REDACTED

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AIR LIQUIDE AMERICA CORPORATION, AIR PRODUCTS AND CHEMICALS, INC., THE BOEING COMPANY, CNC CONTAINERS, EQUILON ENTERPRISES, LLC, GEORGIA-PACIFIC WEST, INC., TESORO NORTHWEST CO., THE CITY OF ANACORTES, WASHINGTON AND INTEL CORPORATION, Complainants, v. PUGET SOUND ENERGY, Respondent.	DOCKET NO. UE-001952 COMPLAINANTS' PREHEARING BRIEF

Air Liquide America Corporation ("Air Liquide"), Air Products and Chemicals, Inc. ("Air Products"), The Boeing Company ("Boeing"), CNC Containers ("CNC"), Equilon Enterprises, LLC ("Equilon"), Georgia-Pacific West, Inc. ("G-P"), Tesoro Northwest Company ("Tesoro"), the City of Anacortes, Washington ("Anacortes"), and Intel Corporation ("Intel") (collectively referred to herein as "Complainants") respectfully submit this Prehearing Brief. Complainants request that the Washington Utilities and Transportation Commission ("WUTC" or "Commission") issue an order: 1) determining that the continued use of the Dow Jones Mid-Columbia indices to set Complainants' retail electric rates is not just and reasonable; and 2) imposing a rate that is just and reasonable.

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I. INTRODUCTION

Through a convergence of events that Washington Governor Gary Locke compared to a "perfect storm," wholesale power prices in the Northwest have skyrocketed to unprecedented and previously unfathomable heights. Gov. Locke, Remarks at the Energy Press Conference (Dec. 14, 2000). The Dow Jones Mid-Columbia Firm Index price for on-peak power for the month of January 2001 is expected to be approximately 18 times the price for the same period in 1999. Air Liquide v. PSE, WUTC Docket No. UE-001952, Ex. 7 to Deposition of William Gaines (Jan. 3, 2001) ("Deposition of William Gaines") These price increases are a direct result of a complete market failure in California that both the California Public Utility Commission ("CPUC") and the Federal Energy Regulatory Commission ("FERC") have determined to be an emergency. San Diego Gas & Elec. Co. v. Sellers of Energy, FERC Docket No. EL00-95-000, 93 FERC ¶ 61, 294 (Dec. 15, 2000) ("FERC December 15 Order"); *see* Application of Southern California Edison Co., Application No. 00-11-038, Draft Interim Opinion Regarding Emergency Requests for Rate Increases ("CPUC January 4, 2001 Draft Order"). According to FERC Commissioner Massey, this market failure has resulted in an "apocalypse" in California. Id. mimeo at 3 (Commissioner Massey concurring). The California market has a direct impact on wholesale power markets in the Northwest, which has created a similar emergency. *See* PSE v. All Jurisdictional Sellers of Energy, FERC Docket No. EL01-10-000, Complaint of Puget Sound Energy (filed Oct. 26, 2000).

Recognizing the seriousness of this emergency, the Washington Attorney General, on behalf of Gov. Locke, yesterday filed an Amicus Brief in the U.S. Court of Appeals for the D.C. Circuit. According to a statement from Governor Locke, the Federal Energy Regulatory Commission has violated federal law by failing "to ensure that prices of short-term wholesale

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energy are just and reasonable." Press Release date January 3, 2001. Gov. Locke's Federal Amicus Curiae brief also states:

> The failed effort to restructure the California electricity market has caused prices in the wholesale markets to become volatile and elevated to levels in excess of $1,000 per megawatt hour – more than 30 times the price of the same unit of energy one year ago. These prices are far in excess of the cost to produce electricity and are causing harm to electricity consumers in Washington.

Amicus Brief of the State of Washington at 1, Re Southern Cal. Edison, (No. 00-1543) (D.C. Cir. 2000).

Puget Sound Energy ("PSE" or "Puget") sells power to approximately 12 of its largest industrial and public agency customers at rates based on the Dow Jones Mid-Columbia Firm and Non-Firm indices. Each of the Complainants, except for G-P, purchases power under Schedule 48, which sets the price of electricity based on the daily Dow Jones Mid-Columbia Non-Firm Index price. G-P purchases electricity pursuant to a special contract ("G-P Contract"), which is based on the daily Dow Jones Mid-Columbia Firm Index price. Complainants have experienced catastrophic increases in the price of their electricity over the last few months, which has caused the closure or partial curtailment of some of the largest industrial facilities in the Puget Sound region. *See* Air Liquide, et al. v. PSE, WUTC Docket No. UE0001952, Affidavit of Mathew G. Franz (Dec. 12, 2000). As a direct result of these exorbitant electric rates, most of the Complainants have resorted to the unprecedented remedy of acquiring and using on-site temporary diesel fired electric generators. High electric prices have created an economic emergency that threatens the welfare of this state. According to Gov. Locke, "the prosperity that we have worked so hard to achieve during the past decade could be undermined in a matter of months." Gov. Gary Locke Press Release (Dec.

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20, 2000). In short, the economic impact of these prices for PSE's largest customers and their communities is a microcosm of the apocalypse that has struck California.

While the full extent of the potential harm is unknown, the cause is not; continued use by PSE of the Mid-Columbia indices to establish retail electric prices is not just and reasonable. An emergency exists and Complainants have taken temporary actions to lessen the impacts of the emergency, however, without Commission action to provide Complainants with relief in this proceeding, the Puget Sound region will unnecessarily suffer the full and irreparable impacts of this emergency.

The Commission should reject PSE's continued use of the Mid-Columbia indices to set Complainants' rates for the following reasons:

- Complainants' rates exceed PSE's cost of service, and are producing excessive profits for PSE;
- The Mid-Columbia indices are thinly traded and do not provide an accurate indicator of market prices; therefore, the continued use of these indices violates the intent of Schedule 48 and the G-P Contract;
- Day ahead and real time spot power markets are fundamentally flawed; thus, they no longer provide a reasonable basis to set retail rates;
- PSE breached, or at least has repudiated, its commitment to provide cost based retail access, which has deprived Complainants of a substantial benefit of their bargain under Schedule 48 and the G-P Contract;
- Schedule 48 was an experimental tariff, and the fundamental assumption underlying Schedule 48 no longer exists (*i.e.*, a viable, robust market); and
- The Commission can provide relief without harming PSE's other commercial, industrial and residential customers, or jeopardizing the financial health of PSE.

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For the foregoing reasons, the Commission should immediately suspend PSE's use of the Mid-Columbia indices and adopt a new rate based on PSE's cost of providing electric service to Complainants.

II. PROCEDURAL SUMMARY

On December 12, 2000, the Complainants filed a Complaint1/ against PSE in this Docket requesting that the Commission: 1) authorize an emergency adjudicative proceeding to require PSE to serve the Complainants under Schedule 49; and 2) order that PSE refund the transition charges that Complainants paid to PSE pursuant to Schedule 48 and the G-P Contract. In the alternative, the Complainants requested that the Commission establish an interim price cap under Schedule 48 and the G-P Contract.

On December 14, 2000, the Commission convened a prehearing conference to consider the issues raised by the Complaint, as well as a proposed procedural schedule. Following the prehearing conference, on December 18, 2000, the Administrative Law Judge issued an Order Consolidating Proceedings; Prehearing Conference Order; and Notice of Hearing ("Prehearing Conference Order"). The Prehearing Conference Order granted Complainants' request to "convene an evidentiary hearing on December 29, 2000, to determine whether price caps or other emergency rate relief should be implemented" for Schedule 48 customers and G-P. On the evening of December 21, 2000, PSE served Complainants with a Motion to Compel Depositions. On December 22, 2000, a procedural conference was convened

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1/ On December 15, 2000, the Complainants filed an Amended Complaint that added the City of Anacortes as a Complainant, and on December 28, 2000, Complainants filed a Second Amended Complaint that added Intel as a Complainant.

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by the Administrative Law Judge to consider PSE's Motion. It was determined that PSE had the right to depose each of the witnesses that Complainants intended to produce at the hearing, as well as any witnesses that submitted affidavits upon which Complainants sought to rely. To permit depositions, the Administrative Law Judge requested that the hearing set for December 29 be set over until January 8-9, 2001. Complainants agreed to the setover. On December 27-28, 2000, PSE deposed all of Complainants potential witnesses for the hearing set for January 8-9. On January 3, 2001, Complainants deposed PSE's single witness, William Gaines.

III. STATEMENT OF FACTS

Complainants intend to prove the following facts by offering live testimony and documentary evidence at the hearing set for January 8-9. To the extent it is practical, Complainants have provided cites to the documents that substantiate Complainants allegations.

A. Summary of Schedule 48 and G-P Contract

In May of 1996, PSE entered into the G-P Contract based on a documented bypass threat involving Whatcom County PUD. Also in May of 1996, Puget Sound Power & Light Company ("PSP&L") approached the Industrial Customers of Northwest Utilities ("ICNU") to solicit the support of the industrial customers of PSE who were members of ICNU for a proposed merger between PSP&L and Washington Natural Gas Company ("WNG"). These discussions led to the execution of a Settlement Agreement, dated May 22, 1996, between PSE, ICNU and a number of PSE's large industrial customers that also were considering bypass opportunities ("Settlement Agreement"). The Settlement Agreement followed closely upon a separate agreement

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executed between G-P and PSE which also was tied to a market index. The Settlement Agreement provided that PSE's predecessor, PSP&L, would propose Schedule 48 in exchange for the customers' remaining on PSE's system for at least five years and supporting the pending merging between PSP&L and WNG.

Schedule 48 was designed to be an experimental transition mechanism to "open access to competitive energy markets on an economic basis for all customer classes." Settlement Agreement at 1. Although the Settlement Agreement was executed in May of 1996, the Schedule 48 tariff was not approved by the Commission until October 30, 1996.

The G-P Contract and the Settlement Agreement which led to Schedule 48 were negotiated in light of several considerations. First, both PSE and the Industrial Customers, including G-P, were working based on the assumption that energy prices would vary between the prevailing rates of $15 per KWh and approximately $50 per KWh. Air Liquide, et al. v. PSE, WUTC Docket No. UE-001952, Affidavit of Ken Canon at ¶ 4 (Dec. 12, 2000) ("Affidavit of Ken Canon"). The $50 per KWh rate was thought to approximate the long-term costs of new power generation resources. Id. Second, there was a commitment from PSE that Schedule 48 customers would receive open access to competitive energy markets no later than the end of the five-year Schedule 48 service agreements. Settlement Agreement at 4. WUTC v. PSP&L, WUTC Docket No. UE-960696, Staff Report in Support of Schedule 48 at 7 (Sept. 25, 1996). Third, the Schedule 48 customers agreed to pay PSE certain transition charges representing the difference between PSE's historic embedded generation related costs and projected prices for market power. PSE, Schedule 48, Fifth Revised Sheet No. 48-e. Thus, Schedule 48 and the G-P Contract were experimental market transition tariffs that were intended to establish a just and reasonable rate,

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provided by market prices within a specified range, until open access was provided to the customers during the five year transition period, or no later than December 2001.

In 1996, PSE had the option of providing industrial customers with either direct market access or an experimental market transition tariff. PSE chose the latter; accordingly, PSE chose to maintain Commission jurisdiction over the justness and reasonableness of all components of Complainants' retail electric rates.

PSE's open access commitment was memorialized in the Settlement Agreement as follows:

> Puget will, on its own initiative, submit for filing with the Commission a cost-based schedule of general applicability regarding open access to competitive electric energy markets on an economic basis for all customer classes. Such filing will be made not later than eleven (11) months prior to the end of the rate stability period. . . .

Settlement Agreement at 4. The parties acknowledged that Puget could only satisfy its open access commitment if the PSP&L/WNG merger was approved. Settlement Agreement at 1. The merger was subsequently approved, and the Commission adopted a Rate Plan that expires on December 31, 2001. Re PSP&L, WUTC Docket No. UE-960195, Fourteenth Supp. Order at 13. (Feb. 5, 1997) PSE has no intention of honoring this commitment to provide open access. Affidavit of Ken Canon at ¶ 7; *see* Air Liquide, et al. v. PSE, WUTC Docket No. UE-001952, Air Liquide's Response to PSE Data Request No. 33 (December 27, 2000).

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Schedule 48 and the G-P Contract established rates based on the Mid-Columbia Non-Firm Index.2/ Use of the index was intended to accomplish two goals. First, the energy component of the rate was to reflect prices in a robust wholesale power market. Air Liquide, et al. v. PSE, WUTC Docket No. UE-981410, Deposition of Ronald E. Davis at 19: 11-16; 30: 1-7, 56: 7-13; 57: 6-11 (Jan. 25, 1999). The parties assumed that the market price of wholesale power would approximate the cost of producing electric energy, and vary from $15 per kwh to a high of $50 per kwh. Affidavit of Ken Canon at ¶ 4. Second, Schedule 48 and the G-P Contract rates were expected to save Complainants substantial sums compared to purchasing power pursuant to Schedule 49 or the otherwise applicable rate schedule. Air Liquide, et al. v. PSE, WUTC Docket No. UE-001952, Boeing Response to PSE Data Request No. 4 ("UE-001952 Data Responses"). In fact, prior to the adoption of Schedule 48 in 1996, PSE presented many of the Complainants with detailed analyses that demonstrated how much money they would save by switching to Schedule 48. Id. These analyses calculated the net present value of the savings under three different energy market scenarios. Re PSP&L, WUTC Docket No. UE-960195, WUTC Staff Data Request No. 14. The base case assumption, which is included in the Staff report recommending approval of Schedule 48, states that the delivered Schedule 48 price in 2000 was expected to be 23.05 mills, and the delivered price for 2001 was expected to be 22.27 mills. WUTC v. PSP&L, WUTC Docket No. UE-960696, Staff Report in Support of Order Approving Schedule 48 at 5. This was projected

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2/ Prior to 1997, the California Oregon Border ("COB") index was used because the Mid-Columbia index was not in existence. Also, on July 12, 2000, the Commission approved an amendment to the G-P Contract that switched the pricing to the Dow Jones Mid-Columbia Firm Index. Re Special Contract, WUTC Docket No. UE-960612, Second Supp. Order (July 12, 2000).

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to be significantly lower than the Schedule 49 rate of 36.71 mills. Id. Even the most pessimistic market forecast projected that Complainants would save money compared to Schedule 49.

The market price assumptions were a key component of Schedule 48, because they were used to set the power cost transition charge. PSE, Schedule 48, Fifth Revised Sheet No. 48-e; WUTC v. PSP&L, WUTC Docket No. UE-960696, Order Approving Schedule 48 with Conditions at 3 (Oct. 30, 1996). The transition charge was intended to compensate PSE for the difference between expected Schedule 48 rates and the embedded cost of its resources. *See* Air Liquide, et al. v. PSE, UE-001952, PSE Response to Complainants Data Request Nos. 7 and 14; PSE Response to Staff Data Request No. 7 and 12. Despite the transition charge, Schedule 48 was expected to result in a revenue shortfall for PSE of approximately $70 million. Re PSP&L, WUTC Docket No. UE-960696, WUTC Staff Data Request No. 12. Puget presumably was willing to absorb this cost for three reasons. First, Puget wanted to gain industrial customer support for its merger. Second, Puget believed that it could make up the shortfall through merger efficiencies. Third, Puget was concerned that without Schedule 48 industrial customers would bypass its service territory. Re PSP&L, WUTC Docket No. UE-960195, WUTC Staff Data Request No. 14.

As described below, the reality of the Schedule 48 experiment has been radically different from its concept. Instead of beginning 2001 with an expected rate of 22.71 mills, the Complainants are facing prices in excess of 500 mills. Ex. 7 to Deposition of William Gaines. Rather than losing money compared to Schedule 49, PSE has made more than $** million in

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revenues above the Schedule 49 rate from just 12 customers.3/ This tremendous reversal from expected results can be traced to one cause: the complete meltdown in Western wholesale power markets that has occurred since May of this year.

B. Summary of Market Failure

There is no dispute that the current market prices have resulted in emergency conditions in the Western United States. These emergency conditions have been recognized by PSE, the regional governors, FERC and the U.S. Secretary of Energy, Bill Richardson. Despite the unanimous recognition that a crisis exists, no government agency, state or federal, has taken action to bring market prices in line with historic norms or the cost of production.

FERC found that the California market structure and rules are providing sellers an opportunity to exercise market power, causing California electric rates to be unjust and unreasonable. SDG&E v. Sellers of Energy, 93 FERC ¶ 61,121, FERC Docket EL00-95-000 at 3 (Nov. 1, 2000) ("FERC Nov. 1 Order"). FERC has adopted remedies that it described as addressing "the seriously flawed electric power markets in California." FERC Press Release (Dec. 15, 2000). FERC continues to recognize that the electric price situation has placed California "in a state of economic emergency . . .." FERC December 15 Order at 25.

California began restructuring its electric industry to implement market-based commodity pricing in 1996. Cal. Assembly Bill 1890, Statutes 1996, chapter 854. To assist California in that effort, FERC approved the establishment of market-based wholesale electricity

3/ This amount does not include the "highly confidential" results from the November financial report or the December revenues. Prices in November, and especially December, were dramatically higher than previous periods.

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pricing in that state, with bulk power prices determined in auctions conducted by two FERC-regulated entities the California Power Exchange ("PX") and the California Independent System Operator ("CaISO"). *See*, *e.g.*, Pacific Gas & Elec. Co., 81 FERC ¶ 61,122 (1997).

In May 2000, wholesale rates for electricity in the PX and CaISO markets began to rise sharply, to levels two to three times historical levels for that month. The escalation of wholesale prices in California continued throughout the summer of 2000. On August 2, San Diego Gas & Electric Company ("SDG&E"), a distribution company that had divested most of its generation capacity, filed a complaint at FERC complaining of unjust and unreasonable wholesale prices and requesting the imposition of a wholesale rate cap. 4/ FERC refused to impose a rate cap, but on August 23 instituted proceedings under section 206 of the Federal Power Act to investigate the justness and reasonableness of rates in the PX and CaISO markets. SDG&E Co., 92 FERC ¶ 61,172 (Aug. 23, 2000).

Although most observers expected wholesale prices in California to retreat once the peak summer loads had diminished, wholesale prices remained high and even continued to rise throughout the autumn. Following an investigation by its staff, FERC issued an order on November 1 proposing measures to remedy problems it identified in the California wholesale markets. FERC November 1 Order. In that order, FERC found that the:

> electric market structure and market rules for wholesale sales of electric energy in California were seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and demand in California, have caused, and continue to have the

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4/ As part of the restructuring, the three investor-owned utilities ("IOUs") in California divested all of their fossil-fueled generation assets to merchant generators, retaining ownership only in nuclear and hydroelectric generation plants.

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> potential to cause, unjust and unreasonable rates for short-term energy. . ..

Id. mimeo at 3. FERC proposed and requested comments on remedies intended to reduce reliance on spot markets (in favor of forward contracts), induce the entry of new suppliers to California, and to reduce the frequency with which sellers receive a market-clearing price above their actual bids. *See* id. mimeo at 3-4.

After receiving comments on its November 1, 2000 Order many of which criticized that order and asked FERC to fix just and reasonable wholesale rates for California. 5/ FERC reaffirmed its prior positions and proposed remedies in an order issued on December 15. FERC December 15 Order. FERC again refused to constrain wholesale prices, although it established a "breakpoint" so that bids above $150/MWh would not establish the market clearing price received by all sellers. Id. mimeo at 58-59. FERC acknowledged that its remedies may take more than two years to stabilize the California market at just and reasonable rates. Id. mimeo at 59 (referring to the 27-month period "it takes to effectuate longer term remedies in the markets" proposed by FERC). As a result, a seller in the California wholesale markets may continue to receive whatever bid price is accepted at auction because it is needed to satisfy load, without regard to the seller's costs. 5/

In the weeks since FERC's December 15 Order, wholesale prices in California have not declined and show no sign of abating in the future. Although FERC apparently hopes that adoption of forward contracts will alleviate the extraordinary wholesale prices resulting from

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5/ For example, the federal Department of Energy urged FERC to require generators to sell into the CaISO market and bid at the running costs, (*see* SDG&E, 93 FERC ¶ 61,294, mimeo at 40 (Dec. 15, 2000)) and the California Public Utilities Commission urged FERC to impose wholesale rate caps. Id. mimeo at 80.

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dependence on spot market sales, critics have noted sellers' current opportunities for profit-taking in the spot markets have discouraged the making of forward contracts or distorted prices for them.

Given FERC's December 15 Order, it appears that no solution to excessive prices in those markets is likely in the near term. Indeed, as noted above, FERC assumes that its proposed remedies will take up to two years to have effect. Having reaffirmed its position despite heavy criticism after the November 1 Order, FERC is very unlikely to alter its course anytime in the near future.

In response to FERC's December 15 Order, Southern California Edison Company ("SCE") filed a petition for a writ of mandamus in the U.S. Court of Appeals for the D.C. Circuit on December 26, asking the Court to direct FERC to fix just and reasonable rates for the California wholesale markets. Re Southern California Edison Co., Case No. 00-1543 (D.C. Cir.). Numerous interested parties have intervened in that proceeding in support of, or opposition to, the requested relief. The requested relief in that proceeding is extraordinary and the prospects for success by the petitioner are highly uncertain. As noted above, the Attorney General of Washington today filed an Amicus Brief supporting the claims raised by SCE.

In dramatic language, California Senator Dianne Feinstein stated that FERC's action "is unacceptable. Rome is burning, our utilities are close to bankruptcy, Californians are facing major blackouts, and the commission is fiddling." Sen. Dianne Feinstein Press Release (Dec. 15, 2000). California Governor Gray Davis first responded to FERC's action, describing it as "an inexplicable decision by armchair Washington bureaucrats fixated on economic ideology that has no practical application to the dysfunctional energy market in California and the West." Gov. Gray Davis Press Release (Dec. 15, 2000). Without appropriate action by both the state and federal

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1 government, continued economic growth will be jeopardized. Id. In response to FERC's continued failure to act, Governor Davis has issued a proclamation convening a special legislative session to remedy the energy market emergency. Gov. Gray Davis Press Release (Jan. 3, 2001). The CPUC also proposes immediate emergency rate relief to address "the severe dysfunction of the California wholesale market" that the CPUC claims have been "created by orders of [FERC] that defy common sense, logic and law." CPCU Jan. 4, 2001 Draft Order.

Governor Locke and Oregon Governor Kitzhaber have also urged state and federal government action, but have yet to order an emergency legislative session. Gov. Locke has stated, "The wild increase in electricity prices is a region-wide problem and it will take the cooperation of the Western states and the federal government to bring them down." Gov. Gary Locke Press Release (Dec. 20, 2000). Governor Kitzhaber also has recognized that the Northwest is not immune from current "energy emergency" that "threatens to engulf the entire West." Jon Sarche, "Western Governors Turn Up Pressure for Electricity Price Cap", Seattle Post-Intelligencer, Dec. 20, 2000. Governor Kitzhaber joined Governors Locke and Davis in requesting additional FERC action and a regional price cap. Id.; Gail Kinsey Hill, "Kitzhaber Wages Power Struggle", The Oregonian, Dec. 21, 2000.

Puget itself has admitted that the current Western electric market is in an emergency situation and has also requested that FERC take immediate action. *See* WUTC Hearing, WUTC Docket Nos. UE-001952, UE-001959, Tr. at 50: 10-11 (Dec. 14, 2000) (statement of Stan Berman) ("WUTC December 14 Hearing"); PSE v. All Jurisdictional Sellers of Energy, FERC Docket No. EL01-10-000, PSE Complaint (filed Oct. 26, 2000). Puget filed a complaint before FERC recognizing the California market problems, detailing the California market's impact upon the

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1 Pacific Northwest electric markets, and requesting a Pacific Northwest electric price cap. Id.
2 ICNU intervened in the FERC complaint case, supporting PSE's request for a regional price cap.
3 PSE v. All Jurisdictional Sellers of Energy, FERC Docket No. EL01-10-000, Motion to Intervene
4 of ICNU (filed Nov. 15, 2000).
5 Contrary to the request of Gov. Locke, FERC has not remedied the problems in the
6 Pacific Northwest energy markets. The only significant federal action taken regarding Washington
7 State was to issue a short term order requiring Pacific Northwest utilities to export their much
8 needed electricity to the California market. Richardson Emergency Order, Dept. of Energy (Dec.
9 14, 2000); Modified Richardson Emergency Order, Dept. of Energy (Dec. 20, 2000). This
10 illustrates the absence of a competitive market. In addition to taking short term action harmful to
11 the Pacific Northwest, FERC took no significant long term action other than a pledge to monitor
12 electric prices over $150 per MW in California. FERC December 15 Order, mimeo at 7.
13 FERC has yet to propose a long term solution, and, in response to requests for price
14 caps from Governors Locke, Kitzhaber and Davis, FERC has only promised to "prepare a report
15 immediately on the potential consequences of imposing region price caps." Gov. Gary Locke Press
16 Release (Dec. 20, 2000). This time frame is unacceptable because it will not remedy the immediate
17 public danger facing the Puget Sound area due to this crisis in the West Cost electric market.
18 FERC has also dismissed PSE's complaint and declined to order the relief requested
19 by PSE, stating that it was unable to order price caps in a bilateral market. FERC December 15
20 Order at 75. PSE apparently denies that its complaint was dismissed by FERC, and continues to
21 insist that FERC, not the WUTC, remedy the Schedule 48 pricing problem. WUTC December 14
22 Hearing, Tr. at 51:25-52:2 (Statement of Stan Berman). PSE Response to Complainants' Amended

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Complaint, Second Affirmative Defense (Jan. 2, 2001). All involved would like FERC to step in and fix our market problems in the Northwest. The reality is that this will simply not happen, at least not during a time period that will provide relief to Complainants. PSE has admitted that an emergency exists in the wholesale markets which are the basis for the Schedule 48 pricing. Given FERC's unwillingness to address Northwest power issues, the remedy PSE suggests, as PSE well knows, is no remedy at all.

C. Impact on Market Failure on Complainants

Since the Commission approved Schedule 48 and the G-P Contract, there have been two significant developments, both of which have worked to the detriment of Schedule 48 customers. First, Schedule 48 customers have not been permitted, and PSE has no intention of permitting them, to make their own energy purchases directly from the market. Second, energy prices, initially assumed to have been variable in the range of $15 to $50 per MWh hour, increased rapidly beginning in the spring and summer of 2000, reaching prohibitive levels in November and December of 2000. PSE's most recent forward price curve for power at the Mid-Columbia suggests that these prices will continue well into next year. The price of January of 2001 is expected to be in excess of $500 per MWh. Ex. 7 to Gaines Deposition. The rates which have been dictated by the Mid-Columbia Indices cannot, under any analysis, be considered a just and reasonable basis for setting jurisdictional retail rates. The exorbitant pricing generated by Schedule 48 has impacted PSE's customers and their communities as exemplified by the experience of Schedule 48 customers within four cities of PSE's service area: Anacortes, Puyallup, Tumwater, and Bellingham.

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Equilon and Tesoro own and operate oil refineries located near the city of Anacortes. As a result of the prices charged by PSE to Tesoro for electricity under Schedule 48, Tesoro has acted to reduce its production by twenty percent, specifically reducing production of propane, diesel, gasoline and jet fuel products. Many homes are heated with propane in Skagit County and Northwest Washington. Tesoro has reduced its purchases of electricity from PSE by one-third, partially offsetting its reduced PSE energy purchases by power conservation and reduced production. In addition, Tesoro has installed 4 temporary and 12 diesel-fueled electrical generators and is in the process of installing 8 additional generators. Similarly, Equilon has reduced its purchases of power from PSE, and is in the process of installing 30 diesel-fueled electrical generators. This will unquestionably impact the price and supply of diesel fuel in the region.

The City of Anacortes sells 70% of its municipal water plant production to the Equilon and the Tesoro refineries. To the extent the refineries cut their production, the city's collection of taxes and its revenues from water service are reduced. These cut backs will impact the Anacortes School District. Mayor Dean Maxwell for the City of Anacortes testified during his deposition that these high electric rates may impact his ability to replace a 70 year old water pipe.

The City of Anacortes became a Schedule 48 customer of PSE at the urging of PSE representatives. The City of Anacortes has seen its electricity expenditures for the year 2000 grow from a budgeted $500,000 to over $1,500,000, as a result of having to pay high energy costs under Schedule 48. The $1,000,000 budget overrun for 2000 will have to be funded at the expense of water rate payers, including residents of the City, many of whom are retirees. As a municipal water supplier, the City is simply not in a position to cut back its supply of water, either to its residents or to residents of other communities served by the City, including LaConner, Oak Harbor, and the

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U.S. Navy base on Whidbey Island. The City has been forced to use its cash reserves to fund its electricity purchases. These expenditures threaten to impair the city's ability to stay within the terms of indentures or bonds issued for capital improvement projects for the City. The City has reluctantly undertaken to commence operation of one diesel-fueled electrical generator in order to reduce the cost of its electrical power. The diesel-fueled generator is a temporary emergency action.

The City just completed its three-year rate review in the spring of 2000, and now will have to consider rate increases going forward both to fund the overruns and its electricity budget and to fund future electrical purchases, however uncertain those purchases now appear.

The City of Anacortes lost 25 jobs when Ligni-Tech was forced to shut down when G-P curtailed production of certain chemical products purchased by Ligni-Tech.

Between the City's operation of its own electrical generator and those which will be operated by Equilon and Tesoro refineries, the Anacortes community faces a cloud from the diesel generators from the burning of some 2,000,000 gallons of diesel fuel per month. There will be impacts on the City and surrounding communities. This is a direct result of Schedule 48 prices.

In Puyallup, Air Products operates an air separation facility, producing industrial gases. As a result of the high electrical prices charged by PSE under Schedule 48, the company is now deciding whether to operate or close its plant on a day-to-day basis, depending upon anticipated electrical costs for each day. However, the company cannot operate on a day-to-day basis forever.

Air Products is now considering bringing in 23 temporary diesel-fueled electrical generators to run its operation. It is questionable if temporary diesel-fueled electrical generators

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can be a solution even in the short-run. One of the gases produced by Air Products is pharmaceutical grade oxygen. By operating the plant with diesel-fueled generators, Air Products may not be able to produce uncontaminated oxygen for hospitals and other healthcare facilities.

In Tumwater, CNC purchases electricity from PSE under Schedule 48. CNC manufactures plastic beverage bottles for water, dairy, liquor and soft drink products. Like the City of Anacortes, CNC was not a party to the settlement agreement which led to Schedule 48, but joined the Schedule 48 tariff in 1998 based on PSE's urging. High electricity charges at CNC's Tumwater facility have eliminated profits for the company this year, at all of its locations in the western United States.

CNC does not have the contractual right to pass on increased electrical cost to its customers. CNC faces an extremely competitive environment, making it unlikely that customers would continue purchasing from CNC if a surcharge were imposed. CNC's response has been to terminate its purchase of electricity from PSE, to curtail production and to install diesel-fueled electrical generators to operate the plant. Six managers and staff have been laid off. The plant is in the process of moving nine of its 23 injection molding machines from the Tumwater facility to locations in California, Pennsylvania and Peru. As a result, 35 production jobs will be lost. In the meantime, the plant is periodically shut down in view of energy costs, with resulting losses to hourly wage employees. For a variety of environmental and technical reasons these diesel generators are very temporary solutions.

In Bellingham, G-P operates a mill producing pulp, fiber and chemical products. The products produced include tissue and paper towels. The G-P mill is a substantial employer of the community. High energy rates have resulted in production shutdowns. Five hundred

employees were initially laid off in December. G-P has brought in its own fleet of diesel-fueled generators, producing between thirteen and fifteen megawatts per hour of electricity. The diesel-fueled generators are not producing enough electricity to permit the plant to return to full operation, but have enabled the company to bring 250 of its employees back to work, leaving 250 still unemployed. Again this self-help temporary remedy to the crisis caused by those high Schedule 48 prices will not remedy the emergency facing all Schedule 48 Complainants.

D. Impact of Market Failure on Puget

In comparison to the situation facing its customers, PSE's financial situation is quite secure. Monthly financial data for October 2000, submitted to the Commission pursuant to WAC §§ 480-90-031(7) and 480-100-031(7), indicates net income for the company was 56% above budget, and 45% above 1999 net income. This increase occurred despite increasing market prices for wholesale electricity. The Company has not made more current data available in response to Complainants' Data Request 1.26. For example, PSE's November 2000 financial data, submitted pursuant to WAC §§ 480-90-031(7) and 480-100-031(7), was classified as "Highly Confidential" by the Company. No such request accompanied the financial data submitted for January through October of 2000. It is unclear why PSE has made a unique effort to limit the availability of this information. The only plausible reason is that PSE's financial data indicates substantial profits directly corresponding to the periods of greatest market volatility.

Puget is unaffected by the market failure because it is not dependent on purchased electricity to supply its customers. PSE Press Release (Oct. 19, 2000); *see* PSE's Response to Bench Request Nos. 4 and 5. President and CEO William S. Weaver attributed the Company's

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increase in third-quarter earnings to "increased prices and volumes in the wholesale electric markets [while PSE was] long on resources. . . .." Id.

PSE has not claimed any adverse effects from the recent market volatility, because PSE does not purchase index-priced supplies to serve Schedule 48 customers. Air Liquide, et al. v. PSE, WUTC Docket No. UE-981410, Ex. 22 (PSE Revised Briefing Paper). In its recent FERC Complaint, PSE claimed that imposing a rate cap in California but not in the Northwest would be fundamentally unfair. PSE v. All Jurisdictional Sellers of Energy, FERC Docket No. EL01-10-000, PSE Complaint (Oct. 26, 2000). However, PSE did not claim any ill effects to the Company stemming from the market failure. Id.

Furthermore, PSE has not lost revenues as a result of customers switching from Schedule 49 to Schedule 48. *See* Air Liquide, et al. v. PSE, WUTC Docket No. UE-001952, Complainants Data Request No 1.11, Oct. 2000. From the time Schedule 48 was approved until the summer of 2000, the Complainants' costs of service under Schedule 48 and the G-P Contract (including transition charges) and what they would have paid if they had continued to receive service under Schedule 49, have been roughly equivalent. However, since the collapse of a properly functioning market in summer of 2000, rates under Schedule 48 have drastically favored PSE, resulting in a windfall or excessive earnings to the Company.

IV. ARGUMENT

A. Summary

The Complaint in this case raises complex legal issues regarding the interplay between the emergency adjudication statute, the complaint statute and the requirement that the Commission set rates that are just and reasonable. The Complainants allege that rates based on the

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Mid-Columbia indices are no longer just and reasonable. If the Commission agrees, it is required by statute to set a just and reasonable rate. In the absence of a properly functioning market, a just and reasonable rate must be based on cost. Furthermore, the hearing, which has been set for January 8, 2001, has been properly noticed under the complaint statute. RCW § 80.04.110. As a result, the Commission has the legal authority, as well as the legal requirement, to immediately set a just and reasonable rate, even without finding an emergency exists.

The Complainants also allege that the current situation is an immediate danger to the public welfare, allowing the Commission the opportunity to use the emergency adjudicative proceedings statute, RCW § 34.05.479. An emergency exists in Western wholesale power markets because those markets are seriously flawed. This has translated into obscene prices for the retail electricity purchased by Complainants. The high prices under Schedule 48 and the G-P Contract have been and will continue be a threat to the welfare of this state due to the extensive socio-economic impacts stemming from many of the Complainants' inability to continue full operations under current rates. Gov. Locke has acknowledged as much. *See* Gov. Locke, Remarks at the Energy Press Conference (Dec. 14, 2000). Accordingly, the emergency adjudication statute provides an additional, but not essential, basis for the Commission to act.

B. The Rates Paid by Complainants Are Not Just and Reasonable

The Commission has broad authority to regulate, in the public interest, the rates charged by PSE. Specifically, the rates charged must be "just, fair, reasonable and sufficient." RCW § 80.28.010. Additionally, the Commission must "preserve affordable . . . electric services to the residents of the state . . . [and] ensure that customers only pay reasonable charges for natural gas and electricity." RCW § 80.28.074. When a complaint demonstrates that any rates charged by an electric company "are unjust, unreasonable, unjustly discriminatory or unduly preferential, or in

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1 any way in violation of the provisions of law . . . the commission shall determine the just,
2 reasonable, or sufficient rates, charges, regulations, practices or contracts to be thereafter observed
3 and in force, and shall fix the same by order." RCW § 80.28.020. PSE is exempt from many state
4 consumer protection and antitrust laws, and the Commission is the Complainants only protection
5 from unjust, unreasonable, unjustly discriminatory and unduly preferential rates and practices by
6 their monopoly service provider. *See* Tanner Elec. Coop. v. PSE, 128 Wn.2d 656, 911 P.2d 1301
7 (1996). Even if rates are set by contract, they are still subject to the requirement that they be just
8 and reasonable. RCW § 80.28.010 ("all charges . . . shall be just and reasonable"); *see e.g.* WUTC
9 v. PSP& L, WUTC Docket No. UE-960299, Sixth Supp. Order (Aug. 1, 1996).
10
11 The terms "just and reasonable" have been defined in a long series of federal case
12 law, which the Commission and the Washington courts have relied on in interpreting
13 RCW § 80.28.010, 711 p.2d at 327. FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944); People's
14 Org. for Wash. Energy Resources v.WUTC, 104 Wash. 2d 798, 819, 711 P. 2d 319, 331 (1985); US
15 West Communications, Inc. v. WUTC, 134 Wash. 2d 74, 117, 949 P. 2d 1337, 1359 (1997). A
16 market-based rate is just and reasonable when it falls within a zone of reasonableness, which is
17 "neither so low as to be 'less than compensatory' nor so high as to be 'excessive.'" FERC
18 December 14 Order at 33. A rate meets this test if it provides the utility with a reasonable rate of
19 return. A determination of whether a rate is just and reasonable generally involves an examination
20 of a utility's prudently incurred cost of providing service. Farmers Union Cent. Exch., Inc v.
21 FERC, 734 F.2d 1486, 1502, *cert denied sub nom.* Williams Pipeline Co. v. Farmers Union Cent.
22 Exch., Inc., 469 U.S. 1034 (1984); People's Org. for Wash. Energy Resources, 104 Wash. 2d, at
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810. Thus, the determination of whether a rate falls within the zone of reasonableness must be made with reference to the utility's costs. Farmers Union, 734 F.2d at 1502.

A regulator may rely on a competitive market in lieu of cost of service regulation to determine that rates are just and reasonable. Elizabethtown Gas Co. v. FERC, 10 F.3d 866, 870-71 (D.C. Cir. 1993). However, when rates are based on non-cost factors, the regulator must "offer a reasoned explanation of how the factor justifies the resulting rate." Farmers Union, 734 F.2d at 1502. Reliance on competitive markets to set regulated rates is only justified when there is "empirical evidence," which demonstrates "that market forces [can] be relied upon to keep prices at reasonable levels." Id. at 1510. In Farmers Union, the court reversed FERC, because it had failed to make such a demonstration. Id. The market cannot be the final arbitor of the reasonableness of a rate. FPC v. Texaco, Inc., 417 US 380, 397 (1974).

When an acceptable substitute is allowed to replace the traditional inquiry into the justness and reasonableness of a rate, the Commission does not abdicate responsibility. Rather, the Commission retains the ultimate, and continuing, responsibility to ensure that all rates are just and reasonable. RCW § 80.28.010 and RCW § 80.28.020.

Washington courts also recognize that the Commission may not abdicate its responsibility to ensure that all charges are just and reasonable. People's Org. for Wash. Energy Resources, 104 Wash. 2d at 819. It has been long established that the Commission has the authority, and the duty, to assert continuing regulatory control over contracts between public service companies and their customers to assure that the performance of those contracts is consistent with the public interest. Raymond Lumber Co. v. Raymond Light and Water Co., 92

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Wash. 330, 159 P. 133 (1916); North Coast Power Co. v. Pub. Service Comm'n, 114 Wash 102, 194 P. 587 (1921) (interpreting statute renumbered RCW § 80.28.060).

In Raymond Lumber Co., the issue was whether a contract for the sale of water by a public service corporation to a sawmill was subject to the Commission's jurisdiction and authority, even if the contract was executed prior to the date of the law creating the Commission. 92 Wash. at 335, 159 p. at 135. The Court found that contracts affecting the public interest are within the scope of the state's continuing authority:

> The rule is that contracts upon subjects which are within the police power, even though valid when made, must be taken to have been entered into in view of the continuing power of the state to control the rates to be charged by public service corporations.

Raymond Lumber Co. v. Raymond Light and Water Co., 92 Wash. at 335-6, 159 P. 135-6.

In North Coast Power Co. v. Pub. Service Comm'n,, 114 Wash. 102, 194 P. 587 (1921), the issue was whether the Commission has the authority to increase the applicable rate despite the existence of a 5-year, fixed-rate service contract that was executed after the effective date of the law creating the Commission. The Court found that at the contract rate the power company sustained a loss of 3.4%, while under the proposed rate the power company would have made a profit of 1.97%. The Court found that the statute provided the Commission with the authority "to meet the situation where changed conditions made it necessary for the company to increase its charges . . .." Id. at 588. Therefore, the Commission has the power to modify existing contracts and rates if they become unjust and unreasonable.

FERC cannot refuse to exercise its jurisdiction to evaluate the justness and reasonableness of rates. Public Service Comm'n of New York v. Mid Louisiana Gas Co., 463 U.S.

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319, 328 (1983)-332; Perman Basin Area Rule Cases, 390 US 747 (1968). In Public Service Comm'n, the Court held that FERC was required to scrutinize the reasonableness of natural gas rates charged to interstate pipelines, regardless of the source from which the pipeline obtained that gas. Id. Thus, implicit in a regulatory commission's duty to ensure that rates are just and reasonable is an obligation to affirmatively monitor rate fluctuations, and remedy any fluctuations that deviate from the zone of reasonableness. Although rates can be based on market forces, as in Schedule 48, the fundamental assumption remains that those forces will produce rates that are just and reasonable. Accordingly, the Commission cannot completely relinquish jurisdiction over a rate, based on market price, and it is appropriate to take remedial action to ensure that rates based on a fundamentally flawed market remain just and reasonable.

Schedule 48 was approved as a just and reasonable rate. WUTC v. PSP&L, WUTC Docket No. UE-960696, Order Approving Schedule 48 with Conditions (Oct. 30, 1996). At the time it was approved by the Commission, the reliance on market indexed pricing provisions was a reasonable substitute for traditional ratemaking inquiry into PSE's cost of production. However, the Commission's continuing oversight regarding the justness and reasonableness of rates requires it to consider empirical evidence that demonstrates that market forces cannot be relied upon to keep Schedule 48 and the G-P Contract prices reasonable. Because competitive markets are currently unreliable, the substitution of market based rates for cost of service regulation produces unjust and unreasonable rates.

Even though the Commission found in 1996 that the Schedule 48 index produced a just and reasonable rate based on the circumstances at the time, if "changed conditions" establish that the index price no longer produces a just and reasonable return to PSE, then it is no longer a

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1 reasonable surrogate for cost-based pricing. In these changed conditions, the Commission has the
2 authority, and the duty, to establish a new rate that is just and reasonable.

3 **1. The Spot Power Market at the Mid-Columbia is Fundamentally Flawed;**
4 **Therefore, It Cannot Be Relied Upon to Keep Rates at Reasonable Levels.**

5 Pricing based on the Mid-Columbia indices suffers from a number of defects that
6 make the rates charged under Schedule 48 and the G-P Contract unjust and unreasonable. First,
7 there is no properly functioning competitive market to discipline prices. The wholesale market in
8 the Northwest, like the California wholesale market, is fundamentally flawed. Amicus Brief of the
9 State of Washington, Re Southern Cal Edison, (No. 00-1543) (D.C. Cir. 2000). Without a properly
10 functioning market, there is no basis to depart from traditional cost of service rate making.

11 Second, both Schedule 48 and the G-P Contract rely on wholesale spot markets to
12 determine prices. Schedule 48 sets prices based on non-firm day ahead and real time spot market
13 and the day ahead market transaction, and the G-P Contract sets prices based on a day forward
14 prescheduled basis (transactions call for delivery for more than one day excluded). This market is
15 roughly equivalent to the Combined California ISO real time market, and the California PX day
16 ahead market. According to FERC, "over reliance on spot markets . . . lies at the very heart of the
17 high prices in California." FERC December 15 Order at 28. FERC went in to order the California
18 Utilities to rely on long-term purchase and abandon spot market purchases. Id. Schedule 48 and
19 the G-P Contract suffer from the same flaw; they rely exclusively on a dysfunctional spot market to
20 set prices.
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2. The Mid-Columbia Indices Are Thinly Traded and Do Not Represent the Actual Market Price of Serving Complainants' Load

Even if there was a properly functioning power market, which there is not, the Mid-Columbia indices do not represent market prices. At times, the volume of transactions reported by Dow Jones at the Mid-Columbia has been dwarfed by the size of the Schedule 48 and special contract loads. For example, the Mid-Columbia Firm Index on-peak price for December 11, 2000, was $3,300 per megawatt hour, but the volume was only 362 a MW. Similarly, the Mid-Columbia Non-Firm Index on-peak price on the same day was $1,285 per megawatt hour, while the volume was only 43 a MW. These facts demonstrate that the indices represent the highest price that buyers are willing to pay for a very small increment of load. They do not represent the market price of serving almost 300 MW of Schedule 48 and special contract loads.

Further, the market will continue to be very thinly traded as long as the very tightly specified product definition specified by Dow Jones does not change. While Complainants have only been able to perform a very limited analysis of PSE wholesale purchase and sales transactions, it is very revealing. Complainants have found that the transactions PSE reports to Dow Jones may be only **% of the total purchase and sales activity of PSE for the day since the product Dow Jones is reporting is of little interest to most purchasers or suppliers.

The Complaints have very serious concerns which have arisen from the review of the transactional data. To illustrate these concerns, consider the transactions and associated volumes that were reported on a lightly traded Sunday on November 12, 2000. On this date, the 24 hour firm index reported a volume of ** MWh, equivalent to ** MW per hour. Based upon the interpretive index provided by PSE for the transactional data, it would appear that PSE was a party—as either a purchaser or a seller—of every transaction that Dow Jones reported. If this is

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correct the objectivity of the index becomes questionable. In addition, review of the sampled data shows that in most days there are simultaneous purchase and sale transactions for the precise quantity of power every hour with the same supplier at the same price. Though the transaction would provide no power or financial reward to either party, the transactions would have a direct and real impact on the reported volumes and price. If these offsetting transactions are included in PSE reports to Dow Jones it would undermine both the robustness and the integrity of the index. However, even if the index instructions provided by PSE are in error with regard to these offsetting transactions, the remaining transactions are still illustrative of another problem with this thinly traded market. Even with the offsetting transactions excluded, PSE's activity still represented 135 MW of the reported 389 MW or 35% of the reported market. Such market dominance by a party who has much to gain or lose based on the index price, raises extremely serious questions regarding the validity of the index.

The use of the highest market price to set prices for all of Complainants load is analogous to California, where FERC concluded that "a significant factor causing high prices was the fact that every MW in the market is priced at the spot market clearing price." FERC December 15 Order at 28. FERC also concluded that over reliance on spot markets combined with a market clearing price based on the most expensive transaction resulted in "unprecedented cost exposure for consumers of California." Id. at 27.

The continued use of the Mid-Columbia indices also fails to satisfy an essential purpose of Schedule 48 and the G-P Contract. Index based pricing was an experimental concept that was intended to reflect the cost of serving these loads in a competitive market. *See* WUTC v. PSP&L, WUTC Docket No. UE 960696, Order Approving Schedule 48 with Conditions at 10-11 (Oct. 30, 1996). As demonstrated above, the Mid-Columbia indices do not represent a properly

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functioning competitive market, nor do they represent either the actual market prices or actual costs of serving the loads. While Complainants assumed the risks of price fluctuations in a properly functioning competitive market, they did not assume the risks that the market would be seriously flawed.

3. Complainants' Rates Greatly Exceed PSE's Cost of Service, Which is Producing Excessive Profits For PSE

Market based prices are not just and reasonable when they exceed a zone of reasonableness relative to the cost of providing service. FERC December 15 Order mimeo at 37, Farmers Union, 734 F.2d at 1502. PSE admits that it does not separately acquire power to serve complainants' load. PSE Response to WUTC Bench Requests 4 and 5. Thus, PSE's cost of serving Complainants is a function of its resource stack, which is composed of its own resources and power purchases. PSE produced a load resource balance chart that shows that PSE's load, including Complainants, is not expected to exceed PSE's resources for each month of 2001. As a result, PSE's costs of serving Complainants will not exceed the cost of PSE's resource. Ex. 2 to Deposition of William Gaines.

PSE's cost of service could be determined in two ways. First, the cost could be determined by reference to the average cost of PSE's resource stack. The Schedule 49 price is a good proxy for this price. For the first 10 months of 2000, the price paid by the Schedule 48 customers exceeded the price those customers would have paid under the otherwise applicable tariff by $***. For the G-P Contract, the price was $*** higher.

PSE's cost of service could also be determined by looking at the cost of the most expensive 300 MW of resource on PSE's system. Given PSE' load resource balance, that cost is

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based on PSE's combustion turbines ("CTs"), which have a heat rate of approximately 12,000 kWh/mmbtu. Ex. 7, Deposition of William Gaines. Since PSE's CTs are likely to be displaced by market purchases at certain times of the day and year, lower prices must be assumed at the times when the market price is below PSE's highest generating cost. Under this type of analysis, the prices paid in 2000 by the Schedule 48 and special contract customers in 2001 are expected to exceed PSE's incremental cost by approximately $*** million, even assuming critical water.

PSE has been understandably embarrassed about reporting its results of operations for November 2000. These results undoubtedly show a very dramatic increase in the revenues that PSE has received from the Schedule 48 and special contract customers. In addition, under the cost analysis described above, these revenues show that PSE is earning an excessive rate of return from these customers. Based on the data available through October 2000, PSE's rate of return on rate base from serving the Schedule 48 and special contract customers is expected to exceed **%. This compares to a 9.03% rate of return which was determined to be reasonable for Avista in its recently completed rate case. WUTC v. Avista Corp., WUTC Docket Nos. UE-991606/UE-991607, Third Supp. Order at 100 (Sept. 29, 2000).

C. PSE Has Breached Its Commitment to Provide Open Access

Schedule 48 was intended, upon its creation in 1996, to be the first step towards open access to competitive energy markets on an economic basis for all customer classes. PSE has failed to abide by its contractual obligations to provide open access. In addition, the Complainants obligation to purchase under Schedule 48 and the G-P Contract should be rescinded due to commercial frustration. The only appropriate remedy is to return the Complainants to Schedule 49.

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1. The 1996 Settlement Agreement Obligated PSE to Provide Open Access

PSE has breached its commitment to provided cost-based open access. In May 1996, ICNU and its members signed a settlement agreement with PSP&L. In the Settlement Agreement, the parties agreed "to support the principal of open access to competitive energy markets on an economic basis for all customer classes." Settlement Agreement at 1. ICNU members compromised their position, agreed to withdraw their opposition to the merger and support both Schedule 48 and the merger in "order for Puget to be able to provide service to Customers on such terms and conditions and to move toward providing open access to competitive markets on an economic basis for all customer classes." Id. The Settlement agreement continues, "with Puget's commitment to the principle of open access and with the proposed offering of Schedule 48, Industrial Parties believe that approval of the merger would be in the public interest." Id.

Schedule 48 and the G-P Contract were designed as the first step in a transition to open access. The Settlement Agreement detailed subsequent steps that PSE was required to take. The additional steps stipulated to in the Settlement Agreement have not been implemented by PSE. Thus, a fundamental aspect of the agreement, the creation of open access, has not occurred.

2. PSE Has Failed To Comply With Its Obligation Under The Settlement Agreement

The Settlement Agreement represented a compromise of ICNU's position regarding the merger, in consideration of promoting open access. ICNU and its members have fulfilled their obligations under the Settlement Agreement by supporting the merger and the adoption of Schedule

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48. However, to the detriment of their industrial customers, PSE has willfully avoided any of their contractual duties.

Puget specifically agreed to "work with the Industrial Parties to develop and propose legislation that will foster open access to competitive energy markets on an economic basis for all customer classes." Id. Puget has ignored this contractual obligation. As such, it constitutes a breach of contract.

Additionally, Puget agreed to "work with the Industrial Parties on preparing a proposed rate schedule of general applicability regarding open access to competitive electric markets for all customer classes on an economic basis." Id. Puget has also ignored this contractual obligation. This also constitutes a breach of contract.

Finally, the Parties agreed to develop a cost based rate schedule regarding open access to competitive energy markets. Id. Alternatively, the Settlement Agreement held that "if the collaborative participants and Puget do not agree upon the form and substance of such rate schedules, Puget will, on its own initiative, submit for filing with the Commission a cost based rate schedule of general applicability regarding open access to competitive electric energy markets on an economic basis for all customer classes." Id. Such filing will be made by Puget no later than eleven months prior to the end of the Rate Stability Period (December, 2001). Id. This obligation has been ignored by PSE. PSE has stated repeatedly that it does not intend to propose cost-based open access upon the expiration of Schedule 48 and the G-P Contract. Affidavit of Ken Canon at ¶ 7. This constitutes anticipatory repudiation.

An anticipatory breach occurs when one of the parties to a bilateral contract either expressly or impliedly repudiates the contract prior to the time of performance. Wallace Real

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Estate Investment, Inc., v. Groves, 124 Wash. 2d 881, 881 P.2d 1010 (1994). An anticipatory breach is a "positive statement or action by the promisor indicating distinctly and unequivocally that he either will not or cannot substantially perform any of his contractual obligations." 124 Wash. 2d at 898, 881 P. 2d at 1019. (internal citations omitted). PSE's statement that it intends not to propose cost based open access upon the expiration of Schedule 48 and the G-P contract meets the requirements for an anticipatory breach.

In PSE's Answer to Complainants Amended Complaint, they allege that a breach of contract action is not ripe because these tariffs have not yet expired. PSE Answer to Complainants' Amended Complaint at 9. While these tariffs have not yet expired, PSE's actions, or lack thereof constitute a breach of PSE's obligations under the Settlement Agreement particularly since such actions were required by no later than January 1, 2001. Alternatively, if PSE is correct that this action is not ripe, PSE's actions and statements do not constitute a material breach, they do constitute an anticipatory repudiation of a fundamental element of the bargain. Wallace, 124 Wash. 2d at 898, 881 P. 2d at 1019. As such, PSE has breached the Settlement Agreement, and the Complainants should be relieved of their obligations, if any, to purchase under Schedule 48 and the G-P Contract priced at the Mid-Columbia indices.

3. The Contractual Obligations Should Be Excused Under The Doctrine Of Frustration

The contractual obligations in Schedule 48 and the G-P Contract, to the extent that they exist, should be excused under the doctrine of frustration. Any event that substantially frustrates a party's principal purpose in entering into a contract discharges that party's obligations under the contract. Wash. State Hop Producers, Inc. v. Goschie Farms, Inc., 112 Wash. 2d 694,

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1 700-702, 773 P.2d 70, 73-75 (1989). The transaction must be such that it would have made little
2 sense without the purpose that is frustrated, and the nonoccurrence of the frustrating event must
3 have been a basic assumption underlying the contract. Id.

4 The doctrine of frustration requires four essential elements: 1) a supervening event
5 must have substantially frustrated the promisor's principal purpose (Scott v. Petett, 63 Wash. App.
6 50, 61, 816 P.2d 1229, 1236 (1991)); 2) nonoccurrence of the supervening event must have been a
7 basic assumption on which the contract was made (Felt v. McCarthy, 130 Wash. 2d 203, 208-09,
8 922 P.2d 90, 93 (1996)); 3) the frustration must have resulted without the fault of the promisor's
9 principal purpose (Foster v. Sunnyside Valley Irrigation Dist., 102 Wash.2d 395, 403, 687 P.2d
10 841, 845 (1984)); and 4) the promisor must not have assumed a greater obligation than the law
11 imposes. Weyerhaeuser Real Estate Co. v. Stoneway Concrete, Inc., 96 Wash. 2d 558, 562, 637
12 P.2d 647 (1981).
13

14 The prices paid by Complainants have reached such an extreme level that the
15 agreements should be rescinded based on the doctrine of frustration of purpose. The catastrophic
16 increases in the price of electricity is the supervening event that has substantially frustrated the
17 principal purpose of the contract. The basic assumptions under which the contract was made are
18 that: 1) a robust competitive market would develop in the Northwest; 2) the Mid-Columbia indices
19 would represent the price of power in a competitive market; and 3) the Mid-Columbia indices
20 would represent the cost of market power to serve Complainants' load. Based on the projected cost
21 of new resources at the time Schedule 48 and the G-P Contract were approved, the market price,
22 and thus the price paid by Complainants, was expected to be substantially lower than the price of
23 embedded cost resources under Schedule 49. Each of these assumptions which have been proved
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1 incorrect were basic assumptions on which the contract was made and PSE has been unjustly
2 enriched at the expense of Complainants. Id. The catastrophic market conditions have resulted
3 without the fault of the Complainants. *See* FERC November 1 Order. The Complainants did not
4 accept the risk that the Northwest Energy markets would collapse. Thus the doctrine of frustration
5 should apply. Finally, the court will analyze whether the parties foresaw the risk and allocated that
6 risk to either party. Weyerhauser Real Estate Co., 96 Wash. 2d at 563. Washington does not view
7 foreseeability as a separate factor, but as "a relevant factor in determining whether the
8 nonoccurrence of the frustrating event was a basic assumption of the frustrated party in entering the
9 transaction." Wash. State Hops Producers, Inc., 112 Wash. 2d at 706. Additionally, "foreseeability
10 of the frustrating event is not alone enough to bar rescission if it appears that the parties did not
11 intend the promisor to assume the risk." Id. If the parties did not foresee the risk nor allocate the
12 risk, then the contract is frustrated. Weyerhauser Real Estate Co., 96 Wash. 2d at 564-566.
13
14 The appropriate remedy in cases of commercial frustration is to refund the transition
15 charges paid by Complainants, rescind the contract and place the parties where they were before the
16 contract, Schedule 49. Wash. State Hop Producers, Inc., 112 Wash. 2d at 696. To compensate PSE
17 for the expected differences between market prices and PSE's embedded costs, Complainants have
18 paid PSE transition charges. These transition charges were paid in anticipation of the customers
19 being legally able to purchase electricity directly from third party power providers, within the five
20 year term. The transition charges were designed to pay for the historic power cost demands that the
21 customers had placed on PSE prior to Schedule 48. Customers were to pay the difference between
22 PSE's embedded power costs under the current tariff and PSE's estimate of the non-firm price of
23 power. PSE, Schedule 48, First Revised Sheet No. 48-e; WUTC v. PSP&L, Docket No. UE-
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960696, Order Approving Schedule 48 with conditions at 3 (Oct. 30, 1996). The transition charges recognized that PSE planned and acquired resources from these customers and that it would take time before PSE could restructure its energy portfolio to align its supply obligations to the customers rights in their new status as Schedule 48 customers. Air Liquide, et al. v. PSE, Docket No. UE-981410, Fifth Supp. Order at 25 (Aug. 3, 1999). Therefore, at the end of Schedule 48, the Schedule 48 customers would no longer owe any power costs related to stranded costs. Since the parties must be placed back in their original position, PSE should refund all transition charges paid by the Complainants.

4. The Contractual Obligations Should Be Excused Under the Doctrine of Impossibility or Impracticality of Performance

Impossibility of performance, which excuses a party's performance of a contract, encompasses both strict impossibility and impracticality due to extreme and unreasonable difficulty, expense, injury or loss. Thornton v. Interstate Sec. Co., 35 Wash. App. 19, 30, 666 P.2d 370 (1983). Although, the mere fact that a contract's performance becomes more difficult or expensive than originally anticipated, does not justify setting it aside. Id. A party assumes the risk of increased cost within a normal range but might not assume the risk of "extreme and unreasonable difficulty." *See* Restatement (Second) of Contracts § 261 cmt. d. (1981). It has long been recognized in Washington that when a party by his contract assumes an unqualified duty, he is bound to perform if possible, notwithstanding the occurrence of an unexpected, yet foreseeable event, against which he might have guarded in his contract. Thornton, 35 Wash. App. at 30, 666 P.2d at 377. For risks a party does not assume, in order for a party to be excused, the "unexpected, yet foreseeable event" which renders performance impossible must be

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fortuitous and unavoidable on the part of the promisor. PUD No. 1 of Lewis County v. WPPS, 104 Wash. 2d 353, 363-64, 705 P.2d 1195, 1204 (1985).

The outrageous wholesale power prices in the Northwest have caused extreme and unreasonable difficulty, expense, injury and loss to the Complainants. This is not a case where the contract has merely become more expensive than originally anticipated, the high electric prices have created an economic emergency that threatens the welfare of the Complainants, and the entire Northwest region. The Complainants did not assume an unqualified duty to continue to pay rates that are not just and reasonable. Additionally, the current market conditions happened through a disastrous convergence of events, which were unavoidable on the part of the promisor. Therefore, the Complainants should be excused under the doctrine of impracticability.

V. REMEDIES FOR UNJUST AND UNREASONABLE RATE

A. The Commission is Required by Statute to Set a Just and Reasonable Rate

Once the Commission concludes that the rates charged by PSE to Complainants are not just and reasonable, which Complainants will prove at hearing, then the Commissions statutory obligations are clear:

> Whenever the commission shall find. . .. that the rate . . . charged or collected…by any electrical company . . . for . . . electricity . . . are unjust, unreasonable, unjustly discriminatory or unduly preferential, or in any wise in violation of the provisions of the law. . .. the commission *shall* determine the just, reasonable, or sufficient rates, charges, regulations, practices or contracts to be thereafter observed and in force, and shall fix the same by order.

RCW § 80.28.020 (emphasis added). The Commission has numerous options to establish a just and reasonable rate, including a return to Schedule 49, or the imposition of a rate cap on Schedule

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48. However, in the absence of a properly functioning market, the only basis for setting a just and reasonable rate is PSE's prudently incurred cost of providing service. Farmers Union, 734 F. 2d at 1502.

1. The Commission Should Impose the Schedule 49 Rate

As noted above, the Commission has a number of options for determining a just and reasonable rate. The facts of this case suggest that the most appropriate rate is the Schedule 49 rate or the rate schedule that would otherwise apply to each Complainant in the absence of market–based rates. First, the Schedule 49 rate is the most recently approved cost of service rate for serving this class of customer and, thus, it is a good indicator of PSE's cost of service. Second, when a contract is rescinded, the remedy is often to put the parties in the same position they would be in absent the contract. Most of the Complainants would be purchasing power pursuant to Schedule 49 in the absence of Schedule 48 or a special contract. Third, imposing Schedule 49 rates is reasonable because that rate is higher than the rate that was expected to occur under Schedule 48.

PSE makes much of the fact that Complainants have chosen to become "non-core customers." The reality, however, is that this distinction has had little practical impact. PSE continues to treat Complainants as part of its system load, and it does not acquire resources specifically to serve Complainants. Air Liquide, et al. v. PSE, WUTC Docket No. UE-001952, PSE Response to Bench Requests 4 and 5; Air Liquide, et al. v. PSE, WUTC Docket No. UE-981410, Ex. 22 (PSE Revised Briefing Paper). There is no evidence that PSE has changed its resource position, for instance by making a long-term sale, in reliance on Complainants' non-core status. Arguably, PSE is not required, on a long-term basis, to plan to serve Complainants load, but

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this fact has little relevance since PSE has continued to serve that load without making long-term resource decisions.

Schedule 48 even contemplates that Complainants can return to core status once Schedule 48 terminates:

> At the expiration of the term of the Service Agreement, Customer may commence taking service under *any retail tariff* providing firm service; however, the Customer understands and acknowledge that such service may be subject to payment by such Customer of any long-run resource costs and any incremental capacity costs . . . incurred by the Company to provide such service.

PSE, Schedule 48, Third Revised Sheet 48-g (emphasis added).

Similarly, for the G-P Contract, G-P is "non-core with respect to power supply, i.e., Puget would not plan for their power supply needs *during the five year period*". Commission Staff Report, Docket No. UE-960612/UE-960613 (June 7, 1996) (emphasis added). The Schedule 48 provision is interesting from a number of perspectives. First, it allows a customer to return to tariff firm service. In other words, the customer may choose to become a core customer again. Second, the customer is required to pay additional costs only if returning to core status creates incremental capacity needs or long-term resource needs. If such needs are not created because of PSE's load resource balance, then there is no additional charge. Finally, this language refers to incremental capacity needs, but not incremental energy needs. This suggests that the customers would be served at PSE's average system energy costs just like other customer classes.

The Commission should impose the Schedule 49 rate or the otherwise applicable embedded cost rate, while permitting the Company to seek any incremental capacity costs or long-term resource costs that it incurs as a result of the load returning to core status, consistent with the

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Commission's least cost planning principles. Complainants continue to maintain that to the extent PSE can demonstrate that returning to Schedule 49 harms "core" customers, Complainants are willing to pay a reasonable "surcharge."

2. As an Alternative, the Commission Should Impose a Rate Cap

One option for the Commission to consider would be to impose a rate cap on Complainants' rates. This alternative could approximate PSE's cost of service. However, this option is less attractive because it would still rely on a fundamentally flawed power market. When the rate is below the cap, it could still exceed the market cost of serving Complainants' load because all prices would be based on high spot market prices. Furthermore, when the price is below the cap, it could exceed PSE's actual cost of providing service.

A price cap could be based on a number of factors and should vary by month. For example, the cap could be based on the price of a CT and an estimated gas price. One way to set the cap would be to multiply the monthly closing price for NYMEX gas times the heat rate of the highest 300MW of CT generating capacity available to PSE. In the alternative, the price could be set for all of 2001, based on a proxy price. Alternatively, the cap could be based on the lower of the Complainants' or PSE's incremental cost of production. This would result in an accurate cost of production or avoided cost price cap.

3. Adopting a Just and Reasonable Rate Would Not Violate the Merger Rate Plan

All of PSE rates, including Schedule 48 and the G-P Contract were intended to remain in place for a minimum of five years, with nominal 1%-1.5% annual increases, following the PSP&L/WNG Merger. Re PSP&L, WUTC Docket Nos. UE-951270, UE-960195, Fourteenth Supp. Order at 13 (Feb. 5, 1997). Both Schedule 48 and the G-P Contract have explicit provisions

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specifying a five year life. The merger Rate Plan fixed current rates with a fixed rate increase for five years that prevented PSE from requesting a rate increase until December 2001.

The Commission approval of Schedule 48, the G-P Contract and the PSP&L/WNG Merger were predicated on the assumption that rates must be just, reasonable and sufficient. If the rates were insufficient, and did not provide PSE an opportunity to earn a reasonable rate of return they would be insufficient and confiscatory; and therefore illegal. RCW § 80.28.010; Bluefield Water Works and Improvement Co. v. Pub. Serv. Comm'n of W. Va; 262 U.S. 679 (1923); Fed. Power Comm'n v. Hope Nat. Gas Co., 320 U.S. 591 (1944). Likewise, if any prior approved rates become unjust and unreasonable, the Commission is obligated to determine a just and reasonable rate. RCW § 80.28.020. These statutory and constitutional principles may not be abrogated by a commission order.

4. Setting a New Rate Does Not Require Interim Rate Authority

Setting a just and reasonable rate now does not require that the Commission determine that it has interim rate authority. The Commission has all of the facts it needs to determine that Complainants current rates are not just and reasonable, and to determine a new just and reasonable rate. PSE is then free to make a new filing showing that the rates are not just and reasonable. The only requirement to set a new just and reasonable rate is that the Commission hold a hearing. RCW § 80.28.020. Complaint statute requires that PSE be given a minimum 10 days notice of the hearing. RCW § 80.04.110. Additionally, the Commission found sufficient cause to shorten the 20 day notice required by WAC 480-09-700. Air Liquide, et al. v. PSE, WUTC Docket No. UE-001959, Second Supp. Order (Dec. 27, 2000). Both of these notice requirements have been satisfied.

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Authorizing the Complainants to switch to Schedule 49, or placing a cap on the price of Schedule 48, will not jeopardize adequate service to any customer at just and reasonable rates. First, the imposition of a surcharge would be designed to ensure that no other customer class is harmed by the return of the Complainants to Schedule 49. Neither remedy will harm PSE's ability to provide service at current rates. Puget does not serve the Complainants current load on the daily spot market, but rather treats it as system load. Air Liquide, et al. v. PSE, WUTC Docket No. UE-981410 Ex. 22 (PSE Revised Briefing Paper). Therefore, any return by the Complainants to service under Schedule 49, or an interim price cap on Schedule 48, should not cause PSE to alter the method that it provides electric service to any customers in the immediate future. Additionally, the Commission could authorize PSE to recover any additional revenues lost while the interim rates were in effect. WUTC v. PSP&L, WUTC Docket No. U-73-57, Fourth Supp. Order (Sept. 27, 1974).

VI. EMERGENCY ADJUDICATIVE PROCEEDING STATUTE

A. The Commission Can Exercise Its Authority Under the Emergency Adjudicative Statute And Set a Temporary Just and Reasonable Rate

If the Commission determines that Complainants have met their burden of proving that their rates are not just and reasonable, the Commission is required to set a just and reasonable rate. RCW § 80.28.020. The Commission requires no further statutory authority. If, however, the Commission finds that some element of proof is missing, or that some other technical defect exists, then the Commission has independent substantive authority to fashion a remedy under the Emergency Adjudicative Proceeding Statute. RCW § 34.05.479. These unprecedented emergency conditions have resulted in unjust and unreasonable rates that have no relationship to the cost of

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production, or the expectation of market participants, and are causing significant economic harm to the Complainants who are purchasing their electricity at market based rates; and, therefore, causing significant harm to the public welfare in the form of business closures, economic slowdowns, higher retail prices, lost jobs and in some cases higher prices for the products produced by Complainants. Without immediate Commission action, the health, safety and welfare of the Puget Sound area may suffer significant permanent harm.

1. The Unprecedented Market Price Volatility is an Immediate Danger to the Public Welfare

a. The Commission is Authorized to Utilize Emergency Adjudicative Proceedings When the Public Health, Safety or Welfare is in Immediate Danger

The Commission is authorized to utilize emergency adjudicative proceedings to address an "immediate danger to the public health, safety, or welfare . . .." RCW § 34.05.479(1); WAC § 480-09-510. The statute provides the Commission discretion in evaluating the appropriate criteria for determining if an immediate danger exists, but does not contemplate imposing additional, non-statutorily based requirements for using emergency adjudicative proceedings. The statute contemplates that the Commission may authorize emergency proceedings when: 1) a danger exists; 2) the danger is immediate; and 3) the danger threatens the public health, safety or welfare. Id.

The statutory requirements must be interpreted based on common sense, and the Commission should interpret the requirements according to their plain meaning. Nat'l Union Ins. Co. v. PSP&L, 94 Wash. App. 163, 171, 972 P.2d 481, 484 (1999); Welch v. Southland Corp., 134 Wash. 2d 629, 633, 952 P. 2d 162, 165 (1998). A danger is defined merely an "[e]xposure or

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vulnerability to harm or risk." The American Heritage Dictionary 472 (3d ed. 1992). The common understanding of the word immediate includes "[o]f or near the present time and place" and "[c]lose at hand; near." Id. at 902. And the term public health, safety and welfare is commonly understood to have a broad and expansive meaning. For example, public welfare is best understood as a "society's well-being in matters of health, safety, order, morality, economics, and politics." Black's Law Dictionary 1588 (7th ed. 1999). Therefore, the Commission is authorized, within its jurisdiction over public utilities, to initiate emergency proceedings to remedy any close at hand exposure to harm to the Puget Sound area's health, safety, welfare, order or economics.

The emergency adjudicative proceeding statute does not place any limitations on the types of public dangers agencies are empowered to remedy. *See e.g.* Boise Cascade Corp., 68 Wash. App. 447, 843 P.2d 1092 (1993). In Boise Cascade, the Forest Practices Appeal Board was found to have general authority to issue a stay to the Department of Natural Resources' approval of the application of certain herbicides in Klickitat County. The Appellate Court's only requirement was that the agency finds that the public health, safety, or welfare imperatively requires emergency action. Id. at 454.

The only potential limitation on the Commission's power is whether it has jurisdiction over the cause of the public danger. Without any basis in the text of the emergency adjudicative statute, Puget has asserted that there can be no immediate danger to the public health, safety or welfare because of economic harm borne by the Complainants. WUTC December 14 Hearing, Tr. at 55:9-17 (statement of Stan Berman). As mentioned above, the emergency adjudicative proceeding statute includes economic harm as a basis to grant an emergency order. Any private economic harm that results in job losses, higher retail prices, potential economic

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slowdowns and other ill effects upon the larger community is a significant threat to the public health, safety and welfare. Therefore, the Commission is empowered to utilize an emergency adjudicative proceeding to remedy a pubic danger caused by exorbitant electricity prices.

The Commission has previously authorized emergency adjudicative proceedings on at least one occasion to avert harm to "seriously affected business." WUTC v. US West Communications, Inc., WUTC Docket No. UT-950446 (Apr. 28, 1995). The exhaustion of available telephone numbers in Area Code 206 had prompted the Commission to introduce 360 as a new area code. However, because the new area code did not use a one or a zero as a middle digit, some telephone equipment would have been unable to reach the new numbers. The Commission initiated an emergency proceeding to remedy the problem after "[w]eighing the evidence of substantial and devastating hardship arising from the current schedule of optional dialing upon existing customers, including seriously affected businesses . . .." Id. The Commission's previous authorization of emergency adjudicative proceedings on the basis of averting the threat of immediate economic harm to the general public and business community is consistent with the statutory standard.

The extent of the economic harm borne by the Complainants is relevant to the Commission's determination of whether an immediate public danger exists. The Commission recognized this when it raised the question of whether "the financial ability of individual ratepayers to pay increased cost for electricity [is] a consideration relevant to determine whether there exists an immediate danger to the public health, safety, or welfare?" Air Liquide, et al. v. PSE, Docket No. UE-001952/ UE-001959, Order Consolidating Proceedings at 3 (Dec. 18, 2000). While the impact of high rates on an individual customer may not threaten the public welfare, when those

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high prices threaten the viability of some of the largest industrial facilities in PSE's service territory, the threat to the public welfare is self evident.

b. The Current Market Price Volatility Is Beyond the Ability of the Complainants to Cure

The circumstances which have led to the current danger to the public health, safety or welfare are not relevant in determining whether a public danger exists. The Commission has sought to answer the question of whether "the circumstances that Complainants assert constitute an immediate danger to the public health, safety, or welfare [needs to] be circumstances beyond the ability of Complainants to cure?" Air Liquide, et al. v. PSE, Docket No. UE-001952/ UE-001959, Order Consolidating Proceedings at 4 (Dec. 18, 2000). Puget raised a similar issue when it alleged that there is no immediate public danger because the Complainants have assumed the risk of harm. WUTC December 14 Hearing, Tr. at 55:9-17 (statement of Stan Berman). The relative "fault" of the parties is irrelevant as to whether a public danger exists. Even if relevant, the circumstances which have led to the immediate public danger are beyond the Complainants' control, and are risks which have not been allocated to the Complainants.

In determining whether or not a public danger exists, neither the emergency adjudicative statute nor the pertinent WAC provisions authorize the Commission to consider the question of who, if anyone, assumed the risk, or caused the threat, of the public danger. This question is simply not relevant to whether a rate is just and reasonable or an immediate public danger exists. The Commission should not narrow the emergency adjudicative proceeding statute by inserting non-statutory limitations on the Commission's authority to initiate emergency proceedings.

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A public danger exists regardless of whether any parties to this proceeding have the power to remedy it. Puget has the power to propose a cost based rate that would protect the Puget Sound area, but has failed to do so. In fact, Puget's proposed post-Schedule 48 rate for the Complainants is a continuation of this unjust and unreasonable market indexed rate. PSE filing dated Jan. 2, 2001. The Complainants could internalize the cost of electricity until they suffer extreme losses in operating their facilities. However, these issues are not relevant. A danger exists to the public health, safety and welfare of the Puget Sound area, and the threat of harm is not being abated by either the Complainants or PSE. To authorize an emergency adjudicative proceeding, all the Commission need consider is that in the immediate future the public health, safety and welfare will be harmed without Commission action.

The Complainants cannot cure this problem by simply purchasing a financial hedge. The ability to hedge is based on the assumption that prices are being set by a properly functioning competitive market, which is not the case. It is not clear at this time whether anyone would offer such a product in today's market and if available, Complainants would simply be looking at these high prices over a longer period of time. Financial products like hedges do not provide a rate discount, they simply smooth the current and projected future prices over a period of time, which here would require a very long-term commitment. Additionally Schedule 48 customers' contracts expire in November 2001, and the G-P Contract expires in May 2001, it does make sense to purchase a hedge beyond the date. Therefore, a financial hedge, if available, would not provide an adequate solution.

The Complainants have not assumed the risk of harm. A party cannot have assumed the risk of an event that was not foreseen at the time of the agreement. The Complainants chose to

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pay market based rates based on the assumption that the rates would approximate historic costs. Within a *zone of reasonableness*, the Complainants assumed the risk that the market price of power would rise, while PSE assumed the risk that the market price would drop. However, no one could have foreseen that the market price of power would completely deviate from historic norms, causing these rates to no longer be just or reasonable. Because the Complainants did not foresee the possibility of exorbitant electric rates, they could not have assumed the risk of the current prices.

c. The Current Market Price Volatility is an Immediate Danger to the Public Health, Safety or Welfare

The current market price of electricity is a threat to the public health, safety and welfare. The Puget Sound area communities are already facing job losses, higher electric and water rates, higher retail prices for commodities produced by the Complainants, and economic slow down. A threat to the economic welfare was sufficient to constitute an emergency in UT-950446. WUTC v. US West Communications, Inc., WUTC Docket No. UT-950446. Additionally, the environmental quality of the Puget Sound area is threatened by the sudden increase in diesel powered generation. Id. *See* Boise Cascade, 68 Wash. App. at 450. Alone any of these conditions constitutes an immediate public danger, combined they represent a serious threat to the public health, safety and welfare of the Puget Sound area.

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2. The Commission May Remedy the Immediate Danger to the Public Health, Safety and Welfare by Granting the Complainants Requested Relief

a. The Commission May Take Any Action Within Its Jurisdiction Necessary to Protect the Public Health, Safety or Welfare

The Commission is authorized to take "such action as is necessary to prevent or avoid the immediate danger to the public health, safety, or welfare . . .." RCW § 35.04.479(1). The Commission's authority under the emergency adjudicative statute is independent of its authority under Title 80, Public Utility Regulation. This provides the Commission with broad authority to waive existing procedural rules, and take substantive action to prevent or avoid the public danger, including imposing interim rates. The only procedural limitations on the Commission's authority are the state and federal due process rights of any parties, and the need to conduct an expedited hearing. RCW § 34.05.479(5). Furthermore, the Commission must provide practicable notice "to persons who are required to comply with the order." RCW § 34.05.479(4). Likewise, the only substantive limitations on the Commission's authority to remedy a public danger are that the Commission has jurisdiction over the parties, and that it may only take actions that will prevent or avoid the public danger. RCW §§ 34.05.479(2) and (3).

The Washington Administrative Code provides the Commission with similar broad authority to remedy public dangers. Specifically, the Commission may authorize emergency adjudicative proceedings to "suspend or cancel authority, to require that a dangerous condition be terminated or corrected, or to require immediate action in any situation involving an immediate danger to the public health, safety, or welfare requiring immediate action by the commission." WAC § 480-09-510(1). Therefore, the Commission's rules allow it to require any immediate action it deems necessary to terminate or correct a danger to the public health, safety or welfare.

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Puget has asserted that the emergency adjudicative statute only authorizes the Commission to utilize expedited procedures. WUTC December 14 Hearing, Tr. at 105: 7-15 (Statement of Stan Berman). The language of the emergency adjudicative statute contains no such limitation and permits the Commission to take "such action as is necessary to prevent or avoid the immediate danger . . .." RCW § 34.05.479(2). This includes the Commission entering "an order . . . to justify the determination of an immediate danger and *the agency's decision to take specific action*." RCW § 34.05.479(3)(emphasis added). Expedited procedures alone will rarely constitute an action necessary to prevent or avoid an immediate danger to the public health, safety or welfare. Therefore, Mr. Berman's assertion would defeat the purpose behind the emergency adjudicative proceedings statute.

b. The Commission Need Not Find that the Complainants' Current Rates are Unjust or Unreasonable Before Granting Emergency Rate Relief

Under RCW § 34.05.479, an emergency adjudicative proceeding can be authorized if there is an immediate danger to the public health, safety, or welfare and this danger requires using an emergency proceeding. RCW § 34.05.479 outlines a three-step process. First, the Commission must determine that there is an immediate public danger that justifies emergency adjudicative proceedings. RCW § 34.05.479(1). Second, the Commission can take any action necessary to avoid or prevent the immediate public danger. RCW §§ 34.05.479(2) and (3). Finally, after ordering interim or temporary relief, the Commission must initiate a full blown proceeding to remedy the long-term causes of the public danger. RCW § 34.05.479(5).

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c. Temporary or Interim Rates Approved by the Commission Must Remedy the Immediate Danger While Not Creating a New Danger to the Public Health, Safety or Welfare

The purpose of implementing an interim rate under RCW § 34.05.479 is to remedy an "immediate danger to the public health, safety or welfare." The goal of any interim relief is to simply remove that danger. RCW § 34.05.479(2). Consideration of the adequacy of the rate in the long-term is postponed until after the danger is removed. RCW § 34.05.479(5). Therefore, there is no need to determine whether the interim rate itself is just, reasonable or sufficient before ordering interim rate relief to remove the danger.

However, use of the emergency adjudicative proceeding statute to remove one danger to the public health, safety or welfare should not create another danger in the process. The remedy fashioned by the Commission to remove the first danger should be tailored in such a way as to avoid this result. Therefore, any emergency relief approved by the Commission's order in the current proceeding should protect PSE's ability to continue service to its other customers.

The remedy suggested by the Complainants would not create a new emergency.

d. The Commission Does Not Have the Authority to Require Customers of Regulated Utilities to Protect Themselves from the Effects of the Monopoly

The Commission is charged with the duty to regulate companies having monopoly power in supplying utility and transportation services and commodities. RCW § 80.01.040. Specifically, the Commission has the authority to:

> Regulate in the public interest, as provided by the public service laws, the rates, services, facilities, and practices of all persons engaging within this state in the business of supplying any utility service or commodity to the public for compensation, and related activities; including, but not limited to, electrical companies, gas

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> companies, irrigation companies, telecommunications companies, and water companies.

RCW § 80.01.040(3). The Commission protects customers from the adverse effects of the utility's monopoly power by acting as a surrogate for competition. Jewell v. WUTC, 90 Wash. 2d 775, 783; 585 P. 2d 1167, 1172 (1978).

While the Complainants receive power under a rate schedule using market-indexed rates, there is no competitive utility which the Complainants switch to when rates become unjust and unreasonable. The Commission does not have the statutory authority to abdicate its duty by requiring customers to protect themselves from a monopoly's power. RCW § 80.01.040. In fulfilling this duty the Commission should not increase the monopoly power of the utility by requiring customers to buy additional services to protect against unjust and unreasonable rates.

3. After Ordering Emergency Relief the Commission Must Investigate the Justness and Reasonableness of the Complainants' Rate

Once the immediate danger to the public welfare has been remedied the Commission is required to conduct a prompt and expeditious hearing to establish a long term solution. After ordering emergency relief the Commission "shall proceed as quickly as feasible to complete any proceedings that would be required if the matter did not involve an immediate danger." RCW § 35.04.479(5). At the conclusion of the proceedings, the Commission is empowered to enter final relief, which may differ from the emergency relief granted prior to a full investigation into the causes of the immediate public danger.

After remedying the immediate public danger caused by the Complainants unjust and unreasonable rates, the Commission should conduct a standard complaint proceeding into the

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justness and reasonableness of electric rates Schedule 48 and the G-P Contract. The Commission should proceed in the complaint as expeditiously as possible. This post-emergency order proceeding should evaluate, *inter alia*, the proper cost-based just and reasonable rate for the Complainants; the resources PSE utilizes to serve the Complainants; whether the Complainants new rate is subject to refund, or surcharge, as the case may be, with interest, to reflect the difference between such Schedule 49 rate and the cost-based just and reasonable rate; the permanent price cap for Schedule 48; and/or the Complainants refund of the transition charges paid to PSE in exchange for market access at the end of the five year service agreements and G-P Contract.

VII. CONCLUSION

Dysfunctional Western power markets have created an economic emergency in California, as well as the state of Washington. The continued use of the Mid-Columbia indices to set retail rates in this state is no longer just and reasonable. As a result of these conditions, the Commission is required by statute to set a new just and reasonable rate. Complainants urge that the Commission immediately impose the embedded cost tariff that would otherwise apply to Complainants or establish rate caps based on PSE's actual cost of providing service.

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3 Respectfully submitted,

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