are above or below market depends upon the time at which one is examining them, and the time frame to which the analysis projects. At the time of the merger, the conclusion was different than now since less depreciation had been accrued. For instance, in the merger, Public Counsel witness William Marcus testified on the extent of Puget's stranded costs. He predicted that the Colstrip plants together would have negative stranded costs (i.e. be below market) from 2002 to 2020. Ex. C-65, next to last line.

In essence, for any large generating station, the cost to ratepayers is higher in the early years and declines over time, just as a typical home purchase does. Ratepayers have borne the high initial years of Colstrip and are now close to realizing the lower years. It is particularly unfair for Puget to now sell the asset, especially without proposing to compensate ratepayers for the high initial costs they have borne.

6. Benefits may be overstated in all analyses

Puget's analysis assumed that Portland General Electric (PGE) would sell its share of Colstrip. Yet at this time we do not know that it will. Ex. 15, p.5. If PGE does not sell its share, the price that Puget gets will be reduced by $20 million. Ex. T-6 (Gaines), p.12.

In addition there is no assurance at this time that the transmission sale will take place. If is does not, the selling price is reduce by $88.6 million. Ex. T-6, p.12.

All analysis in this case assumed that these sales would take place. Failure of either of these sales could further reduce all calculations of benefits.

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B. ABSENT A LEAST COST PLAN, THE PROPOSAL SHOULD BE REJECTED

The proposal should be rejected on the sole basis that Puget has not submitted a least cost plan, "LCP", as required by WAC 480-100-251. Without an LCP it is impossible for the Company to demonstrate that this sale will further the Company's "responsibility to meet its load with a least cost mix of generating resource and improvements in the efficient use of electricity." WAC 480-100-251 (1). A least cost plan must be submitted every two years, yet Puget's last one was in 1992-93. Tr.155.

A least cost plan requires consultation with the Commission Staff and with the Public. Puget agreed to file a new LCP as a result of the merger to account for its combined gas and electric operations, and has failed to do so. Even though Puget's technical advisory group on least cost planning was meeting in December 1998, Puget failed to discuss the proposed Colstrip sale with it. Tr.157.

It appears that Puget might try to argue that its submission in this case constitutes a least cost plan analysis. See Mr. Gaines, Tr. 157. The first answer to such an assertion is that Puget has not in fact gone through the LCP process, including consultation with Staff and a public process. Tr. 172-175. In addition to that large failure, the documents contained in this application by Puget fall far short of what is required in a least cost plan.

Puget's evidence fails to include:

a range of forecasts including examination of the impact of economic forces on the consumption of electricity,

an assessment of technically feasible improvements in the efficient use of electricity,

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an assessment of generating resources, including purchases,

a comparison of generating options and demand side management,

an integration of demand forecast and resource evaluations into a 20 year forecast,

> "describing the mix of resources that will meet current and future needs at the lowest cost to the utility and its ratepayers."

a two year plan of specific actions to implement the plan, nor

a progress report that relates the new plan to the previous plan.

WAC 480-100-251 (3) and (4).

The least cost plan rule was adopted by the Commission for several reasons, including the failure of the electric industry's large thermal-nuclear program in the 1970's and 1980's. Utilities such as Puget spent millions of dollars on Skagit/Hanford, Pebble Springs, and WPPS nuclear plants without a comprehensive study of demand variables (such as price elasticity) nor supply alternatives such as energy efficiency. To rectify this failure, the rule requires the utilities to consider, in public, a range of possible demands and a range of possible ways to meet that demand, with both traditional supply and demand side management.

One view of the future is that some utilities continue to be suppliers and others will divest supply and become distribution ("wires") utilities. Over the last year or two, many have heard that Puget expects to be a wires company. Tr. 176. It is with some surprise that we are now told on this record that Puget does not have any such plans and that its proposed sale of Colstrip, and Centralia, are opportunistic, not part of a plan. Tr. 165.

If this proposed sale is just an opportunity, and not part of an overall plan, then there is

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good reason for the Commission to examine the overall future of this Company and how it proposes to deliver electricity at least cost.

Supply deficit. It is particularly troubling that Puget has failed to compare its loads to resources, as required by the Commission rule. Puget is in deficit now and yet is selling a major generation resource. Ex. 15, p.2. The buy back of one-half of the Colstrip power is only for two years. Ex. T-6, p.13.

Puget has not presented any compelling analysis of what it intends to do to obtain power for the current deficit, let alone to replace Colstrip. This is not to say that there are not options available. However, we do not know how Puget proposes to maneuver among those options nor how much it will cost ratepayers nor whether it is a least cost plan.

The Commission would be justified in issuing a complaint to hold Puget in violation of Commission rules for failure to complete a LCP since 1993. The Commission should not consider this proposed sale of Puget's largest generating station absent a full and public integrated resource plan.

C. THE MERGER ORDER DOES NOT JUSTIFY PUGET'S PROPOSAL

1. Selling Colstrip is not a "power stretch goal," nor any other merger savings

The key to Puget's plan is the effect of the merger rate plan and Puget's intent to keep the short run benefits of the sale for its stockholders. Demonstrating that the sale is not merger related eliminates any colorable claim that the benefits should accrue to stockholders.

The overwhelming body of independent evidence shows that the sale of Colstrip, Puget's largest generating station, was never intended as a power stretch goal nor any other merger

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related savings.

Mr. Lazar was the lead witness and negotiator for Public Counsel in the merger case. He states unequivocally that the sale of Colstrip was never considered and never intended to be part of the "power stretch" goals for PSE. Ex. T-57, p. 7. The power stretch goals were represented as negotiation or litigation to lower the above market purchased power contracts. The Tenaska and Montana Power contract changes are examples of power stretch savings. They produce savings during the rate plan, which stockholders get to keep, and savings after the rate plan for the benefit of ratepayers. Ex. T-57, p. 7.

Mr. Lazar also showed that the projections made by the stipulating parties included an assumption that Colstrip would continue to be part of Puget's supply. The coal costs are a significant part of its operating expenses.

Mr. Lazar also showed that Puget has already achieved a substantial portion of its "stretch goals". Ex. C-72. Puget refused to provide information regarding its achievements with other purchased power contracts, claiming that power stretch savings were irrelevant to this case. Thus we do not know if it has achieved even more of its goals than shown on Ex. C-72. Ex. 15 p. 8. He showed that if Colstrip were to be added to the goals, in the manner now proposed by Puget, it would be so large as to swamp the original goals.[3] Tr. 408. This is one more demonstration that Colstrip was never intended to be part of the "stretch goals."

Ken Elgin, who was the lead Staff person in the merger case, testified that sale of Colstrip

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[3] It is fine for Puget to exceed its goals, in fact we hope it does, generating savings for itself and for ratepayers.

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was not part of the power stretch goals nor any other merger savings. Tr. 273. He also showed that a continuation of Colstrip was embedded in the calculations that the parties relied upon in the merger stipulation. Tr. 275, Ex. 53.

Puget's witness, Mr. Gaines, acknowledged that the proposed sale of Colstrip was a target of opportunity, not part of a plan. Tr. 165.

As demonstrated elsewhere in this brief, there are not really any savings at all from the proposal of Puget. Puget is simply trading short run savings to itself for long run liabilities for ratepayers. It is selling off a capital asset in a structured transaction that provides benefits in the short run that are more than outweighed by the bow wave of costs in the future. In short, since there are no savings, this transaction cannot provide "merger savings."

Since the proposed sale of Colstrip does not qualify as "merger savings" there is no reason for the stockholders to get the benefit of the reduced power supply costs and the benefit of the gain on the sale during the rate plan.

2. The rate plan does not justify Puget keeping the benefits

Puget seems to suggest that it should get to keep the early year savings because it has borne cost burdens as a result of the merger rate plan. Ex. T- 16, p.1, Tr. 111. This argument should be rejected for numerous reasons. Puget knowingly and willingly accepted the rate plan as a condition for its merger and should not be allowed to escape its obligations simply because it has the opportunity.

The rate plan was supported by the many considerations that went into the merger stipulation. These are indicated in the stipulation and merger order and need not be repeated

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here. Considerations did not include allowing Puget to sell off a capital asset and structure a deal so that savings occurred in the early years and losses were pushed into later years.

Any revenue need that Puget asserted at the beginning of the merger was resolved in the merger stipulation. Public Counsel's analysis showed that there was no revenue need. Ex. 73, Tr. 412-414.

The BPA residential exchange issue was fully anticipated in the merger and Puget was compensated for it by the increase in rates over the rate plan period. (Interestingly, Puget settled this issue with BPA after the stipulation was reached and prior to the Commission's order accepting it.)

Puget has already done rather well on its stretch power goals. In the merger it set a specific goal. It has already achieved a substantial part of its goal, based upon only two known contract reformations. Ex. C-72, Tr. 407-408. Puget refused to divulge information on the current status of three other contracts, claiming that information was irrelevant to this case. Ex. 15, p.8.

This record is not the place to develop the current financial condition of Puget. Nevertheless, Puget's recent press statements show that it is doing well. Ex. 10. It notes the good market for surplus power and operating savings. To the surprise of most parties, Schedule 48, which was expected to be a net revenue drain, has turned out to be a net benefit to Puget. Ex. T-57, p.18.

3. The Commission did not consider performance based ratemaking on its merits

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It appears that Puget may argue that the Commission and parties considered the possibility of performance based ratemaking (PBR) as an alternative in the merger case. Tr. 354. In aid of this, Puget introduced Public Counsel's motion to strike part of Puget's rebuttal case in the merger. Ex. 71, Tr. 362. However, the order by the Commission granting Public Counsel's motion made it clear that the proposal was stricken not on its merits but because Puget had improperly attempted to introduce the concept in its rebuttal case. The Commission did not allow Puget to expand the case beyond the proper bounds by introducing a new proposal at the end of the case in the guise of rebuttal. The Commission also rejected Puget's attempt to improperly introduce, as rebuttal, its asserted need for a rate increase.

D. ANY CAPITAL GAIN SHOULD GO TO RATEPAYERS

1. Commission precedent is to provide to ratepayers the gain on sale of property that has been in ratebase

In a prior Puget rate case, Public Counsel successfully argued that gains on property sales by Puget should go to ratepayers. Docket No. U-85-53. In that case Public Counsel's witness, Jim Lazar, disclosed that the Company was selling utility property to its unregulated subsidiary at book value, and the subsidiary was then selling it at a gain and keeping the profit for Puget. Mr. Lazar argued that the gain was income to Puget and should go to ratepayers since the property had been in ratebase and therefore supported by ratepayers. Second Supplemental Order, Docket No. U-85-53, "Order", p. 31. Puget responded with several arguments. As summarized by the Commission:

> Puget's principal argument against the suggested adjustment is that the property is nondepreciable and, therefore, gain on the property belongs exclusively to the stockholders because ratepayers did not contribute to the capital cost of using the asset.

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> First, it should be noted that many of the parcels appear to have been improved, according to the brief notes on the information provided by Puget, and the company's argument would not apply to the value of improvements. Order, p. 33.

Note that Puget apparently conceded that if the property were depreciable, then ratepayers had a claim on the proceeds from the sale. Puget asserted that because the property was non-depreciable, ratepayers had no claim on the gain.

The Commission rejected Puget's argument, but did not otherwise rely upon any difference between depreciable and nondepreciable real property. The important factor was that the property had been in ratebase and therefore supported by ratepayers. Notice that the Bremerton office building was one of the property sales at issue, Ex. T-57, p.2, and it presumably included both land and improvements, just like Colstrip.

All other Puget arguments were also rejected by the Commission, relying in part upon the principles of two appellate cases from other jurisdictions cited in the Order. Order, p. 33.

> The Commission believes that the difference between net book value and fair market value at the time of the transfer should be considered gain on the sale of the property and treated as income to the company. Order, p. 32.

The Commission found that it did not have sufficient data with which to make an adjustment in that case. It ordered Staff to make a thorough analysis and present it in the next case.

In the next rate case, the Commission reaffirmed this result, over the renewed objections of Puget, in both the original order and on reconsideration. Third Supplemental Order, Fifth Supplemental Order on Reconsideration, Docket Nos. U-89-2688-T and U-89-2995-T. Both Puget and Staff sponsored adjustments that provided the gain to ratepayers amortized over five years. Staff further reduced ratebase during that period in order to account for the time value of

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the money. Third Supplemental Order, p.53. The Commission accepted Staff's adjustment with the modification that it set the amortization to 15 years to more accurately reflect the period of time over which the Company realized the gains.

Again in the 1989 case Puget criticized Staff and Public Counsel for failing to distinguish between depreciable and non-depreciable property. Third Supplemental Order, p. 51. The Commission again rejected this distinction.

Puget appealed the 1989 Commission decision to court. When the case reached the Court of Appeals, the parties reached a settlement. Stipulation dated May 1992, Ex. 50. This stipulation by its own terms only concerns non-depreciable real property. Ex. 50, p. 1, 5. In the stipulation, the parties (1) limited the case to property sales beginning in 1984 rather than 1974 as in the Commission order; (2) apportioned the gain between stockholder and ratepayers based upon the time it was held by the Company (stockholders) and the time it was in ratebase (ratepayers), and (3) otherwise followed the Commission order to provide the benefits to ratepayers. Ex. 50, p. 2-5. For transactions after 1989, the gain/loss on such property is to be deferred and allocated to customers. Ex. 50, p. 5.

In the next Puget general rate case, the Commission again adjusted Puget's income to provide to ratepayers the gains from property sales, with a sharing that reflected the portion of time that a property was owned by Puget and in ratebase. Eleventh Supplemental Order, Docket No. UE-920433, UE-920499, UE-921262, pp. 48-50. There is no mention of any distinction between depreciable and non-depreciable property.

In the instant case Puget is once again trying to take for its shareholders the gain it

realizes upon the sale of utility property that has been in ratebase and supported by ratepayers. Once again, its attempt should be rejected.

During the hearing the Bench seemed concerned about what should happen if there was a loss in the sale of property. This record has not fully developed that situation since it is not at issue here. Mr. Lazar proposed some reasons that the loss is the responsibility of the Company and its stockholders, and others where ratepayers would likely have some responsibility. Tr. 336, 369-374. With the potential of stranded costs in the electric utility industry, there may be another day in which this scenario can be fully litigated. Since this situation is not presented by this case, and has therefore not been fully argued, we recommend that the Commission not decide what it would do in case of a loss.

Colstrip has been in ratebase, or accruing AFUDC which is its equivalent, for its entire life. Therefore under the formula for sharing established in the stipulation and used in the last 1992 rate case, all of the gain should go to ratepayers.

E. RATEPAYERS MUST RECEIVE BENEFITS FROM THE EARLY YEARS TO AVOID BEING WORSE OFF FROM THE SALE

In our view, the evidence demonstrates that there is likely to be no positive net benefit from the proposed sale. However, if the Commission should conclude that there are positive benefits, and decides to approve the sale, it must still make significant adjustments to Puget's proposed allocation of benefits and liabilities in order to hold ratepayers harmless.

The net benefit calculated by Puget is the combination of benefits to shareholders in the early years and net liabilities to ratepayers in subsequent years. The ratepayer portion itself is

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composed of a few years of positive benefits which are then more than offset by liabilities in the subsequent years. Again, the result is a net negative for ratepayers.

Using Exhibit 20, p.1 as an example, to make ratepayers no worse off than they would otherwise be, the $3 million net benefit is the maximum benefit that should be provided to stockholders. This can be accomplished several ways. One would be to let shareholders keep $3M at the time of the sale. The remainder of the sale gain and short term power supply savings must go to ratepayers to make them no worse off. This could be done by deferring the power supply saving and the rest of the gain on sale, with an accrued return, until the next rate case, at which time the account balance would be provided to ratepayers, presumably amortized over an appropriate period of time, with a return. Any less benefits provided to ratepayers will leave them worse off.

Put another way, in this example, the net benefit of $3 million is the combination of +$76 million for shareholders and -$73 million for ratepayers. To make sure that ratepayers are no worse off, they must get $73 million more than proposed by Puget. This is accomplished by limiting the shareholder benefit to no more than $3 million and moving to ratepayers the rest of the benefit which Puget has proposed to keep, i.e. $73 million. Since this is, appropriately, all based upon a present value calculation, and ratepayers do not get their share until years later, their share must accrue a return in order for them to be made whole. In other words, under this scenario, for ratepayers to be no worse off, they must get all the benefits that Puget assigns to stockholders, except for the net gain amount of $3 million.

We are not suggesting that shareholders should be allowed to keep all of the net benefit

from the transaction, nor are we suggesting that there really is likely to be a net benefit at all. In fact the analysis of Mr. Lazar shows that even when the net of shareholder and ratepayer "benefits" is properly calculated, there is a large negative net impact from the sale.

Mr. Lazar has outlined an alternative method to apply the short run benefits to ratepayers by reducing rates now. Ex. T-57, p.22, Ex. 58, p. 10.

III.CONCLUSION

Public Counsel recommends that the Commission reject this filing on the basis that it is not consistent with the public interest. This petition harms ratepayers, especially given the split of advantages and disadvantages proposed by the Company. The Company has not filed an LCP, the merger order does not justify the proposal, and any capital gain should go to ratepayers.

If the Commission decides to permit the sale, there are several options which could protect ratepayers. The gain and power cost savings should be deferred, with a return, to the next rate case, at which time savings would be amortized to ratepayers. Another alternative is to allow Puget to refile this case with a proposal to resolve all of its potentially stranded costs. A third alternative is to allow the sale with the condition that benefits be flowed through to ratepayers now.

If the Commission wishes to approve the sale and wants to "split" the savings, then the amount to be awarded Puget is no more than a portion of $3 million. All other gain and savings in the short run must accrue to ratepayers for them to have a chance to be held harmless.

DATED this 30th day of August, 1999.

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