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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. PUGET SOUND POWER & LIGHT COMPANY, Respondent.	DOCKET NO. U-89-2688-T
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. PUGET SOUND POWER & LIGHT COMPANY, Respondent.	DOCKET NO. U-89-2955-T THIRD SUPPLEMENTAL ORDER

PROCEEDING: On February 17, 1989, Puget Sound Power & Light Company, hereafter referred to as "respondent", "company", or "Puget", filed tariff revisions designed to produce a general increase in its rates and charges for electric service in the state of Washington in the approximate amount of $70.5 million. The company calculated this number by adding average 1989 ECAC revenues to the level of rates approved in the last general rate case and calling the result "present rates". The tariff filings were suspended by Commission order issued March 8, 1989, under Docket No. U-89-2688-T.

On May 26, 1989, Puget filed a revision to its Tariff WN U-60. The tariff revisions would move into general rates approximately $75 million in rates which had been included in the company's Energy Cost Adjustment Clause (ECAC) proceeding. This treatment was described in Docket No. U-89-2688-T, but not included in the tariff sheet revisions filed with that case. These tariff revisions were suspended by Commission order dated June 7, 1989, under Docket No. U-89-2955-T.

The two dockets were consolidated by Commission order dated September 8, 1989.

HEARINGS: Hearings were held before Chairman Sharon L. Nelson, Commissioner Richard D. Casad, Commissioner A.J. Pardini, and Administrative Law Judge Alice L. Haenle of the Office of Administrative Hearings, pursuant to due and proper notice to all interested parties. Hearings were held at Olympia on April 12; May 24-26; July 17-21; October 2-4, 9, 10, 30 and 31; and November 1 and 3, 1989. Hearings for the purpose of taking testimony from members of the public were held in Bremerton on October 5, in Bellevue on October 5, and in Bellingham on October 6, 1989.

APPEARANCES: Puget was represented by William S. Weaver and James M. Van Nostrand, attorneys at law, Bellevue. The staff of the Washington Utilities and Transportation Commission was represented by Marjorie R. Schaer and Robert E. Simpson, assistant attorneys general, Olympia. The general public was represented by Charles F. Adams and Carrington F. Phillip, assistant attorneys general, Seattle. Intervenor Public Power Council (PPC) was represented by John Guadnola, Judith A Bearzi, and Bradley B. Jones, attorneys at law, Tacoma. Intervenor Washington Industrial Committee for Fair Utility Rates (WICFUR) was represented by Grant A. Tanner and Mark Trinchero, attorneys at law, Portland, Oregon. Intervenor Bonneville Power Administration (BPA) was represented by Geoffrey M. Kronick and Veronica Lewis, attorneys at law, Portland, Oregon. Intervenor Federal Executive Agencies (FEA) was represented by Norman J. Furuto, attorney at law, San Bruno, California, and by David W. LaCroix and Vicki E. O'Keefe, attorneys at law, Alexandria, Virginia.

SUMMARY: In this order, the Commission authorizes a major restructure and revision to the company's rates. The Commission has considered the request for an increase of $70,476,506 in rates in Docket No. U-89-2688-T and for a rollover into general rates of approximately $75 million which had been included in the company's prior ECAC proceedings, as set forth in Docket No. U-89-2955-T. The Commission approves the rollover of the ECAC rates, but authorizes only approximately $29 million of the amount requested in Docket No. U-89-2688-T. The Commission authorizes respondent to increase its rates to recover a total of $104,161,623.

Included in this order is a final resolution of the cost recovery issues surrounding Puget's investment in WPPSS project WNP-3. The Commission provides rate base recognition of the value of an exchange contract obtained by the company due to its interest in WNP-3. The Commission allows the company to receive rate recovery of the remaining portion of its prudent investment without fa return on rate base.

Also included in this order is a final reconsideration of Puget's Energy Cost Adjustment Clause (ECAC) process. The Commission finds the ECAC as it now exists, and as proposed by the company to be inconsistent with the public interest, and unacceptable. Until an improved process is offered, Puget's cost recovery will be limited to its general rate filings.

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I. SCOPE OF PROCEEDINGS

A. Procedural History

Puget Sound Power & Light Company is an investor-owned utility company which supplies electricity in a large portion of Western Washington.

On February 17, 1989, Puget filed tariff revisions designed to effect an increase in its rates and charges for electric service within the state of Washington in the annual amount of $70,476,506. The company calculated this number by adding average 1989 ECAC revenues to the level of rates approved in the last general rate case and calling the result "present rates". The Commission issued its Complaint and Order Suspending Tariff Revisions on March 8, 1989, under Docket No. U-89-2688-T. On March 15, 1989, the Commission issued its First Supplemental Order Instituting Investigation.

During the course of its rebuttal case, the company revised its figures to show a revenue requirement of $66,578,336. Puget witness John Story testified the company was still requesting an increase of $70.4 million [TR 4124].

On May 26, 1989, Puget filed revisions to its Tariff Schedule 95 which would move into general rates approximately $75 million which had been included in the company's ECAC proceedings. These tariff revisions were suspended by Commission order dated June 7, 1989, under Docket No. U-89-2955-T.

Because the issues in both cases were closely related, the Commission consolidated the two dockets for hearing by order dated September 8, 1989.

Respondent was last granted a general rate increase of $28,840,720, in Cause No. U-85-53. The rates became effective May 24, 1986.

A motion of the company was granted to incorporate some portions of the record in Cause U-86-131 into this case, primarily dealing with the valuation of power received from the Bonneville Power Administration under the settlement agreement. The Commission did not incorporate those portions of the record in Cause No. U-86-131 which dealt with the proposed transfer to Puget Energy, Inc.

The following sections will describe the evidence presented by each party in this case. A description of the witnesses and evidence presented in Cause U-86-131 is found in the Commission's June 25, 1987, order in that case and will not be repeated here.

B. Company Case

The company's direct case consisted of the testimony and supporting exhibits of the following witnesses:

(1) John W. Ellis, Chairman and Chief Executive Officer of the company, presented a general overview of the company's case. His testimony included a description of the company's rate stability plan, development of the company's least-cost plan, and the DARE project.

(2) Richard R. Sonstelie, President of the company, described the components of the rate increase request. He also generally described the company's proposal for recovery of Bonneville Exchange Power costs.

(3) Robert V. Myers, Senior Vice-President of Operations for the company, described the company's proposal for recovery of Bonneville Exchange Power. His testimony included updates to the record in Cause No. U-86-131.

(4) Ronald G. Bailey, Vice President of Power Systems for the company, testified regarding the company's projected loads and resources, the effects on general rates of updating the Base Unit Cost of Energy (BUCE), and the mechanics of a weather-related ECAC.

(5) Gary B. Swofford, Vice-President of Rates and Customer Programs for the company, described the impact of conservation programs and implementation of the company's Demand and Resource Evaluation (DARE) plan.

(6) Marjorie C. Qualls, Manager of Consumer Affairs for the company, described programs aimed at low-income and elderly customers.

(7) Russel E. Olson, Vice President-Finance and Treasurer of the company, described the company's financial conditions and the rate of return components other than cost of equity.

(8) Charles E. Olson, President of H. Zinder & Associates, Washington, D.C., testified regarding the company's cost of equity and impacts of the ECAC on cost of capital.

(9) John H. Story, Assistant Treasurer for the company, testified concerning the company's results of operations and revenue requirement.

(10) David W. Hoff, Director of Rate Planning and Administration for the company, testified regarding the company's cost of service analysis and rate spread and rate design proposals.

C. Commission Staff Case

The Commission staff's direct case consisted of testimony and supporting exhibit of the following witnesses:

(1) Richard J. Lurito, President of Commonwealth Consulting Group, Inc., McLean, Virginia, testified regarding the company's cost of capital and financial impacts on the company of other witness's recommendations.

(2) Ben Johnson, President of Ben Johnson Associates, Inc., Tallahassee, Florida, presented recommendations regarding ratemaking treatment of the company's investment in WNP-3.

(3) Kimberly Herbig Dismukes, Vice-President of Ben Johnson Associates, Inc., presented the results of WNP feasibility studies performed by her firm and the results of recommendations concerning the disposition of WNP-3 investment.

(4) Don Reading, consulting economist with Ben Johnson Associates, Inc., testified regarding the valuation of BPA settlement power.

(5) Curtis K. Winterfeld, partner in R.W. Beck and Associates, Seattle, testified regarding normalized net power supply costs, evaluation of the company's weather-only ECAC mechanism, and comparative efficiency of electric and gas water heaters for domestic use.

(6) Ellie Reynolds, Utility Tariff Administration Specialist for the Commission staff, testified regarding proposed tariff changes in line extension and service connection schedules.

(7) Bruce W. Folsom, Utilities Rate Research Specialist for the Commission staff, testified regarding rate design issues, late payment and field service charges, conservation, least-cost planning, and the Commission staff position regarding the ECAC.

(8) Tho Nguyen, Revenue Requirements Specialist for the Commission staff, testified concerning several ratemaking adjustments to the company's rate base and results of operations.

(9) Michael P. Parvinen, Revenue Requirements Specialist for the Commission staff, presented several pro forma and restating adjustments.

(10) Merton R. Lott, Revenue Requirements Specialist for the Commission staff, presented the Commission staff recommendations on the majority of the ratemaking adjustments to rate base and results of operations. He covered the pro forma results of operation and the calculation of the revenue requirement and general rate increase.

D. Public Counsel Case

Public Counsel presented the following witnesses:

(1) Charles Komanoff, from Komanoff Energy Associates, New York, New York, evaluated the company's proposal for rate recovery of Bonneville Exchange Power costs.

(2) James R. Dittmer, from Dittmer, Brosch and Associates, Inc., Lee's Summit, Missouri, quantified issues sponsored by certain other witnesses. His testimony also addressed affiliated transactions, recovery of WNP-3 investment, ratemaking treatment of the Executive Incentive Plan, and gains on sales and transfers of utility property.

(3) Richard Byers, Energy Policy Specialist for the Washington State Energy Office, provided the results of a technical analysis of questions posed by Public Counsel to the Energy Office. The analysis compared the costs of gas and electricity used for residential space and water heating.

(4) Tim Stearns, Policy Coordinator of the Northwest Conservation Act Coalition, Seattle, presented an assessment of the company's conservation programs and resource acquisition planning.

(5) Jim Lazar, a consulting economist from Olympia, addressed issues including power supply costs, the ECAC, the company's cost-of-service study, rate design, water heater rental program, line extension policy, and late payment charges.

E. Intervenor WICFUR Case

Intervenor WICFUR presented the testimony of the following witnesses:

(1) Dennis E. Peseau, President of Utility Resources, Inc., Salem, Oregon, addressed rate spread, the components of

a weather-only ECAC, and the link between the ECAC and the company's cost of capital.

(2) George C. Carter, III, Vice-President of Utility Resources, Inc., presented an analysis of the company's proposed power cost adjustment, and evaluated the company's cost-of-service study.

F. Intervenor FEA Case

Intervenor Federal Executive Agencies presented the testimony of the following witnesses:

(1) Hugh Larkin, Jr., Certified Public Accountant from Larkin & Associates, Livonia, Michigan, recommended a number of adjustments to rate base and results of operations.

(2) John B. Legler, professor of Banking and Finance in Georgia at the University of Georgia, Athens, Georgia, testified regarding cost of capital and fair rate of return.

G. Intervenor PPC Case

Intervenor Public Power Council presented the testimony of Lon L. Peters, Senior Economist at the Public Power Council, Portland, Oregon. Mr. Peters evaluated the company's proposed revisions to the ECAC.

H. Intervenor BPA Case

Intervenor Bonneville Power Administration participated in cross-examination of witnesses, but did not present testimony.

I. Company Rebuttal Case

On rebuttal, the company recalled Mssrs. Ellis, Sonstelie, Russel Olson, Charles Olson, Bailey, Swofford, Hoff, Myers and Story. The company also presented the following additional rebuttal witnesses:

(1) Eric Hirst, Corporate Fellow at Oak Ridge National Laboratory, Oak Ridge, Tennessee, testified regarding the company's proposed changes to the ECAC mechanism. He also addressed the interface between ECAC mechanisms and least-cost planning.

(2) Wendell Tangborn, a consulting hydrologist with HyMet Company, Seattle, analyzed the parties' recommendations on the number of water years properly used in estimating normalized power supply costs.

(3) J.R. Lauckhart, Director of Power Planning for the company, testified regarding the company's proposals for modifications of the ECAC mechanism.

(4) Charles F. Luce, Special Counsel to Metropolitan Life Insurance Company, New York, New York, testified regarding the prudence of the company's actions on WNP-3.

(5) David H. Knight, Bellevue, has retired from the company since he gave testimony in Cause No. U-86-131. Mr. Knight testified in this cause regarding prudence of the company's actions regarding WNP-3.

J. Testimony from Members of the Public

Hearings for the purpose of taking testimony from members of the public were held on October 5 in Bremerton and Bellevue, and on October 6 in Bellingham. Witnesses in all locations offered both testimony and exhibits. The Commission heard 28 witnesses in Bremerton, 28 witnesses in Bellevue, and 37 witnesses in Bellingham.

In addition to the public testimony, the Commission received and considered numerous cards, letters and petitions from concerned members of the public regarding the rate increase request. Materials received have been included in this record as Exhibits 877 and 878.

II. ISSUES AND GOVERNING PRINCIPLES

The ultimate determination to be made by the Commission in this matter is whether the rates and charges proposed in respondent's revised tariffs are fair, just, reasonable and sufficient pursuant to RCW 80.28.020. These questions are resolved by establishing the fair value of respondent's property in service, determining the proper rate of return permitted respondent on that property, and then ascertaining the appropriate spread of rates charged various customers to recover that return.

The purpose of a rate proceeding is to develop evidence from which the Commission may determine the following:

(1) The appropriate test period, which is defined here as the most recent 12-month period for which income statements and balance sheets are available. The test period is used for investigation of the company's operations for the purposes of these proceedings;

(2) The company's results of operations for the appropriate test period, adjusted for unusual events during the test period, and for known and measurable events;

(3) The appropriate rate base which is derived from the balance sheets of the test period. The rate base represents the net book value of assets provided by investors' funds which are used and useful in providing utility service to the public;

(4) The appropriate rate of return the company is authorized to earn on the rate base established by the Commission;

(5) Any existing revenue deficiency; and

(6) The allocation of the rate increases, if any, fairly and equitably among the company's ratepayers.

RCW 80.04.130 places the burden of proving that a proposed increase is just and reasonable on the public service company proposing such an increase.

In addition to the basic issues listed above, this case presents several issues which have been deferred to this general rate case from previous cases. In its Seventh Supplemental Order in Cause No. U-81-41, the Commission required the company to update the Base Unit Cost of Energy (BUCE), to derive a weather-related energy cost adjustment mechanism, and to demonstrate the impact of the ECAC on the company's cost of capital. The Commission in Cause No. U-86-131 reserved for a general rate case the valuation of power under the Bonneville Exchange contract.

III. TEST PERIOD

The test period for purposes of this proceeding is the 12 months ending September 30, 1988. This is the most recent and most complete information available throughout the period of this proceeding. It is used by all of the parties as the basis for the analysis of the company's performance and condition.

That period is hereby found to be the appropriate test period for examination of the company's operations for purposes of this proceeding.

IV. ECAC

A. Issues

The company's Energy Cost Adjustment Clause (ECAC) mechanism was established in Cause No. U-81-41. After a number of years, the Commission reopened that docket to review the ECAC mechanism and to determine whether it should be retained, and, if so, whether modifications should be instituted.

The Commission's Sixth and Seventh Supplemental Orders in Cause No. U-81-41 required presentation in this rate case of evidence addressing several issues. First, the company was directed to update the Base Unit Cost of Energy (BUCE) before any revised ECAC-type proceeding was implemented. Second, the company was required to derive a weather-related energy cost adjustment mechanism. Third, the company was required to demonstrate the impact of the ECAC on the company's cost of capital.

Many of the parties to this proceeding have addressed these three issues. Their positions will be summarized in the following section.

B. Positions of the Parties

1. Company

Company witness Ronald Bailey presented the company's proposal for modifications to the ECAC. Mr. Bailey testified the revisions complied with the Commission's directives in several ways. First, the company eliminated from the scope of power costs a number of costs not related to weather. Second, the company proposed a "Load Adjustment Factor" to take account of the impact of weather on loads. Mr. Bailey defined the Load Adjustment Factor as an amount per kwh that is added or subtracted from the Energy Cost Adjustment Rate (ECAR) in order to adjust rates for the effect which variance in loads from those assumed in fixing general rates has on rate recovery of non-Allowable-Energy-Cost generation costs.

Third, the ECAC as modified incorporated an avoided cost ceiling for new resources. The company contended major new long-term purchases of firm power to meet new loads could not be completely eliminated from an ECAC procedure. The company proposal included amortization and return for conservation investment.

Company witness Eric Hirst supported the company's proposal to use the ECAC to recover on a current basis costs of additional conservation programs and purchased power because

they are necessary to the company's least-cost plan. Mr. Hirst recommended the Commission remove "disincentives" to conservation by approving the company's proposal. He contended that including purchased power acquired through competitive bidding is consistent with least-cost planning.

Company witness Charles Olson performed a study to determine the link between the ECAC and cost of capital. He studied five electric utility companies subject to fuel cost risk at September 30, 1989, and found an investor requirement of 12.9% to 13.4%, which is above his estimate for Puget's company-specific figures. Dr. Olson testified that he would recommend a cost of equity 30 basis points higher if the ECAC were eliminated. On cross-examination, Dr. Olson admitted the 30-basis-point difference could be due to measurement error rather than the effect of the ECAC [TR 1170].

2. Commission Staff

The Commission staff recommended rejection of the company proposal and elimination of the ECAC mechanism. Commission staff witness Curtis Winterfeld outlined a number of changes which should be made to the company's proposal if the ECAC were retained. The Commission staff also repeated its position that ECAC-type mechanisms are illegal under Washington law. Commission staff witness Richard Lurito testified that tests could not be made to demonstrate the impact of the ECAC because comparable companies are difficult to find and because the risk profile of the company before and after the institution of the ECAC is different enough that the time periods cannot be compared.

The Commission staff contended the company had not complied with the Commission's directives in several ways. First, Dr. Olson's testimony did not establish the impact of the ECAC on cost of capital. Second, costs of conservation and new firm purchase contracts are not related to weather. Third, the Commission had indicated in several orders that the ECAC was not the proper forum for introduction of new purchase power contracts, in part because the parties do not have sufficient time in an ECAC proceeding to review the contracts and submit evidence about them.

3. Public Counsel

Public Counsel recommended the ECAC be terminated because the need for the ECAC has passed. Public Counsel witness Jim Lazar listed disadvantages to ratepayers of the ECAC, including confusion, lack of rate stability, loss of the chance to review new contracts before their recovery, and diminished incentives to the company for efficiency.

4. Intervenors

Intervenor FEA witness John Legler included in his cost of equity all risk factors perceived by investors and included in stock prices. He indicated it is impossible to quantify the effect of a single factor on the company's cost of equity. Intervenor FEA did not take a position regarding the ECAC on brief.

Intervenor WICFUR recommended termination of the ECAC. On brief, intervenor WICFUR argued that the company's revised ECAC moves further away from the criteria the Commission outlined in its prior orders. WICFUR contended the revised ECAC was not weather related and included the cost of the new, long-term resources, both contrary to the Commission's directives. Intervenor WICFUR also stressed that the company had failed to quantify a downward adjustment in the cost of capital to reflect the risk-reducing features of the ECAC.

Intervenor Public Power Council recommended elimination of the ECAC on the basis that the company had failed to demonstrate its proposal meets the Commission's criteria. Intervenor PPC suggested substitution of biennial general rate proceedings.

C. Commission Discussion and Decision

During the last two years, the Commission has undertaken an examination of our policies on fuel adjustment clauses for electric utilities. This policy review has focused on Puget Power's existing Energy Cost Adjustment Clause (ECAC) and on Washington Water Power's proposed Power Cost Adjustment mechanism. In our Sixth and Seventh Supplemental Orders to Cause No. U-81-41 (Puget Power), and in our First Supplemental Order to Docket No. U-88-2363-P (Water Power), the Commission enunciated three broad policies relating to power cost adjustment clauses.

The Commission used these policy goals to evaluate, and ultimately to deny, Water Power's proposed power cost adjustment clause. In its Order in that case (Docket No. U-89-2363-P), the Commission stated the three policy criteria.

> First, a power cost adjustment clause should be linked to those factors which are weather-related. This is particularly important in the Northwest because changes in hydro conditions from year to year affect the cost of operating the electric utilities regulated by the Commission.

> The Commission also noted [referring to its Cause No. U-81-41 Orders] that ratepayers can intuitively understand this link between unusual weather and cost, and that ratepayer understanding is a key attribute of any regulatory procedure such as a power cost adjustment clause.
>
> Second, the Commission determined that a power cost adjustment clause should be a <u>short-run</u> accounting procedure that reflects the <u>short-run</u> cost changes affected by unusual weather. A PCA [power cost adjustment clause] should exclude the cost of new long-term resources acquired to meet new load. The prudency of long-term resources is the proper subject for general rate cases, and should not be a part of a short-run oriented PCA.
>
> Third, the Commission ruled that ratepayers should receive the benefit of a cost-of-capital reduction if the Commission approves a PCA for a company. A PCA introduces rate instability for ratepayers and produces earnings stability for stockholders. Ratepayers should receive a benefit for this tradeoff in the form of a cost-of-capital reduction. The Commission stated that "if no such downward adjustment can be demonstrated..., then the Commission will have to seriously question a power cost adjustment clause's raison d'etre." [First Supp. Order, Docket No. U-88-2363-P, at p. 8]

As we did with Water Power's proposed PCA, the Commission used these three criteria to evaluate Puget's ECAC in this case.

The Commission finds that Puget's ECAC is not consistent with these three policy directions. Puget's proposal continues to include elements that are not weather-related. These items include the costs of new long-term contracts and conservation programs acquired to meet new loads, and cost changes related to thermal plant availability. The Commission also received testimony in this case that the ECAC's influence on Puget's cost of capital is too difficult to measure. Because of these findings, and because Puget's ECAC has become cumbersome, difficult to administer, and hard to explain to ratepayers, the Commission will require that the Energy Cost Adjustment Clause be terminated.

Puget's ECAC has evolved into a mechanism that is not simple and is not easy to adjudicate. The adjustments to the ECAC mechanism proposed by Puget in this case would not simplify the process; they would make it more complicated. As proposed, the Commission would be asked to determine the prudency of significant new resources in a one-day hearing process. These resources are frequently controversial and it is very difficult in the course of a one-day proceeding for the parties to develop a full record on which the Commission can base its findings. The Commission's desire to limit a power cost adjustment mechanism to those weather-related costs that are universally regarded as being beyond the control of management is an attempt by the Commission to separate the non-controversial cost changes from the sometimes-controversial ones.

The Commission is not opposed to power cost adjustment clauses. The Commission continues to believe that a power cost adjustment clause can be developed that is simple and fair. Such a mechanism should be virtually automatic in nature; that is, it should not involve controversial adjustments. It should include only those costs that are both weather-related and quite clearly beyond the control of management. The Commission continues to believe that ratepayers can understand this link and will support an adjustment mechanism so designed.

The Commission is also aware that a less-than-general-rate-case regulatory mechanism may be useful to support the acquisition of least cost energy resources by electric utilities. As the parties to this case are aware, the Commission has recently opened a collaborative process to address these issues. The Commission urges the parties to use this process to develop a workable set of regulatory tools for the Commission's consideration. Aside from what may come from this initiative, the Commission always stands ready to consider other specific proposals.

As mentioned, the Commission recognizes that certain supply-side resources (e.g., purchase power contracts negotiated through the competitive bidding process) and demand side resources may be most appropriately reviewed by the Commission in a modified regulatory process. Such a process would be less than an eleven-month general rate case but greater than the one-day, non-controversial power cost adjustment mechanism the Commission is seeking. Thus, if there are compelling reasons for such a modified regulatory process, the Commission is willing to modify our second policy criterion that long-term resources should only be reviewed in general rate cases. The Commission suggests that the parties can use the collaborative process to design such a mechanism for the Commission's consideration.

V. VALUATION OF BONNEVILLE EXCHANGE POWER/WNP-3

The caption set forth above is deceptively simple. This is unquestionably the most exhaustively analyzed issue in this proceeding. The development of the record spans a period of four years, beginning with Cause No. U-86-131. It is possible to go even further back in history to trace this Commission's responses to numerous resource planning decisions of Puget and the other investor-owned utilities. As previously noted, portions of the record in Cause No. U-86-131 have been incorporated into this record. Before turning to the positions of the parties, the Commission wishes to acknowledge the expense and effort reflected in the development of this record.

A. Background

The reader may wish to review the previous orders in Cause No. U-86-131 for a complete picture of the history of this filing. It is sufficient for purposes of this order to mention that Puget, together with numerous other participants, entered into a nuclear power project known as WNP-3. The project began in 1973. The site of the project is Satsop, Washington. Puget agreed to assume a 5% share of the investment and output of the project. The project was halted by the Bonneville Power Administration (BPA) and the Washington Public Power Supply System (WPPSS) in May, 1983. Puget and the other investor-owned utility participants sued WPPSS and BPA in July of 1983 based upon this construction delay. On September 15, 1985 Puget and the other complainants entered into a Settlement Agreement. This agreement provided that BPA would assume all but nominal responsibility for the WNP-3 project. The complainants would drop their suit against the BPA and in exchange, BPA would provide a specified amount of energy and capacity to the complainants on an exchange basis at a price reflecting only the assumed operating costs of a fictitious nuclear plant. These costs would be based upon a set of "surrogate" plants. Puget has been exchanging power with BPA under this agreement since January 1, 1987. Puget's books originally displayed a total WNP-3 investment of approximately $170 million (as of December 31, 1986). This amount included the actual cash expenditures as well as a carrying cost known as AFUDC (allowance for funds used during construction). The $170 million did not include funds expended and rate based as CWIP (construction work in progress) before that procedure was declared unlawful. Power v. Utilities & Transportation Commission, 101 Wn.2d 425, 679 P.2d 922 (1984).

Puget has attempted to obtain rates to recognize its non-CWIP investment in WNP-3 for several years. Puget has been sensitive to the fact that ratepayers are generally

unsympathetic to such a proposal. For this reason, Puget has proposed creative methods for ameliorating the "rate shock" which would be caused by inclusion of $170 million in rates. In Cause No. U-86-131, the company suggested that the investment and the Settlement Agreement Power (Bonneville Exchange Power or BEP) could be assigned to a subsidiary which would be in a position to refinance the debt, and sell the power to Puget at a price reflecting only debt costs rather than a return on stockholder's equity. The impact of such a proposal on the ratepayer would be felt in the Energy Cost Adjustment Clause (ECAC) rate process. This would have avoided a general rate case. In a separate proceeding instituted by the company, (Cause No. U-86-115) Puget attempted to obtain financial enhancement without a rate case by obtaining Commission approval to flow directly to stockholders ("below-the-line") accumulated investment tax credits (ITCs) which otherwise would have been flowed to ratepayers ("above-the-line") over the relevant plant life (20 to 30 years).

The Commission and interested parties were not unsympathetic to Puget's desire to avoid a general rate increase proceeding. Although the Commission was interested in the opportunity to reach an amicable resolution of the WNP-3 cost recovery issue in Cause No. U-86-131, efforts to encourage a settlement proved fruitless. The Commission was forced to conclude that a complete resolution of the WNP-3 issue would require a full blown rate case. The Commission was able to assist the company in avoiding an immediate rate case by approving (on a conditional basis) the ITC accounting requested. This order (Cause No. U-86-115) allowed the company to book as income over $30 million per year for 1987, 1988, and 1989. Any remaining amounts of ITC would be available for 1990./[1]

B. Positions of the Parties.

1. Company

Puget asserts that BEP represents the equivalent (for ratemaking purposes) of 2/3 of its 5% share of a completed WNP-3 plant. Therefore, Puget believes the BEP contract should be treated as a rate base asset and valued at original cost less any recent amortization. Puget also requests rate base recovery of a "side record" of interest costs related to the WNP-3 investment from January 1, 1987. This "side record" was

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[1] The 1990 use of remaining ITC was predicated upon a possible extension of the rate stability period. This period has now ended. The Commission expects any remaining ITC to be amortized above-the-line in the manner which was required prior to Cause No. U-86-115.

required by the Commission in its Order On Petition For Reconsideration in Cause No. U-86-131. The purpose of the "side record" was not specified. The ratemaking effect of Puget's proposal is set forth clearly at page 25 of the company's brief. A total addition to rate base of $178,692,039, is requested by the company. A footnote suggests that elimination of the "side record" from the calculation would reduce the rate increase requested by $5,530,400.

Puget argues strenuously against the "value of power" approaches suggested by the Commission (as well as Puget itself) in Cause No. U-86-131, and by the Commission staff and Public Counsel on this record. The company believes that all of its expenses which led up to the BEP contract were "prudent" and the contract is "used and useful". Therefore, the rate base of the company must, as a matter of law, include all such expenses.

2. Commission Staff

Commission staff proposes a 3-part Value of Power/Abandoned Plant approach to the WNP-3 investment. The Commission staff proposal is as follows:

a. The company should be allowed full rate base treatment based upon the value of the BEP contract. Using a 65 to 85 mills/kwh range for comparable resources in the late 1980s (75 mills per kwh was the staff witness' best estimate), the value of power is estimated to be $70,618,000.

b. Only costs incurred prior to March, 1981 would be treated as "prudently incurred". These costs, represent about 25% of the WNP-3 investment or $44,136,000. This amount would be amortized without a return on the unamortized balance over a period of ten years.

c. The balance of the WNP-3 investment would be disallowed as imprudent and unrecoverable. This figure is $61,791,000.

Commission staff compares the BEP agreement to the elephant in an old Hindu fable. Each party perceives the beast as something different. Staff argues that the BEP agreement is neither a nuclear plant nor a pure power purchase agreement. It is, rather, a hybrid, and deserves special treatment consistent with law and sound policy. The three-part approach provides a balancing of ratepayer and stockholder responsibility

in a manner which, in the opinion of the staff, is consistent with prior decisions of the Commission.

3. Public Counsel

In a variation of the "value of power" approach, Public Counsel concludes that the company has already received a more than adequate recovery of its WNP-3 investment. Public Counsel cites the $30 million in CWIP, an alleged double recovery in ECAC rates ($16.6 million), and $93 million in ITC recovery. Public Counsel also goes on to argue that much of Puget's investment was imprudently incurred and investors expect the company to receive at least a partial writeoff. Public Counsel questions the legality of providing a rate base treatment for a power contract. Finally, Public Counsel urges the Commission to consider applying a cost recovery methodology which maximizes the benefits available under the Residential and Small Farm Exchange program.

C. Commission Discussion and Decision

Rarely in the history of this Commission has there been presented a ratemaking problem as confounding as the cost recovery of WNP-3. A search of the legal literature discloses no precedent for the transactions which led Puget to ultimately trade its intangible legal rights and remedies concerning WNP-3 for a power purchase and sale agreement with BPA. (The 1913 federal case cited by Puget in its brief is of limited value due to its peculiar circumstances which will be discussed later.) The staff aptly compares the present debate to the old Hindu fable. Puget perceives the BEP agreement to be a rate base asset identical to a tangible "facility" as contemplated by the Supreme Court of this state in Power v. WUTC, supra. Puget also perceives the original cost of the asset to be the sum total of the company's expenses related to the WNP-3 project. The Commission staff accepts the possibility of according rate base treatment to the BEP agreement, but reduces its value for ratemaking purposes to the avoided costs prevailing at the time of the agreement, thereafter amortizing such unrecovered costs as the staff determined to be prudently incurred. Public Counsel provides a variation on this approach but offsets the BEP by several factors to nullify further cost-recovery.

The fact that it has taken four years to bring this issue to final decision stands as testament to the complexity of the undertaking. The Commission itself and the contesting parties have invested enormous time and expense in presenting a massive record of evidence and opinion. The Commission is grateful for this effort. It is with the deepest sense of

regret that the Commission concludes that none of the proposals is completely acceptable.

The company's proposal is appealing, yet flawed. Its appeal is that it applies what appears at first glance to be sound and traditional ratemaking theory to reward the company for successfully obtaining a resource in spite of the halt of WNP-3. If what is being considered is the prudence of WNP-3, the Commission believes that Puget has sustained its burden of proving that its expenses incurred in connection with WNP-3 were prudent. Although the staff argued that the company's planning process was imperfect, the staff failed to prove any negative consequences of the company's inadequate planning. Had the company reexamined the status of the project in 1980, as suggested by witnesses Johnson and Komanoff it would have been prudent for the company to conclude that the WNP-3 project or a plant of similar cost should still be pursued. No party has challenged the assertion that some resource was needed. Therefore, as a public utility, obligated to meet the public's continuing demand for power, Puget was required to seek resources. It follows that all reasonable expenses incurred in that pursuit must be recoverable either with or without a return thereon. As noted by the most recent Supreme Court rulings, the determining factor as to whether only the expense itself, or the expense plus a return may be provided depends upon whether the expense should be considered in valuing utility property and whether the character of the "property" meets the definition of "used and useful" under RCW 80.04.250.

Puget contends that in the Commission's acceptance of a settlement of Washington Water Power's last rate case, Cause No. U-86-99, the Commission established the precedent of treating the BEP agreement as a rate base asset. Puget then argues that since it has proved its investment to be "prudent", it follows that the entire investment must be included in rate base. This is not true. Puget is fully aware of the nonprecedential nature of the settlement process. Settlements do not provide the Commission with the record upon which to make an industry-wide policy setting decision. If the Commission were to begin utilizing settlements in such a fashion it is unlikely that another settlement would ever be presented for consideration.

In addition, it was never the intent of the Commission, in describing the BEP agreement as a "used and useful" resource to render a legal opinion as to the appropriate ratemaking treatment for such a resource. This hearing, for the first time, provides the Commission with the basis for addressing the proper treatment of Puget's WNP-3 investment and the related BEP contract.

The Commission agrees with the basic approach taken by Commission staff. The BEP contract is a unique resource. If it were to be given traditional ratemaking treatment, the contract would bear no rate of return. All costs would simply appear as an expense on the company's books. To allow such a result would require that the Commission blind itself to the realities of this unprecedented circumstance. Puget found itself with a substantial investment in a project which was indefinitely delayed. Should the project be officially terminated, Puget could expect to receive over a period of five or ten years rate recovery of its prudent investment with no return. Acting reasonably, the company pursued its legal remedies and succeeded in mitigating the loss substantially by obtaining a different resource, the BEP contract. Under such circumstances, the value of the new resource should be considered in mitigation of what otherwise would have been a loss to both the stockholders and the ratepayers.

The company argues that the original investment in WNP-3 must be tracked through dollar-for-dollar into the BEP "valuation". The company cites Bonbright v. Geary, 210 Fed. 44 (1913). In that injunction proceeding, the federal court was justifying its decision to stay the effect of an Arizona agency decision. Of relevance was an exchange between the predecessor utility and a federal agency of a hydroelectric facility. The court, in a bench ruling, expressed the opinion that having exchanged a rate base power plant to the federal government for a power contract, the utility was entitled to have the contract valued and added to its rate base. The court could not and did not express an opinion as to what that value should be. Therefore, if Bonbright stands for anything, it is the proposition that a power contract, under some circumstances may be afforded rate base treatment.

In the Commission's last order in Cause No. U-86-131, we expressed a belief that the BEP contract could be given a value. We estimated that value from a limited record to be approximately 59 mills per kwh. Based upon a much better record, the Commission is now prepared to approve the 75 mills per kwh estimate included in witness Reading's testimony. There are many criteria to be considered in placing a value on an exchange agreement such as BEP. The Commission believes that Mr. Reading's range of avoided cost rates (65 to 85 mills) represents a reasoned analysis. It is only reasonable to base this decision on the midpoint in that range. Of the 75 mills per kwh which we find to be the value of the BEP agreement, we must determine the portion which is associated with capital investment. The record in Cause No. U-86-131 provides a figure of 38 mills per kwh associated with O & M expenses. We adopt that figure and calculate the rate base asset on the remaining 37 mills per kwh. We calculate by the net present

value of the power received over the course of the contract, using the energy numbers found in the company's response to Bench Request No. 4, Exh. 834, at a discount rate of 10.22 per cent to be 2,621,134 Mwh. Multiplying that number by 37 mills/kwh provides us with a total rate base of $96,981,958.

As previously noted, the Commission agrees with the company on the issue of "prudence". While it is true that the WNP-3 project was entitled to Puget's constant vigilance, and while that responsibility is not diminished by the fact that Puget's share was 5%, it does not follow that Puget was presented with a viable alternative to its involvement prior to the halt of the project. It is conceded by all parties that Puget was prudent in entering into the project. It is not disputed that to withdraw from its responsibilities to its partners would have been difficult for Puget. More importantly, it has not been seriously argued that Puget did not need resources comparable in output to WNP-3. Therefore, it is difficult to follow the "prudence" approach of the Commission staff without finding that an alternative project existed or could have been initiated in March, 1981 at a significantly lower cost than WNP-3. Therefore, the Commission will not disallow any costs on the basis of imprudence.

This leaves the question of what to do with that portion of Puget's investment which is not represented in the value of the BEP contract. Here again, the Commission agrees with the suggestion of the Commission staff that this portion of the investment should be treated as an expense recoverable over a reasonable period of ten years without a return on the unamortized balance. This approach will be consistent with our prior decisions regarding extraordinary expenses and provides a fair sharing of responsibility between stockholders and ratepayers.

Finally, there is the company's request for inclusion of the so-called "side record" in its calculation of the investment. As previously noted, the Commission's request that such a record be maintained did not state to what purpose that record would be put. The order stated as follows:

> Should the company seek to obtain rate relief, this Commission will make every effort to expedite a review of such filing. In the meantime we direct the company to maintain a side record to its books, setting forth the interest accruals associated with WNP-3 from January 1, 1987.

--Commission Order on Petition for Reconsideration, Cause No. U-86-131, (August 10, 1987) page 3.

The company elected to not seek the expedited "rate relief" suggested by the Commission. Instead the company opted to maintain a period of "rate stability" (thereby allowing the "side record" to grow to more than $45 million). That rate "stability" was achieved in part due to the fact that the Commission provided an ECAC mechanism which included much of the company's growing power costs including the O&M costs associated with BEP. Stability was also achieved in part due to the Commission's decision to help maintain the company's financial integrity by allowing ITCs to be flowed below the line. Given the fact that accounting rules make no provision for ratemaking treatment for such a side record, and given the totality of the circumstances surrounding the accrual of this side record, the Commission must conclude that ratemaking consideration of the side record is improper.

In response to adjustments suggested by Public Counsel, the Commission can only say that they may not be accepted. Public Counsel argues that there should be a deduction for the time value to ratepayers of CWIP. However, ratepayers often make funds available "up front" for costly projects whose benefits are not achieved for several years. To accept Public Counsel's suggestion in this case would be unprecedented and dangerous. Public Counsel's ECAC concerns are not an appropriate direct offset to the WNP-3 investment, but we have taken his argument into account in our decision on the "side record". Finally, to attempt to reduce rate base or results of operations based upon ITCs as suggested by Public Counsel would run in direct contradiction of applicable Internal Revenue Service regulations. The purpose of the ITC order (Cause No. U-86-115) was to maintain the financial integrity of the company and thereby assist the company in maintaining rate stability. To draw any further inference would be improper.

Therefore, the Commission will resolve the WNP-3/BEP as follows:

1. The company's investment net of amortizations is found to be $149,024,781.

2. Of this amount, $96,981,958 will be placed in rate base as the value of BEP using a 37 mills per kwh capital cost (75 less 38 mills per kwh for O&M).

3. The balance of the investment, $52,042,823, will be amortized over ten years as set forth in Table 1.

TABLE I

Bonneville Exchange Power
for the Year Ended 9-30-88

Line No.	Description	Amount
1	Depreciation of $96,981,958 Over 27.5 years	$3,526,617
2	Amortization of $52,042,823 Over 10 years	5,204,282
3	Charged to Expense During Test Year	(5,550,336)
4	Federal Income Taxes	(2,968,506)
5	Federal Income Taxes During Test Year	1,887,114
6	Total Operating Expense	$2,099,172
7	Net Operating Income	($2,099,172)
8	Plant in Service	$96,981,958
9	Less Depreciation Reserve	1,763,308
10	Less Deferred Tax EOP	1,013,550
11	Rate Base	$94,205,100

VI. CONSERVATION

The parties have raised a variety of issues relating to the company's activities in promoting energy conservation. These are addressed in this section, although they may also be discussed elsewhere in this order.

A. Water Heater Program

The Commission staff, Public Counsel, and intervenor FEA all argued that the company should not be permitted to give rate base treatment to expenditures associated with its water heater installation program. Public Counsel presented evidence that the program does not in fact conserve electricity since gas heaters are more energy efficient, and since the

company is not installing the most cost-effective electric water heaters available.

Because the water heater program is included in a filed tariff which the Commission has approved, we feel constrained to allow all expenses associated with this program (with the exception discussed below) to be included in rate base and earn the authorized rate of return, including the legislatively authorized 2% rate of return adjustment for conservation measures. For this reason, we agree with the company's proposal to include the costs of this program in rate base.

However, we share the concerns of the parties about the cost-effectiveness of this program. The company attempted to justify the program on the grounds that it was consistent with its filed least-cost plan. Mere compliance with the filed plan is not automatic proof of prudence. The Commission noted at the hearing on the company's least-cost plan that numerous interested persons had expressed concern about the company's hot water heater program. While we did approve the company's filed tariff, we are now persuaded that there may be more cost-effective ways to provide water heating to Puget's customers. We therefore order the company to file an improved program for water heating efficiency by May 1, 1990. We encourage the company to work with the parties to develop a program which achieves the maximum amount of cost-effective water heating efficiency.

In addition to arguing that the entire cost of the program be removed from rate base, the Commission staff and Public Counsel argued that the expenses associated with advertising for the water heater program be disallowed. Expenses associated with advertising are not tariffed items, and have not been approved by the Commission for inclusion in rate base. Public Counsel introduced copies of advertisements which leave no doubt that their intent was not to increase water heating efficiency <u>per se</u> but to promote electric water heating at the expense of gas (Exh. 639). We find that these advertisements are "promotional advertising" within the meaning of WAC 480-100-043(2)(a). The Commission therefore will not permit their inclusion as adjustments to the operating expense or in rate base of the company.

B. Adjustments to Rate of Return

Public Counsel's witness Tim Stearns suggested that the company be penalized for failing to be a leader in conservation efforts by lowering the overall rate of return by .5% (Exh. T-754). In his brief, the Public Counsel did not recommend adopting Mr. Stearns's proposal, noting that the

Commission has initiated a process to review a number of methods for rewarding cost-effective conservation programs and penalizing ineffective programs. (Public Counsel brief at 55) We agree with Public Counsel that this matter is best deferred to our separate proceeding and decline to make an adjustment to rate of return.

The company requested the Commission establish administratively a continuation of the 2% addition to rate of return on rate based conservation measures currently mandated by RCW 80.28.025. (Puget Brief at 201, fn. 95) We decline to address the Company's request at this time since this issue is not ripe for review and is best left to other forums such as the legislature or the separate proceeding discussed above.

C. Major Accounts

In addition to the water heater program, the company proposed the addition of $10,043,149 for conservation program additions. The Commission staff argued that $248,110 of this, associated with the Major Accounts program, should be excluded from rate base since it is simply designed to promote good business relationships between the company and its large customers. We agree with the Commission staff that this is not a proper conservation expense, and it should therefore be removed from rate base. The company should in the future separate Major Accounts program expenses from conservation expenses. However, we believe it is a prudent expense of the company and therefore will allow the inclusion of $66,594 of these expenses associated with the test year as an adjustment to the company's operating expense.

VII. RESULTS OF OPERATIONS

A. Legal Principles

Having determined the appropriate test period for this case, the Commission must analyze the company's test year operations. The parties agree that the company's net operating income (NOI) per books is $176,942,425.

The booked results of the company's test year operations must be adjusted to remove amounts which are not representative or which are not properly included within the test period. This type of adjustment is called a "restating actual" adjustment. Additional adjustments are then made to test period results to give effect to known and measurable changes which are not offset by other factors occurring during or after the test year. These adjustments are called "pro forma" adjustments.

The parties made restating actual and pro forma adjustments based upon their respective exhibits pertaining to the financial data of the company during the test period. Table II compares the results of operations as proposed by the parties. In all of the following sections, the numbers used to identify the adjustments are those used by the Commission staff, for convenience of reference.

TABLE II

Puget Sound Power & Light Company
Comparison of Parties' Positions
Restating Actual and Pro Forma Adjustments
12 Months Ending September 30, 1988

	Line No.	Description	Company	Staff	FEA	Public
	1	NOI - Actual	$176,942,425	$176,942,425		$176,942,425
		Uncontested Adjustments				
2.01	2	General Revenues	($19,883,780)	($19,883,780)		($19,883,780)
2.02	3	Upper Baker Rewind	98,752	98,752		98,752
2.03	4	Depreciation	531,713	531,713		531,713
2.05	5	Colstrip Housing	4,478	4,478	4,478	4,478
2.09	6	Temperature Adjustment	2,224,915	2,224,915		2,224,915
2.10	7	Lease Income OBC Land	271,973	271,973	271,973	271,973
2.18	8	Interest on Customer Deposit	(325,590)	(325,590)		(325,590)
2.19	9	Bad Debts	(1,292,183)	(1,292,183)		(1,292,183)
2.20	10	Rate Case Costs	(130,495)	(130,495)		(78,619)
2.21	11	Storm Damage	636,240	636,240		636,240
2.24	12	Pebble Springs	18,112	18,112		18,112
2.25	13	Skagit/Hanford	36,732	36,732		36,732
2.26	14	Company Insurance	926,449	926,449		926,449
2.30	15	Colstrip Transfer	254,854	254,854	254,854	254,854
3.01	16	FICA Tax Increase	(248,843)	(248,843)		(248,843)
3.02	17	Wash. State Unemp. Ins.	75,456	75,456		75,456
3.03	18	Fed. Unempl. Tax Adjust.	(3,918)	(3,918)		(3,918)
3.05	19	Wash. Utility Tax Adj.	(469,576)	(469,575)		(469,575)
	20	Total Uncontested Adj.	($17,274,711)	($17,274,710)		($17,222,834)
		Contested Adjustments				
2.04	21	Property Sales	$40,140	$1,658,609	$1,658,609	$1,658,609
2.06	22	Adjust Operating Expense	419,812	736,996	754,521	754,521
2.07	23	Late Pay Charge	864,375	0	0	0
2.08	24	Field Charge	70,381	0	0	0
2.11	25	Power Costs	(33,778,557)	(26,875,683)		(30,549,903)
2.11	26	Power Cost - PC	0	0		1,822,385
2.12	27	1989 Proforma ECAC Rev.	47,015,346	0		0
2.13	28	Sales for Resale Other	1,517,564	2,144,102		2,144,102
2.15	29	Wage and Salary Increase	(2,199,867)	(586,430)		(586,430)
2.16	30	Investment Plan	(178,597)	(141,325)		(141,325)
2.17	31	Employee Insurance	(918,023)	(510,935)		(510,935)
2.22	32	Conservation Program Addit.	(6,684,481)	(6,726,264)	(5,077,567)	(6,590,944)
2.23	33	Retirement Plan	476,839	476,839	1,157,676	476,839
2.27	34	Bonneville Exchange Power	(1,067,310)	(1,062,312)	(7,667,294)	0
2.28	35	Production Adjustment	1,562,072	1,264,131		1,376,072
2.29	36	Employee Benefits	0	6,326		14,935
2.31	37	Water Heater Program	0	202,104	420,272	554,807
3.04	38	Property Taxes	(685,001)	(128,654)		887,185
3.06	39	Montana Energy Tax	(8,641)	8,918		8,918
3.07	40	Montana Corp. License Tax	259,440	259,441		259,464
3.08	41	FIT Pro Forma Tax	395,380	1,712,880		1,590,480
3.08	42	Deferred Taxes	0	2,195,867	2,195,867	2,195,867
3.09	43	Tax Benefit on Pro Forma Int.	(2,518,452)	(2,885,594)		(1,697,637)
4.01	44	Overhead	0	0	50,161	0
	45	Total Contested Adj.	$4,582,420	($28,250,984)		($26,332,990)
	46	NOI - Adjusted	$164,250,134	$131,416,731		$133,386,601

B. Uncontested Adjustments

The top portion of Table II sets forth uncontested adjustments to NOI. The determination that these adjustments are uncontested among the parties is based on the parties' briefs.

The Commission has examined these adjustments and finds them to be proper, resulting in a decrease in NOI of $17,274,710.

C. Contested Adjustments

1. 2.04 Property Sales

This is the net operating income side of an adjustment which accounts to ratepayers for the net gain on Puget's sale and transfer of properties that were previously included in the company's rate base. The adjustment is fully discussed in rate base section VIII.C.1.

The Commission has accepted the Commission staff's proposed adjustment, except for the period over which the net gain should be amortized. Using a 15-year amortization period results in an increase to NOI of $487,064.

2. 2.06 Adjust Operating Expense

This adjustment was originally composed of seven parts. Two of these items are still contested after briefs. The five items which are no longer contested include Idea$ Plu$, outside service contracts, company payments for administration of the investment plan, overhead allocation to non-regulated affiliated companies, and reclassifying gain associated with Bucklin Hill relocation. The two contested items are removal of certain advertising expenses and removal of corporate dues to two organizations.

Advertising Expenses. The company adjustment removed the "Community Involvement" and "History" advertising programs. The Commission staff adjustment removed those two programs, as well as the "Advertising Research", "Co-op Water Heater Rental" and "Water Heater Rental" programs. Intervenor FEA agreed with removal of expenses according to the Commission staff's calculation, characterizing the staff approach as more comprehensive than that of the FEA witness. Public Counsel recommended that advertising for conservation be expensed, rather than capitalized. Public Counsel also recommended disallowance of all advertising related to the water heater rental program.

In support of its adjustment, the company cited the provisions of WAC 480-100-043(3)(e) which defines categories of advertising which are not recoverable from persons other than shareholders. The definition of "promotional advertising" does not include "advertising which promotes the use of energy efficient appliances, equipment or services..." The company argued the purpose of the advertising is to encourage customers to install energy-efficient water heaters in place of existing inefficient ones. The company characterized advertising research as necessary to evaluate the effectiveness of conservation advertising.

The Commission staff classified the advertising as promotional and intended to compete with the gas industry for customers. The Commission staff contended in the alternative that if the advertisements were not removed because of their promotional characteristics, they should be removed as part of the staff's adjustment 2.31 (Water Heater Rental Program). The Commission staff also characterized advertising research as conducted for promotional purposes.

Public Counsel contended advertising costs are properly categorized as operating expenses rather than capital costs. Public Counsel urged the Commission to reject advertising connected with the water heater program on the basis the program is not a conservation program.

The Commission has reviewed the advertisements included in the record as Exhibit 653. These advertisements do not provide information about energy efficiency or conservation. The advertisements attempt to portray electricity as a better alternative than gas, for reasons varying from "no hole in the wall" to the promise of emergency repair service. Other than referring to the water heaters as "energy efficient" or "super insulated" without further explanation, there is nothing to connect these ads with conservation. These ads are promotional. Because the ads are promotional, the research regarding their effectiveness has the same characteristics. The Commission therefore accepts the Commission staff's calculation of the amount of advertising expense which should be disallowed.

Corporate Dues. The company's adjustment removed dues paid to certain organizations during the test year. The Commission staff adjustment removed dues paid to two additional organizations, the Association of Washington Business and the Washington Research Council.

The company contended the two organizations in question provide benefits to the company and its customers without lobbying or representing the company before political

bodies. Mr. Story on rebuttal adopted the testimony of Mr. Ellis in a previous case describing the purpose of participation in the Association of Washington Business as sharing information about medium and small business customers in a manner similar to chambers of commerce (T-886, pp. 13-14). In Exhibit 654, the missions of both the Association of Washington Business and the Washington Research Council are listed. The company characterized the purpose of the Washington Research Council as "information-gathering and analysis", rather than lobbying.

The Commission staff referred to the same mission statements to demonstrate they are intended as "image building and lobbying" organizations. The Commission staff argued that inclusion of dues to these organizations could cause ratepayers to support political positions contrary to their beliefs or not in their best interests. In addition to the "analysis" function listed in Exhibit 654 is the purpose "... to recommend improvements in government operations..."

The FEA adopted on brief the Commission staff adjustment, as more comprehensive than that of the FEA witness. Public Counsel on brief adopted the Commission staff's adjustment.

The Commission notes the only breakdown of the components of this adjustment lists a single figure for corporate dues. This presentation requires the Commission to either accept or reject dues to both organizations without the opportunity to separate the two.

The Commission accepts the company position on this portion of the adjustment for this case only. The company has demonstrated some benefits to ratepayers from these memberships. In the future, the company should account for the lobbying activities of the Association of Washington Business in a manner similar to that used for expenses of the Edison Electric Institute.

3. 2.07 Late Pay Charge

The company in this case proposed establishment of a one percent per month charge for late payment. The company presentation included within the pro forma results of operation an adjustment increasing net operating income by $864,375. This amount was the company's estimate of revenues which would be derived from a late pay charge. The issue in this adjustment is not whether a late pay charge should be instituted, but whether the late pay charge is a proper pro forma adjustment. (The issue of whether a late payment charge should be implemented is discussed in Section XII.C.3, below.) The company argued the revenue requirement imposed on the general body of

ratepayers would be decreased by a late pay charge, because revenues would be recovered from those customers causing the costs.

The Commission staff contended the late pay charge was not a proper pro forma adjustment. The Commission staff stressed that the company does not currently have an approved late pay charge, so such a charge is not known and measurable. The Commission staff also argued the inclusion of the late pay charge as a pro forma adjustment would understate the company's actual revenue requirement. The Commission staff treated the request for a late pay charge as a rate design issue.

Intervenor FEA opposed this pro forma adjustment for the same reasons as the Commission staff. Public Counsel also addressed the late payment charge as a rate design issue.

The Commission agrees with the Commission staff and the FEA that the proposed late payment charge is not a proper pro forma adjustment. At the time the company's case was filed, the Commission had not approved a late payment charge. With no such charge existing, the adjustment could not possibly be "known and measurable" and should not be included as a pro forma adjustment. (As we note below, however, revenues from the implementation of the charge should be recognized in setting rates. This is a rate design/rate spread function.) If a late payment charge were adopted, the result would be additional revenue for the company. This adjustment should be rejected. The company is directed in future filings not to include as pro forma adjustments revenues from programs which do not yet exist.

4. 2.08 Field Charge

The company proposed establishment of a charge for each visit to a service premises which does not result in a disconnect. In presentation of its case, the company included a pro forma adjustment which would increase NOI to reflect anticipated revenues from imposition of such a charge. As in the previous item, the issue in this adjustment is whether the company's adjustment reflects appropriate accounting treatment. The company contended collection of these revenues from customers causing the costs would result in a reduced revenue requirement for other ratepayers.

The Commission staff and FEA argued that this was not a proper pro forma adjustment because revenues from a program the Commission has not approved cannot be known and measurable. Public Counsel on brief adopted the Commission

staff position that the company had not properly accounted for the revenues in preparing its revenue requirement.

As with the late payment charge, the Commission rejects this adjustment. At the time of filing of the company's case, a field charge did not exist. Revenues from such a charge could therefore not be known and measurable. The company is directed in future filings not to include in the form of pro forma adjustments revenues from programs which do not yet exist.

5. 2.11 Power Costs

The company identified on brief three issues relating to power costs. The Commission staff, Public Counsel, and intervenor WICFUR addressed several additional issues. To ensure the issues of all parties are fully discussed, the discussion of this adjustment will adopt the form used by the Commission staff on brief.

The first major issue involved updating of the company's resources utilized in the test year for known and measurable changes expected for the rate year. In this case, contested changes involved changes in contract prices and introduction of recently-executed power purchase contracts.

The second major issue involved normalizing variable power supply expenses and secondary sales in the company's Production Costing System model. In this case, contested issues included use of the production factor, the estimated price of interchange sales and purchases, and the number of years of historical water conditions which should be included in stream-flow studies used to normalize power costs.

a. Updating of Test-Year Contract Prices

Company witness Mr. Bailey made a number of adjustments to pro form test period power supply expenses to reflect changes in the amount of power to be purchased during the rate year and in the expected prices for purchases. In connection with the existing Hanford Exchange contract, Mr. Bailey on rebuttal changed his estimate for post-June 1990 costs to 52.66 mills per kwh, based on an updated estimate provided by the Washington Public Power Supply System (WPPSS) on June 29, 1989 [TR 3465]. Mr. Bailey indicated on cross-examination that negotiations about this post-June 1990 price have now led to filing of a complaint against WPPSS. Mr. Bailey also on rebuttal testimony proposed updating estimates for power purchased through the BEP agreement. Mr. Bailey had in his original testimony used a figure of 40 mills per

kwh, which he characterized as the midpoint of BPA's range of estimates for this contract [TR 1002].

The Commission staff objected to Mr. Bailey's rebuttal updates on two bases. First, the Commission staff noted it did not have the chance to offer evidence about the two updates that were offered for the first time on rebuttal. Although the company knew of the updated Hanford Exchange estimates prior to preparation of the staff and intervenor cases, the company did not disclose the new estimate before rebuttal.

Second, the Commission staff contended the company did not disclose information calling into question the reliability of the Hanford Exchange estimates, except on cross-examination. The Commission staff characterized the estimates as unreliable and excessive. The Commission staff recommended the Commission exclude from any pro forma adjustment the estimates of future contract costs associated with the Hanford Exchange Agreement, limiting any pro forma adjustment to changes in the level of power purchased and changes in BPA's existing Priority Firm rate.

The Commission staff also requested the Commission direct the company in future cases to serve on all parties any information updating documents and workpapers, as updates become available, if the material is to be used on rebuttal.

Public Counsel on brief recommended the Hanford Exchange power be valued at the current rate of 23.5 mills per kwh, as the only known and measurable rate. In the alternative, Public Counsel indicated the Commission could accept a "market rate" of 30 mills per kwh, or, at the most, the company's original figure of 40 mills per kwh. Public Counsel objected to the company's 52.66 mills per kwh rebuttal figure, citing cross-examination of Mr. Bailey regarding Puget's position in negotiations and the lawsuit against WPPSS.

b. New Contracts

The company adjustment recognized several new contracts. Mr. Bailey's direct testimony referred to a "New Contract". On rebuttal, he revised his adjustment to reflect the terms of an agreement with Montana Power which was executed in October 1989.

The Commission staff on brief took no exception to the pro forma adjustments for new contracts presented by Mr. Bailey on rebuttal (Brief, p. 65). The Commission staff did object to the company submitting the contract for Commission approval for the first time on rebuttal, when the other parties did not have the full opportunity to explore the issues and

present witnesses. The Commission staff requested that the Commission direct the company to time its contract negotiations to provide an executed agreement to parties prior to preparation of their cases, and to develop alternative filing and hearing dates for proceedings to take into account contract negotiations.

c. Production Factor

In using its production factor to compute variable power costs in mills per kwh, the company multiplied its 1990 resources by the ratio of the company's test year loads to forecasted 1990 loads. The company contended this method was more consistent with historical test period ratemaking than the approach of the Commission staff.

The Commission staff on brief supported the use of a Production Factor mechanism, while at the same time expressing concern about consistency with "known and measurable" standards. The Commission staff recommended the company's 1990 resources should be run against its forecasted 1990 loads, rather than using the company's ratio method.

d. Thermal Interchange Prices

The company calculated the thermal interchange energy rate based on the actual price of interchange energy that will be charged by Pacific Northwest utilities from which the company will buy power. Mr. Bailey testified that the company obtained its rate estimates in telephone conversations between company personnel and unnamed sellers (Exhibit 803). When asked for information about the telephone calls, Mr. Bailey could not provide the identities of persons contacted, details of questions asked, or an explanation of the manner in which their responses were used [TR 3470-3474], and indicated no notes of the calls were kept.

The Commission staff characterized Mr. Bailey's figures as unsupported. The Commission staff noted on brief that no documentation had been provided regarding the company figures. Commission staff witness Mr. Winterfeld recommended an adjustment using the terms of the Pacific Northwest Coordination Agreement. Mr. Winterfeld estimated 1990 prices for thermal interchange by escalating published historical operating cost data for specific units at 5% per annum to 1990 cost levels.

e. Historical Streamflow Data

The company recommended Puget's normalized power supply costs be estimated on the basis of all available

historical water years, which in this case is the 50 years 1929 through 1978. The company noted other entities in the Northwest which use 50 years, including the Northwest Power Pool, the Pacific Northwest Utilities Conference Committee, and the Corps of Engineers. The company characterized its position as consistent with its own prior practice, although only 40 years' data were available prior to this case. The company warned that using a rolling average would eliminate the drier earlier years and retain wetter years, thereby understating the company's power costs.

The Commission staff supported the use of a 40-year rolling average. Mr. Winterfeld conducted studies indicating the cumulative error would be less under a rolling average method. Mr. Winterfeld noted the use of rolling averages by Pacific Power & Light Company and by The Washington Water Power Company, although those companies do not use a Production Factor.

Public Counsel recommended the use of a 40-year rolling average. Mr. Lazar noted the use of this method by other regional investor-owned utilities. Mr. Lazar also recommended the Commission not allow surcharges during dry water conditions if power costs are set in general rate proceedings on normalized conditions.

Intervenor WICFUR supported the use of a 30-year rolling average. On brief, WICFUR indicated either a 30-year or 40-year rolling average would be acceptable, although a 30-year rolling average would provide the most recent data.

f. Commission Discussion and Decision

The Commission notes that the parties have not provided a breakdown of this complicated adjustment sufficient to allow the Commission to accept different parties' positions on different individual issues.

The Hanford Exchange issue is the largest portion of this adjustment in terms of dollar impact. The Commission agrees with the Commission staff and Public Counsel that the company's rebuttal proposal is inappropriate. The update was based on figures which are the subject of litigation, and which estimates the company has characterized in that litigation as too high. The Commission accepts the alternative recommendation of Public Counsel at 40 mills per kwh.

Based on its determination regarding the Hanford Exchange issue, the Commission is compelled to accept the position of Public Counsel on the remaining portions of the adjustment. The Commission does so, with the caveat that it

does not necessarily accept the bases of the remaining portions of the adjustment.

The Commission is concerned that the company apparently did not distribute to the parties in this case updated background material and workpapers in time for the parties to present evidence on the Hanford Exchange issue. The company's tactic of presenting such a major change proposal on rebuttal is unacceptable. The company in future cases should distribute updated discovery material as soon as it is received. Information received early in the case should not be hoarded, only to reveal it for the first time at rebuttal.

6. <u>2.12 1989 Pro Forma ECAC Revenues</u>

The company proposed an adjustment to increase operating revenues by $74.598 million to reflect the average level of ECAC revenues through the end of 1989. The company indicated this was consistent with the format it used to calculate the 9.1% level of increase. The effect of this adjustment would be to delete current ECAC rates from the permanent rate increase presentation.

The Commission staff did not include the ECAC revenue within the pro forma statement. The Commission staff calculated an ECAC offset in its revenue requirement calculation. The Commission staff criticized the company's estimates as based on out-of-date figures and not properly computed.

The Commission accepts the Commission staff's adjustment of zero for "1989 pro forma ECAC revenues". Both the company and the Commission staff in the adjustment entitled "General Revenues" have removed all the ECAC revenues from the test period. The adjustment proposed by the company would have improperly adjusted test period figures to include revenues for ECAC that the company has not received and will not receive.

7. <u>2.13 Sales for Resale - Other</u>

This adjustment represents the pro forma impact of the power supply analysis on sales for resale.

Consistent with its decision on adjustment 2.11 (Power Costs) above, the Commission adopts the position of Public Counsel, which in turn adopts the Commission staff figures. The adjustment is an increase to NOI of $2,144,102.

The Commission recognizes the potential for mismatch in adopting the position of a party which did not develop its own figures independently. If the parties identify such a mismatch on this adjustment, they are invited to bring the

problem to the Commission's attention in a petition for administrative review.

8. <u>2.15 Wage and Salary Increase</u>

Contested issues in this adjustment include increases for union employees, management wage increases, and increases on bonuses.

<u>Union Employees</u>. The company's rebuttal case was based on the company's most recent contract proposal made to union employees. The company identified the latest contract offer as the "minimum exposure" the company was likely to incur. No contract had been approved as of the last days of hearing in this case. Contract proposals had twice been rejected by union employees. The company contended the effect of failing to use these figures would be to deny the company recovery of prudent expenses which it will undoubtedly incur during the rate year.

The Commission staff maintained the union increase proposed by the company would not be a proper pro forma adjustment until a contract was actually signed and the amount became known and measurable. Because the contract offer was rejected by the union as recently as October, the Commission staff contended it was unlikely a change in union wages would be approved in 1989.

On December 21, 1989, the company filed a motion to reopen this proceeding for the receipt of "judicially cognizable facts" regarding approval of a labor contract on December 20. The motion contended the facts included in an accompanying affidavit were essential for decision in this matter and were not reasonably discoverable at the time of the hearing.

<u>Management Wage Increases</u>. The company based its adjustment on actual total management salaries paid in 1988 and 1989. The company objected to the Commission staff's "average salary" calculation, stating that the "average" pay was distorted by new employees being added at less than average salary. The company asserted the Commission staff's figures would grossly understate the cost of salary increases.

The Commission staff calculated an actual increase in wages of 48.08% (Exhibit 738). Based on this study, the Commission staff attempted to measure the actual increases in wages from period to period instead of choosing a point in time. The Commission staff contended that new positions added are at or above the median, rather than at lower levels.

Increases on Bonuses. The Company did not address this issue separately on brief. The Commission staff opposed pro forma increases on bonuses, which are not based on the level of wages paid. The Commission staff therefore made pro forma increases to wages excluding bonuses.

Public Counsel on brief adopted the Commission staff's figures without separately discussing the issues.

Discussion. The Commission accepts the Commission staff's calculation of the wage and salary increase adjustment. This results in a decrease to NOI of $586,430.

The union wage increase cannot be considered a proper pro forma adjustment until a contract has been signed so that a known and measurable amount can be reflected. This result is unavoidable with the timing this case. At the close of the receipt of evidence, the contract had not been signed.

The company correctly points out that, without an adjustment, union wage expenses will remain at test year levels. Wages which the company will pay during a portion of the rate year under the new contract may be higher than test year levels. The record in this case must, however, come to a close at some reasonable point.

The Commission denies the motion filed by the company on December 21 to reopen the record. The parties have rested their cases and the briefs were submitted in early December. The statutory deadline for deciding this case is in mid-January. If the Commission reopened this case for receipt of additional information from the company (whether or not that information was available prior to December 21), opportunity would have to be given to the other parties to provide their own comments and calculations, and, perhaps, additional cross-examination would have to be scheduled. It is simply too late in the process to provide these additional steps.

After the order has been issued, the Commission will entertain a single-issue filing properly reflecting the wage increases included in the new union contract. The Commission staff should have the opportunity to investigate the filing, although the Commission intends this to be treated with alacrity. The company should provide notice of the filing to other parties in this case. Those parties may wish to provide input and their own calculations regarding the impact of the union wage contract.

The Commission has accepted as more accurate the Commission staff's calculation for management wage increases. Although the company contended the Commission staff's study

incorrectly calculated "slippage", the company did not present its own calculation. The Commission directs the company to present a study of "slippage" as a part of the management wage adjustment in its next general rate case.

9. 2.16 Investment Plan

The differences between company and Commission staff on this adjustment are due to the impact of the pro forma level of wages and salaries. Public Counsel on brief accepted the Commission staff's figures.

Consistent with its determination on adjustment 2.15 (Wage and Salary Increase), the Commission accepts the Commission staff adjustment. This results in a decrease to NOI of $141,325.

10. 2.17 Employee Insurance

The differences between company and Commission staff on this adjustment are due to the effect of the union contract. The company's adjustment was based on the most recent offer to union employees. The Commission staff opposed a pro forma adjustment based on the possible union contract. Public Counsel on brief adopted the Commission staff's figures.

Consistent with its determination on adjustment 2.15 (Wage and Salary Increase), the Commission accepts the Commission staff adjustment. This results in a decrease to NOI of $510,935.

11. 2.22-B Conservation Program Additions

This adjustment is discussed in the Rate Base section. The expense side revises the level of annual amortization of energy conservation investment to include all new conservation costs incurred up to July 31, 1989.

Consistent with its decision regarding rate base, the Commission accepts the Commission staff adjustment, reducing NOI by $6,726,264.

12. 2.23 Retirement Plan

This adjustment pro forms into test year expenses an amount for the average of the latest four years of actual contributions to the employees' pension plan. The company and the Commission staff agreed on this adjustment, basing their calculations on a four-year average. Public Counsel on brief adopted the Commission staff's figures.

Intervenor FEA opposed the company adjustment and recommended the pension expense be set at zero. FEA witness Mr. Larkin noted that the company has not made a pension fund contribution in 1988 or 1989. Because the market value of the pension assets is sufficiently high, Mr. Larkin concluded it was unlikely the company would make a contribution in 1990 or for several years thereafter.

The Commission accepts the adjustment made by the company and the Commission staff. Basing the adjustment on a four-year average of actual contributions provides stability in this expense. Basing the adjustment solely on projections of rate year contributions is less desirable.

13. 2.27 Bonneville Exchange Power

Bonneville Exchange Power has been discussed separately in Section V of this order. Consistent with its determination in that section, the Commission's adjustment will decrease NOI by $2,099,172.

14. 2.28 Production Adjustment

This adjustment reduces production-related rate base and certain production expenses by the same production factor which was used in calculating pro forma power costs. The company and the Commission staff agree on the format for calculation. The differences flow from other contested adjustments.

Given its decisions in adjustments generally relating to wages and salaries, property taxes, and Bonneville Exchange Power, the Commission accepts Public Counsel's adjustment as most consistent with these decisions. The adjustment results in an increase to NOI of $1,376,072.

15. 2.29 Employee Benefits

This adjustment is a direct result of the rate base adjustment discussed in section VIII.C.7.

Consistent with its treatment in that section, the Commission accepts the Commission staff adjustment. The adjustment results in an increase to NOI of $6,326.

16. 2.31 Water Heater Program

This adjustment is a direct result of the rate base adjustment discussed in section VIII.C.8.

Consistent with its treatment in that section, the Commission accepts the Commission staff adjustment. This adjustment will increase NOI by $202,104.

17. 3.04 Property Taxes

This adjustment has three parts. The first is an increase in Montana state property taxes. The Commission staff accepted the company's rebuttal position on this portion as a proper pro forma adjustment.

The second part of the adjustment relates to a Montana law permitting taxing districts to increase spending 35% above the state-supported level by use of local levies. The company adjustment applied the 35% rate, based on representations from Montana Power that the majority of taxing districts would apply the 35% permissive rate. The Commission staff opposed this "permissive" portion of the tax adjustment because no local jurisdiction had adopted it as of the date of hearings [TR 4200].

The third part of the adjustment is a revised pro forma adjustment to Washington property taxes. The company adjustment updated Washington assessed values to January 1, 1989, levels. The company characterized this as the latest known information on taxes. The Commission staff opposed the use of a level of investment after the test period. The Commission staff contended that level would include growth in plant to serve new customers and load, causing a mismatch of expenses and rate base.

Public Counsel adopted on brief the Commission staff's figures from Exhibit 895. The Commission staff amended its position somewhat on brief.

The Commission accepts the revised adjustment proposed by the Commission staff. The permissive portion of the Montana state tax increase is not known and measurable at this time, since the local levies have not been adopted. The Commission staff position regarding Washington property taxes reflects a proper matching of expenses and rate base, and is a proper pro forma adjustment. The Washington levy rate has not yet been determined, and therefore could not be known and measurable at January 1, 1989, assessed levels. Acceptance of this adjustment results in a decrease to NOI of $128,654.

18. 3.06 Montana Energy Tax

This adjustment pro forms the Montana Electric Energy Generating Tax to the level associated with the pro forma generation of the company-owned Montana generating facilities.

Differences between the company's rebuttal adjustment and the Commission staff's adjustment are due to the difference in power supply cost calculations in adjustments 2.11 (Power Costs) and 2.13 (Sales for Resale - Other). Public Counsel on brief adopted the Commission staff's figures.

Consistent with its decisions in adjustments 2.11 and 2.13 above, the Commission accepts the position of Public Counsel, which in turn uses the Commission staff's figures. The Commission is aware this could cause a mismatch of adjustments, since Public Counsel did not calculate his own figures. The parties are urged to bring any such mismatch to the Commission's attention in a petition for administrative review, if necessary.

19. <u>3.07 Montana Corporate License Tax</u>

This adjustment pro forms the Montana Corporate License Tax based on the pro forma level of current taxable income included in the Pro Forma FIT adjustment. The Commission staff has agreed with the company's basic calculation. The differences are due to the parties' calculations of the level of federal current taxable income. Public Counsel on brief adopted Commission staff figures from Exhibit 896. The difference in figures between company and Commission staff is only $1.00.

The Commission finds the calculations of the parties on this issue rather confusing. Because there is a difference of only $1.00 in the end result, the Commission will adopt the company's figure without endorsing one method of calculation over the other.

20. <u>3.08 FIT Pro Forma Tax</u>

This adjustment has several parts. The Commission staff on brief indicated the company and Commission staff followed the same format for calculating the pro forma level of expense for this adjustment. The Commission staff on brief also withdrew its proposal on pension costs to retirements, and agreed with the company treatment of energy conservation and pension cost. The Commission staff further noted on brief that there would be no reason to make an expense adjustment for retirement costs if the Commission accepted the proposed adjustment of intervenor FEA on retirement costs.

The remaining contested issues are vacation pay and bond redemption costs.

<u>Vacation Pay</u>. Because of a change in tax laws, the company has been required to amortize the accrual balance of

vacation pay back into taxable income over a four-year period and has treated this item on a flow-through basis. The Commission staff recommended that vacation pay accruals be treated on a normalized basis, consistent with Commission rules adopting the FCC system of accounts for telephone companies. The Commission staff adjustment would normalize this item in the test year and on a prospective basis. If test year accruals are adopted, a rate base addition must also be made.

The company characterized the Commission staff approach as confiscatory and arbitrary. The company on brief indicated that if the Commission directed the company to adopt normalization for this item, it should be done on a prospective basis only, effective at the time of the order in this case.

Bond Redemption Costs. The Commission staff proposed that the company be required to normalize certain costs associated with the retirement of various bond issues. The Commission staff challenged the company's claim that it had flowed through these tax benefits to ratepayers already, and opposed the company's modification on rebuttal of its weighted cost of debt.

The company opposed the Commission staff's treatment. The company contended it had already flowed the tax benefits through to customers during the years the redemptions occurred. The company agreed it had erred in treating the tax effect of redemption issuance costs in its calculation of pro forma interest, and corrected the error on rebuttal.

Public Counsel on brief adopted the Commission staff's figures included in Exhibit 895, which the Commission staff modified on brief.

Discussion. The Commission accepts the Commission staff's calculation of the FIT Pro Forma Tax adjustment as modified on brief. The company should normalize the effect of vacation pay accruals that are not deductible for income tax purposes both prospectively and for the test year, and the rate base should be adjusted for imputed deferred income taxes. The company should also be required to normalize the costs associated with bond redemptions.

21. 3.08-B Excess Deferred FIT

Intervenor FEA proposed this adjustment to amortize over three years certain deferred federal income taxes. FEA witness Mr. Larkin recommended excess deferred taxes, resulting from the reduction of the federal income tax rate from 46% to 34%, be flowed back to ratepayers. Mr. Larkin's proposal would apply to excess deferred taxes which are not related to

accelerated depreciation. The Internal Revenue Code restricts the flowing back of excess deferred taxes only if they relate to accelerated depreciation. Mr. Larkin based his adjustment on a sharing of benefit between ratepayers and shareholders. Intervenor FEA opposed a company proposal to increase rate base by the amount of the amortization of excess deferred income taxes in the rate year if the rest of the adjustment were accepted.

The company opposed this adjustment. The company contended the amounts in question are not actually "excess" deferred taxes, since the company has accrued insufficient deferred taxes overall in relation to the liability which will be paid in future years. The company further contended all unprotected deferred taxes, including debit balances, should be adjusted if the Commission accepts this adjustment. The company recommended an adjustment to rate base for treating these taxes as a pro forma adjustment to be flowed back more quickly, if the FEA's adjustment were accepted by the Commission.

The Commission staff supported the FEA adjustment. Public Counsel on brief adopted the Commission staff's figures.

The Commission will not make the adjustment proposed by the FEA at this time. The Commission is not convinced the adjustment as structured will appropriately and completely accomplish the goals described by the FEA. The Commission does find the question interesting and would encourage the Commission staff to look closely at this issue in a future proceeding.

22. 3.09 Tax Benefit on Pro Forma Interest

This adjustment provides the pro forma impact of interest on federal income taxes and achieves the proper allocation of interest to operations. Differences between the company and the Commission staff positions are primarily due to the parties' calculations of pro forma rate base and the weighted cost of debt. The Commission staff also objected to the revised method of calculating the weighted cost of debt which the company used on rebuttal.

Intervenor FEA on brief agreed with the Commission staff calculations. Public Counsel on brief adopted the Commission staff's adjustment.

The Commission accepts the Commission staff's position on the method which should be used to make this calculation. The adjustment must be revised somewhat to reflect the Commission's findings regarding pro forma rate base. The Commission

in Section IX.C. has accepted the Commission staff's calculation of the weighted cost of debt.

Table III below sets forth the calculation accepted by the Commission.

TABLE III

Puget Sound Power & Light Company
Calculation of Pro Forma Interest Effect on Tax

Line No.	Description	Commission
1	Rate Base	$1,846,663,716
2	CWIP	18,387,409
		$1,865,052,125
2	Weighted Cost of Debt	0.0429
3	Pro Forma Interest	$80,010,736
4	Actual Interest Expense	87,276,033
5	Adjustment to Interest Expense	($7,265,297)
6	Federal Income Tax Rate	0.34
7	Tax Effect of Adj. Interest	$2,470,201
8	Adj. to Net Operating Income	($2,470,201)

23. 4.01 Overhead

Intervenor FEA's witness Mr. Larkin proposed in his testimony an adjustment to reflect general overheads which should be allocated to non-regulated subsidiaries of the company. The adjustment would have increased NOI by $50,161.

The adjustment was not listed in the brief of intervenor FEA. The Commission will therefore assume FEA has abandoned the proposed adjustment and will not adopt it.

D. Results of Operations Summary

Based on the Commission's determination of specific matters set out above, the Commission concludes the net operat-

ing income of respondent during the test period, as adjusted, is $123,811,087.

Table IV shows the effect on respondent of adjustments to its actual income which have been found appropriate for ratemaking purposes.

TABLE IVa

Puget Sound Power & Light Company
Restating Actual and Pro Forma Adjustments
12 Months Ending September 30, 1988

	Line No.	Description	Commission
	1	NOI - Actual	$176,942,425
		Uncontested Adjustments	
2.01	2	General Revenues	($19,883,780)
2.02	3	Upper Baker Rewind	98,752
2.03	4	Depreciation	531,713
2.05	5	Colstrip Housing	4,478
2.09	6	Temperature Adjustment	2,224,915
2.10	7	Lease Income OBC Land	271,973
2.18	8	Interest on Customer Deposit	(325,590)
2.19	9	Bad Debts	(1,292,183)
2.19	10	Rate Case Costs	(130,495)
2.21	11	Storm Damage	636,240
2.24	12	Pebble Springs	18,112
2.25	13	Skagit/Hanford	36,732
2.26	14	Company Insurance	926,449
2.30	15	Colstrip Transfer	254,854
3.01	16	FICA Tax Increase	(248,843)
3.02	17	Wash. State Unemp. Ins.	75,456
3.03	18	Fed. Unempl. Tax Adjust.	(3,918)
3.05	19	Wash. Utility Tax Adj.	(469,575)
	20	Total Uncontested Adj.	($17,274,710)

TABLE IVb

Puget Sound Power & Light Company
Restating Actual and Pro Forma Adjustments
12 Months Ending September 30, 1988

	Line No.	Description	Commission
		Contested Adjustments	
2.04	21	Property Sales	$487,064
2.06	22	Adjust Operating Expense	682,565
2.07	23	Late Pay Charge	0
2.08	24	Field Charge	0
2.11	25	Power Costs	(30,549,903)
2.11	26	Power Cost - PC	0
2.12	27	1989 Pro Forma ECAC Rev.	0
2.13	28	Sales for Resale Other	2,144,102
2.15	29	Wage and Salary Increase	(586,430)
2.16	30	Investment Plan	(141,325)
2.17	31	Employee Insurance	(510,935)
2.22-B	32	Conservation Program Addit.	(6,726,264)
2.23	33	Retirement Plan	476,839
2.27	34	Bonneville Exchange Power	(2,099,172)
2.28	35	Production Adjustment	1,376,072
2.29	36	Employee Benefits	6,326
2.31	37	Water Heater Program	202,104
3.04	38	Property Taxes	(128,654)
3.06	39	Montana Energy Tax	8,918
3.07	40	Montana Corp. License Tax	259,440
3.08	41	FIT Pro Forma Tax	1,712,880
3.08	42	Deferred Taxes	0
2.09	43	Tax Benefit on Pro Forma Int.	(2,470,201)
4.01	44	Overhead	0
	45	Total Contested Adj.	($35,856,573)
	46	NOI - Adjusted	$123,811,142

VIII. RATE BASE

A. Legal Principles

As provided in RCW 80.04.250,

> The Commission shall have power upon complaint or upon its own motion to ascertain and determine the fair value for rate making purposes of the property of any public service company used and useful for service in this state. . .

The rate base shown on the books is adjusted to take into account known and measurable changes which will occur during the period rates will be in effect. Such pro forma adjustments correct what would otherwise cause a miscalculation of the value of property which is used and useful for providing service.

Table V below shows a comparison of the parties' presentations regarding rate base.

TABLE V

Puget Sound Power & Light Company
Comparison of Parties' Positions
Restating Actual and Pro Forma Adjustments
12 Months Ending September 30, 1988

	Line No.	Description	Company	Staff	FEA	Public
	1	Rate Base - Actual	$1,838,294,709	$1,838,294,709		$1,838,294,709
		Uncontested Adjustments				
2.03	2	Depreciation	$2,641,381	2,641,381		$2,641,381
2.05	3	Colstrip Housing	(189,352)	(189,352)	(189,352)	(189,352)
2.06	4	Adjust Operating Expense	(129,278)	(129,278)	(129,278)	(129,278)
2.10	5	Lease Income OBC Land	48,673	48,673	48,673	48,673
2.30	6	Colstrip Transfer	(2,239,817)	(2,239,817)	(2,239,817)	(2,239,817)
	7	Total Uncontested Adj.	$131,607	$131,607		$131,607
		Contested Adjustments				
2.04	8	Property Sales	$0	($7,907,933)	($7,907,933)	($7,907,933)
2.14	9	Working Capital	(28,527,384)	(40,842,878)		(40,842,878)
2.22-A	10	Conservation Program Amort.		(5,114,463		(5,114,463)
2.22-B	11	Conservation Program Addit.	10,043,149	9,795,039	4,433,102	9,795,039
2.27	12	Bonneville Exchange Power	178,692,039	73,069,666	2,277,000	0
2.28	13	Production Adjustment	(49,809,153)	(43,003,455)		(38,316,618)
2.29	14	Employee Benefits	0	(199,075)		(468,639)
2.31	15	Water Heater Program	0	(3,242,411)	(5,133,041)	(5,271,811)
3.08	16	FIT Pro Forma Tax	0	(2,795,000)	0	(2,795,000)
	17	Total Contested Adj.	$110,398,651	$20,240,510)		$90,922,303)
	18	Rate Base - Adjusted	$1,948,824,967	$1,818,185,806		$1,747,504,013

B. Uncontested Adjustments

The top section of Table V lists rate base adjustments which are uncontested among the parties. As in the results of operations section, the determination that the above adjustments are uncontested among the parties is based in part on the briefs of the parties.

The Commission has reviewed these adjustments and finds them to be appropriate for purposes of this order.

C. Contested Adjustments

1. 2.04 Property Sales

This adjustment accounts to ratepayers for the net gain on the company's sale and transfer of properties that were previously included in the company's rate base. Both the company and the Commission staff calculated a net gain on sales and transfers of property, then amortized the gain to operating income over five years. Differences among the parties related to identity of the properties included and whether a rate base adjustment is appropriate.

Company. The company limited its adjustment to property held prior to transfer in the account Plant Held for Future Use. The company characterized this as consistent with the FERC Uniform System of Accounts. The company proposed to amortize the gain or loss to operating income over five years if the net amount is $50,000 or higher, and to reflect the gain or loss in the current year's income if the gain or loss is less than $50,000. The company opposed any rate base treatment.

The company characterized its treatment as reflecting an amount of gain from property transfers which the company can be expected to have in a typical year. The company also criticized the proposals of other parties as failing to impute selling costs on land that has been transferred but not sold. The company criticized the failure of witnesses for the Commission staff and Public Counsel to make a distinction between depreciable and nondepreciable assets. Finally, the company claimed the treatment of other parties was confiscatory and constituted retroactive ratemaking.

Commission Staff. The Commission staff included in its adjustment all properties sold or transferred that were previously in the company's rate base. The Commission staff contended the FERC Uniform System of Accounts does not bind the Commission in its treatment for ratemaking purposes. The

Commission staff included property sold or transferred from 1974 through March 31, 1989.

The Commission staff recommended a reduction to rate base of $7,907,933, representing the unamortized balance of the gain assuming the gain is amortized over five years. The Commission staff used a five-year amortization period to allocate the gain between ratepayers and shareholders, but indicated on brief it would not oppose a fifteen-year period for amortization (Brief, page 110).

Public Counsel. Public Counsel recommended adoption of the Commission staff adjustments as more detailed that those of Public Counsel witness Mr. Dittmer. Public Counsel noted the Commission's determination in Cause No. U-85-53 that the company's treatment was unfair to ratepayers and that a staff audit should be conducted on this issue.

Public Counsel also requested on brief that specific instructions be given to the company regarding future treatment of sales and transfers of property. The requested language would require the company to report sales or transfers to the Commission prior to their closing, require Commission approval for sales at other than fair market value, and allow sales and transfers to subsidiaries or affiliates only at fair market value, documented by an independent appraisal, and approved by the Commission prior to closing.

Intervenor FEA. Intervenor FEA on brief supported the Commission staff adjustment to amortize over five years the net gain earned between 1974 and March 31, 1989. The unamortized balance should be deducted from rate base as proposed by the Commission staff.

Discussion. The Commission discussed in its order in Cause No. U-85-53 the reasons an adjustment is necessary in this situation. That discussion will not be repeated. The Commission accepts the approach proposed by the Commission staff in this adjustment, with one modification. The gain should be amortized over 15 years, rather than 5 years. This treatment will allow a return to ratepayers the gain on property, while more accurately reflecting the time over which the company realized the gains. The unamortized balance should be reflected as a rate base deduction over the same period. Recalculating the amounts to reflect the 15-year amortization period results in a deduction to rate base of $8,493,705.

The Commission agrees with Public Counsel that clear guidelines for future company transfers and sales of property will avoid the necessity of revisiting this issue. The company will be required to file with the Commission a yearly report

fully documenting sales and transfers of property, both to third parties and to affiliates. Sales and transfers of property will be reviewed in rate cases. The company will be required to establish that sales and transfers of property to affiliates were made at fair market value.

2. 2.14 Working Capital

Both the company and the Commission staff used an investor-supplied working capital approach to measure the allowance for working capital which is added to rate base. The calculations of the company and the Commission staff differed in their treatment of dividends declared and preliminary survey costs.

Dividends Declared. The company treated dividends declared as part of investor-supplied working capital. The company contended its approach was accepted by the Commission in its order in Cause No. U-85-53. The company characterized the declaration of dividends as a reallocation of retained earnings. The company argued that adoption of the Commission staff approach would improperly deny the company a return on investor-supplied working capital.

The Commission staff excluded dividends declared, contending they constitute zero-cost capital to the company, on which ratepayers should not pay a return. The Commission staff cited prior Commission orders in Cause Nos. U-81-41, U-83-54, and U-79-66. The Commission staff contested the company's claim that Cause No. U-85-53 supported the company's approach.

Public Counsel on brief adopted the Commission staff's figures.

Preliminary Surveys. The company included funds expended for preliminary surveys as a part of working capital. The company disputed as irrelevant the Commission staff position that these funds are "tied up". The company contended it would otherwise be required to expense the costs as incurred, which would be more expensive to ratepayers.

The Commission staff treated preliminary survey costs as investment and treated them in a manner similar to construction work in progress. Public Counsel on brief adopted the Commission staff figures.

Discussion. The Commission accepts the Commission staff approach on this adjustment. The Commission staff calculation is consistent with the approach used by the Commission in the past.

As the Commission indicated in its order in Cause U-79-66, dividends declared are available to the company as zero-cost capital and it is not proper that a return be allowed. Preliminary survey costs should be treated as investment. The Commission staff calculation of working capital results in a reduction to rate base of $40,842,878.

3. <u>2.22-A Conservation Program Amortization</u>

The company has historically deferred the initiation of amortization on new conservation until a rate order includes such amortization in rates. The issue in this adjustment is the proper level of amortization approved by the Commission in Cause No. U-85-53.

The company contended its adjustment correctly reflects the level of amortization approved by the Commission in Cause No. U-85-53. The company noted the Commission order in Cause No. U-85-53 does not include language directing the company to adjust its amortization levels to take attrition into account. The Commission in Cause No. U-85-53 accepted the company's method of calculating and amortizing conservation investment. The company contended the Commission staff in this case could not cite exhibits or testimony in Cause No. U-85-53 which show the Commission's calculation of the $11,409,000 negative attrition adjustment adopted by the Commission, which is different than the level recommended by staff witness Mr. Louiselle. The company opposed the Commission staff's adjustment unless a citation to the calculation could be made. The company further argued that operating expenses should also be adjusted if the level of conservation amortization is adjusted.

The Commission staff made an adjustment to restate amortization to its proper test year level, contending the company had failed to amortize the proper level of conservation since the Commission's order in Cause No. U-85-53. The Commission staff contended Mr. Louiselle in that case had used the same level of conservation amortization for each of his attrition calculations other than the alternative using company rate base, and the Commission would have had no reason to change that figure in its own attrition calculation.

Public Counsel adopted on brief the Commission staff figures.

Intervenor FEA in testimony proposed an adjustment through its witness Mr. Larkin (T-719, pp. 9-14). On brief, the FEA accepted the Commission staff's level of amortization from the attrition adjustment (Brief, pp. 14-15).

The Commission agrees with the parties that there is some ambiguity in the description of the attrition calculation from Cause No. U-85-53. It is not possible to go back at this juncture to re-create the Commission's calculation, except for the information contained in the order and in the hearing record. The Commission is satisfied that the parties to this case have made a thorough search of the record in Cause No. U-85-53 and would have cited any explanatory information which existed.

In the absence of clearer information, the Commission will accept the Commission staff's calculation as using the best figures available. Staff witness Mr. Lott used the conservation amortization amount which was used in Mr. Louiselle's attrition alternatives, assuming the Commission would not have changed that figure. The company's recommendation to adjust expenses as well is rejected. If any party has better information, it is invited to present that information in a petition for administrative review of this order.

4. <u>2.22-B Conservation Program Additions</u>

This item adjusts the per book level of amortization to the appropriate 1990 level. The primary issue remaining on brief between the company and the Commission staff is whether Major Accounts activities should be included as conservation expense. Intervenor FEA proposed an adjustment to remove the company's investment in rental water heaters and associated amortization expense which will be discussed under adjustment 2.31 (Water Heater Rental Program).

The company capitalized Major Accounts expenses as part of the company's conservation program. The company described the Major Accounts program as designed to "...improve the effectiveness of delivering services to the Company's largest commercial and industrial customers..." (T-511, p. 14), including activities which fall within the scope of Schedule 83. The company further indicated the Major Accounts program does not necessarily provide new services, but facilitates the delivery of services to the largest customers.

The Commission staff transferred $66,594, the Major Accounts expense associated with the test year to Account 908 (Customer Assistance Expenses), which is a non-conservation account and removed $248,110 from rate based conservation expenses. The Commission staff contended the company's Major Accounts program is designed to promote good business relationships with large customers and has little to do with conservation. Company witness Mr. Swofford stated on cross-examination the activities are related to customer service

[TR 3624]. The Commission staff also recommended the company be directed to separate its Major Accounts activities from its energy conservation program to avoid possible future abuse.

Intervenor FEA on brief proposed an additional adjustment to remove investment and amortization expense associated with the water heater program. That proposal will be discussed in connection with section 2.31 (Water Heater Program).

Public Counsel on brief adopted the Commission staff figures.

The Commission accepts the Commission staff adjustment on this item. The Major Accounts program is tied to customer relations rather than to conservation. Because it was not included here as an exhibit, the Commission has not seen the plan documents to which Commission staff refers at page 130 of its brief, which might explain the specific activities performed by the company under the heading of the Major Accounts program. Based on the testimony of Mr. Swofford, the Commission was not persuaded the Major Accounts expenses are related to conservation. The amounts therefore should not be capitalized. The company should not include future expenses for the Major Accounts program in conservation accounts.

5. <u>2.27 Bonneville Exchange Power</u>

Bonneville Exchange Power has been fully discussed in Section V of this order. Consistent with its determination in that section, the Commission's adjustment increases rate base by $94,205,100.

6. <u>2.28 Production Adjustment</u>

This adjustment reduces production-related rate base and certain production expenses by the same production factor used in calculating pro forma power costs. The company and Commission staff agree on brief to the company's revised method of calculation. The only differences relate to the effect of other contested adjustments on the calculation. Those contested adjustments include the following: 2.15 (Wage and Salary); 2.16 (Investment Plan); 2.17 (Employee Insurance); 2.23 (Retirement Plan); 3.01, 3.02 and 3.03 (Payroll Tax Adjustments); 3.04 (Property Taxes); and 2.27 (Bonneville Exchange Power).

Based on its decisions on these contested adjustments, the Commission accepts Public Counsel's adjustment as most consistent with these decisions. This results in a decrease to rate base of $38,316,618.

7. 2.29 Employee Benefits

The Commission staff proposed this adjustment to restate rate base to the correct level since the effective date of the final order in Cause No. U-85-53. Commission staff described the adjustment as necessary because the company has been allocating employee benefits to construction, operating and maintenance, and other accounts incorrectly on the basis of income since the effective date of the final order in Cause No. U-85-53. The Commission staff recommended use of a method used by Pacific Power & Light Company, in which the costs are recorded in a clearing account and then charged to the appropriate accounts as a loading factor applied to the labor dollars. The Commission staff denied that this adjustment is retroactive ratemaking.

The company opposed reallocation of employee benefits as proposed by the Commission staff. The company on rebuttal contended that any one of several methods of allocation could be properly used. The company characterized this adjustment as retroactive ratemaking.

Public Counsel on brief adopted figures from the Commission staff's Exhibit 895, which were revised by the Commission staff on brief.

The Commission accepts the Commission staff's adjustment, resulting in a decrease to rate base of $199,075. Allocation of employee benefits on the basis of income is not appropriate. An adjustment of this type reviewing rate base does not constitute retroactive ratemaking.

8. 2.31 Water Heater Program

Two issues were raised regarding the water heater rental program. First, the Commission staff, Public Counsel, and intervenor FEA recommended removal of expenses and rate base associated with the water heater rental program. Second, Public Counsel and intervenor FEA recommended removal from rate base of the company's investment in rental water heaters.

Commission Staff. The Commission staff removed expenses and rate base associated with the program, except for those costs it classified as conservation costs. The Commission staff argued that failure to make this adjustment would require the entire body of company ratepayers to subsidize this program. The Commission staff contended this program was designed to retain electric load, rather than provide conservation. The Commission staff questioned the company's

claim that the program rental rates will cover the costs of the program.

Public Counsel. Public Counsel recommended removal of the expenses and rate base associated with the rental program on the bases that the program is designed for marketing rather than conservation, that encouraging customers to use electric water heaters is contrary to the best interest of the customers, and that the program is not cost-effective and must be supported by all ratepayers. Public Counsel also recommended sweeping changes in the company's rental water heater program, including requiring the company to replace or apply additional insulation to water heaters which have already been installed under the program, which have an energy factor of .93 or less. Public Counsel supported disallowance of advertising expenses for the rental water heater program in this adjustment. It is not clear from Public Counsel's brief under which adjustment several of the recommendations would fall, and what the dollar impact would be for each recommendation.

Intervenor FEA. In addition to supporting the Commission staff's adjustments in this matter, FEA witness Mr. Larkin recommended an adjustment to remove from rate base the $70 per water heater investment and associated amortization expense. He calculated the impact of this to be a reduction in rate base of $1,890,630, and amortization expense of $189,063. Intervenor contended the Commission staff should have removed this investment to complete its adjustment. The amounts were removed because FEA contended the program is not related to conservation.

Discussion. The Commission will accept for purposes of this case the company's position on this adjustment, except for advertising expenses. The company noted correctly that the water heater rental program is a tariffed program which has been approved by the Commission. The Commission will not remove the $70 per water heater investment as proposed by intervenor FEA, and will allow all other expenses associated with this program to be included, except for advertising expenses. As discussed in Section VI.A, above, advertising expenses associated with this program were not related to conservation, but were promotional in nature and should be removed.

The parties to this case have raised legitimate concerns regarding the content and direction of the water heater rental program, which concerns should be specifically addressed in the company review of its water heater rental program which the Commission ordered be filed by May 1, 1990. The review is discussed above in connection with Section VI.

9. 3.08 FIT Pro Forma Tax

Calculation of this adjustment is directly related to calculation of FIT expenses. This issue is discussed in section VII.C.20. in results of operations.

Consistent with its results of operations decision, the Commission accepts the Commission staff calculation on this adjustment. This results in an increase to rate base for deferred FIT vacation pay of $988,000 and a reduction in rate base of $3,783,000 for deferred taxes on bond redemptions, for a net decrease of $2,795,000.

D. Rate Base Summary

The proper rate base for respondent for the test year as adjusted for ratemaking purposes is set forth in Table VI. Total rate base is $1,846,664,716.

TABLE VI

Puget Sound Power & Light Company
Restating Actual and Pro Forma Adjustments
12 Months Ending September 30, 1988

Line No.	Description	Commission
1	Rate Base - Actual	$1,838,294,709
	Uncontested Adjustments	
2	Depreciation	$2,641,381
3	Colstrip Housing	(189,352)
4	Adjust Operating Expense	(129,278)
5	Lease Income OBC Land	48,673
6	Colstrip Transfer	(2,239,817)
7	Total Uncontested Adjustments	$131,607
	Contested Adjustments	
8	Property Sales	($8,493,705)
9	Working Capital	(40,842,878)
10	Conservation Program Amort.	(5,114,463)
11	Conservation Program Addit.	9,795,039
12	Bonneville Exchange Power	94,205,100
13	Production Adjustment	(38,316,618)
14	Employee Benefits	(199,075)
15	Water Heater Program	0
16	FIT Pro Forma Tax	(2,795,000)
17	Total Contested Adjustments	$8,238,400
18	Rate Base - Adjusted	$1,846,664,716

IX. RATE OF RETURN

A. Legal Principles

A utility is entitled to the opportunity to earn a rate of return sufficient to maintain its financial integrity, attract capital on reasonable terms, and receive a return comparable to other enterprises of corresponding risk. Bluefield Water Works Improvement Co. v. PSC of West Virginia, 262 U.S. 679 (1923) and FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944).

Table VII below reflects the capital structures and cost rates proposed by the company, the Commission, and inter-

venor FEA. The table included in Public Counsel's brief contained arithmetic errors. Public Counsel's recommendations will therefore be discussed in the text to the extent the numbers appear in the text of Public Counsel's brief.

TABLE VII

Puget Sound Power & Light Company
Comparison of Parties' Positions
Calculation of Rate of Return

Company

Description	Ratio	Cost	Weighted Return
Debt	49.70%	8.29%	4.12%
Preferred	7.80	7.53	0.59
Common	42.50	13.75	5.84
Total	100.00%		10.55%

Staff

Description	Ratio	Cost	Weighted Return
Debt-LT	46.40%	8.43%	3.91%
Debt-ST	4.40	8.59	0.38
Preferred	7.70	7.99	0.62
Common	41.50	12.80	5.31
Total	100.00%		10.22%

FEA

Description	Ratio	Cost	Weighted Return
Debt	49.70%	8.29%	4.12%
Preferred	7.80	7.53	0.59
Common	42.50	12.20	5.19
Total	100.00%		9.90%

B. Capital Structure

To determine the overall authorized rate of return, it is first necessary to establish the appropriate capital structure for the company. This appropriate capital structure need not be the actual capital structure the company experienced during the test period.

The Commission determines the appropriate balance of debt and equity within the capital structure on the basis of economy and safety. Because the composite cost of debt is generally less than that of equity, overall capital costs can be expected to decrease as a greater portion of the capital structure is composed of debt. The economy of lower capital cost must be balanced against the safety of the capital structure.

The concept of "safety" refers to the fact that the company has no legal obligation to pay a return to the holders of common stock. In dire financial circumstances, a company can reduce or suspend the payment of dividends to the owners of common stock without the legal consequences that would flow from a failure to pay interest on a debt. In return, holders of common equity generally demand a greater return than do lenders, who have a claim on the company's earnings.

The company's actual capital structure as of September 30, 1988, was 48.5% long-term debt, 8.9% preferred stock, and 42.6% common equity. None of the parties proposed the use of this actual capital structure.

Company witness Russel Olson recommended a capital structure consisting of 49.7% debt, 7.8% preferred stock, and 42.5% common equity. Mr. Olson characterized this as the actual capital structure the company expects to experience on average over 1990. Mr. Olson estimated the company will have average short-term debt in 1990 of 2.4%, which is included in the debt component. Mr. Olson contended the equity ratio must be set sufficiently high to allow additional debt capital to be issued at any time without adversely impacting the company, whether or not the company actually intended to do such financing. Dr. Charles Olson verified the reasonableness of this capital structure with three groups of comparable companies, concluding that the "typical" A-rated electric utility has a common equity ratio of about 45%.

Commission staff witness Richard Lurito recommended a capital structure consisting of 46.4% long-term debt, 4.4% short-term debt, 7.7% preferred stock and 41.5% common equity. Dr. Lurito described this as the projected actual capital

structure for the company at year-end 1990. Dr. Lurito's proposed capital structure includes a higher level of short-term debt than that recommended by the company and a lower common equity ratio, based on Dr. Lurito's studies of the company's historical levels and financing plans.

Intervenor FEA adopted the company's capital structure recommendation as reasonable and typical of a single-A-rated utility. Intervenor FEA on brief asserted a calculation based on an average year concept was more likely to be accurate than a year-end calculation.

Public Counsel on brief recommended a capital structure including 36.5% common equity after a write-off of WNP-3. The summary table included at page 9 of Public Counsel's brief showed a recommendation of 36.5% common equity, 4.8% short-term debt, 50.4% long-term debt, and 8.3% preferred stock. Public Counsel recommended generally that the equity ratio for the company be adjusted by the level of write-off the Commission orders for WNP-3. Public Counsel contended on brief an equity ratio of 36.5% is sufficient for a healthy utility.

On rebuttal, the company opposed Dr. Lurito's use of year-end numbers for several reasons. First, year-end numbers ignore the variations that will exist during the rate year. Second, using year-end numbers causes some mismatches in financing and expenses which make Dr. Lurito's rate of return recommendations inadequate. Third, use of the year-end level of short-term debt seriously overstates the short-term debt component of the company's capital structure.

The Commission accepts the Commission staff's recommended capital structure consisting of 46.4% long-term debt, 4.4% short-term debt, 7.7% preferred stock, and 41.5% common equity. Dr. Lurito's studies of the company's historical levels of short-term debt over five years and ten years demonstrates that the company's estimate is understated. The company's own model forecasts a year-end 1990 short-term debt ratio of 4.1% [TR 4021]. A common equity ratio of 41.5% is reasonable for this utility and is not out of line with other electric utilities in the region. The capital structure proposed by the Commission staff will properly balance safety with economy.

C. <u>Cost of Debt</u>

The company on rebuttal calculated its embedded cost of debt to be 8.29%. This is a combination of the cost of long-term debt at 8.27% and short-term debt at 8.64% (Exhibit 882, p. 1). To establish rates on variable rate and future

issues, Mr. Olson used a forecast prepared by Data Resources Incorporated (DRI) of interest rates expected to be in effect during the rate year. Mr. Olson had several other criticisms of Dr. Lurito's calculations, including Dr. Lurito's use of the projected year-end 1990 capital structure. The company's position regarding the amount of short-term debt has been discussed above.

The Commission staff calculated a cost of long-term debt of 8.43% and a cost of short-term debt at 8.59%. Dr. Lurito relied on current cost rates to determine the cost of 1990 debt issue and the cost of variable-rate debt. Dr. Lurito contended forecasts such as the DRI forecasts used by Mr. Olson are too volatile to be reliable.

Intervenor FEA adopted on brief the company's cost of debt figures as revised on rebuttal. FEA's witness John Legler agreed that, if forecasts are used to estimate the cost of debt, those should be the most recent forecasts available.

Public Counsel on brief adopted the Commission staff's cost figures for the cost of debt.

The Commission above determined the proper level of short- and long-term debt to be included within the capital structure. The Commission finds the Commission staff's costs of short- and long-term debt to be most reasonable. The Commission is not persuaded by Mr. Olson's reliance on DRI forecasts which varied significantly during the course of this hearing.

D. Cost of Preferred

The company on rebuttal calculated the cost of preferred to be 7.53%. At the rebuttal session, Mr. Olson used updated DRI forecasts of the cost of various Treasury securities to compute the costs of the company's Adjustable Rate Preferred stock for 1990. Mr. Olson amortized over ten years the reacquisition loss of $9.6 million related to reacquired preferred stock, including one-tenth of the amount in his calculation. Mr. Olson used average preferred shares outstanding to adjust for sinking fund requirements as they occur during the rate year.

The Commission staff calculated the cost of preferred to be 7.99%. In calculating the cost of Adjustable Rate Preferred stock, Dr. Lurito used preferred stock yields for A-rated utilities. Dr. Lurito reduced the company's net proceeds by $9.6 million to reflect the fact that the company incurred expenses associated with the issuance of preferred

stock that has since been retired. Dr. Lurito also took into account sinking fund requirements.

Intervenor FEA on brief agreed with the company's figures for the cost of preferred. FEA stressed that the most recent available DRI forecasted rates should be used, if forecasts are used.

Public Counsel on brief accepted the Commission staff figures.

The Commission accepts the 7.99% cost of preferred as calculated by the Commission staff.

E. Cost of Common Equity

1. Company

Charles Olson recommended a range of 13.5% to 14% as the appropriate cost of equity. Dr. Olson calculated by the Discounted Cash Flow (DCF) method an investor return requirement of 12.6% to 13.1%, composed of a growth rate of 3.25% to 3.75% and a dividend yield of 9.36%. Dr. Olson then increased this investor return requirement by 8% to reflect financing costs of 4.2% and to provide an additional premium to protect against "down" markets.

Dr. Olson checked his result by three methods. First, he checked the investor return requirement by an interest premium approach. He added a bond yield of 10.1% to a risk premium of 4.75%, reaching a return requirement of approximately 15.0%. Second, he checked by a risk premium study of Moody's 24 electric companies, resulting in an investors' return requirement of 13.0% to 13.5%. Third, he checked by a DCF study of 11 electric companies, resulting in an investor return requirement of 12.2% to 12.8%.

Dr. Olson recommended the cost of equity be set at a higher level if the ECAC were eliminated. On cross-examination, he recommended an additional 30 basis points as the proper increase.

On rebuttal, Dr. Olson contended Dr. Lurito's growth rate was too low. He also contended the financing costs used by Dr. Lurito and Dr. Legler were too low.

2. Commission Staff

Dr. Lurito recommended a 12.8% return on common equity. Dr. Lurito calculated a 12.25% investors' required return on equity by the DCF method. He then adjusted the

investors' required return by 7% to account for stock flotation costs and a 3% market pressure adjustment. In his DCF method, Dr. Lurito for Puget combined a growth rate of 3% with a dividend yield of 9.16%, for a total of 12.16% bare cost of equity. For six comparable electric companies, Dr. Lurito found a growth rate of 4.25% and a dividend yield of 8.04%, for a bare cost of equity of 12.29%.

3. Public Counsel

Public Counsel on brief adjusted the recommendations of Dr. Olson, Dr. Lurito, and Dr. Legler to reach a recommended cost of equity of 11.8% to 12.25%. Public Counsel on brief argued that all of the cost of equity witnesses had overstated financing and market pressure adjustments in their calculations. Because the company's projected new equity will be done through the Dividend Reinvestment Plan, the Employee Stock Option Plan, and the employee Investment Plan, there should be no need for such adjustments. Public Counsel contended the witness' cost of equity figures without market pressure or financing adjustment were more representative and reasonable.

Public Counsel witness Tim Stearns recommended a 1/2% addition to return on equity as a conservation incentive. That issue is discussed in the section on conservation.

4. Intervenor FEA

Dr. Legler recommended a range of 11.8% to 12.5% for cost of common equity. FEA on brief adopted 12.2% as the midpoint of this range. Dr. Legler's calculation differed from the company's calculation in a growth rate of 2.5% to 3%, compared to the company's 3.25% to 3.75%, and in Dr. Legler's adjustment for market pressure and flotation. Dr. Legler indicated his figures took into account all risk factors, including the ECAC. Dr. Legler used finance theory, including CAPM, bond yield plus risk premium, and DCF methods, and a comparable earnings approach.

Dr. Legler did not recommend a market pressure adjustment and one was not included in his calculations. If the Commission used a market pressure/flotation adjustment, Dr. Legler suggested it should be 0.3% to 0.4% to the cost of equity. He testified on cross-examination that flotation costs should be applied only to retained earnings.

5. Commission Discussion and Decision

After a review of the record, the Commission has determined that the Commission staff calculation of 12.8% is the most reasonable and should be adopted. Dr. Lurito's

calculation of growth rate and dividend yield were based on historical rates for reasonably representative periods. His percentage markup for selling costs and market pressure are appropriate and also reasonable.

F. Other Economic Indicators

The parties have spent substantial effort in discussion of bond ratings and the impacts of each party's recommendations on the company's financial integrity.

The company expressed serious concern that acceptance of Dr. Lurito's recommendations would subject the company to a downgrade of the company's securities from single A to BBB level. The company noted in Russel Olson's rebuttal testimony that one brokerage firm had lowered its recommendation regarding company stock from "neutral" to "unattractive" on the basis of the Commission staff's proposal. The company further cited Puget's dependence on purchased power as a factor which could weaken the company's financial position.

The Commission staff witnesses calculated that earnings of 10.22% would result in after-tax coverage of long-term debt interest obligations of 2.61 times, and before-tax coverage of 3.15 times at a 26% effective tax rate. Dr. Lurito estimated 1990 earnings per share of $2.12 if the Commission staff's figures were accepted.

The Commission has reviewed the parties' presentations and calculations and is satisfied that the figures accepted in this order will allow the company to maintain its financial integrity. The evidence also seems to indicate that a final determination on the ECAC and WNP-3 issues will actually have a positive effect by removing the cloud of uncertainty perceived by financial analysts.

G. Rate of Return Summary

Based on the findings herein, respondent's overall authorized rate of return is 10.22%, as set out below in Table VIII.

TABLE VIII

Puget Sound Power & Light Company
Calculation of Rate of Return

Commission

Description	Ratio	Cost	Weighted Return
Debt-LT	46.40%	8.43%	3.91%
Debt-ST	4.40	8.59	0.38
Preferred	7.70	7.99	0.62
Common	41.50	12.80	5.31
Total	100.00%		10.22%

X. GROSS REVENUE DEFICIENCY

Table IX below details the calculation of the gross revenue deficiency of $104,161,623.

TABLE IX

Puget Sound Power & Light Company
Calculation of Revenue Requirement

Line No.			Commission
1	Rate Base		$1,846,664,716
2	Rate of Return		10.22%
3	Line 1 Times Line 2		$188,729,134
4	Conservation Investment	$97,365,090	
5	Return on Conservation	0.0083	808,130
6	Net Operating Income Requirement		$189,537,264
7	Net Operating Income Adjusted		123,811,142
8	Net Operating Income Deficiency		$65,726,123
9	Conversion Factor		0.6302472
10	Revenue Requirement Deficiency		$104,286,259
11	Rev. Req. Ass. to W/S Customers		124,636
12	Required Tariff Increase		$104,161,623
13	ECAC Offset		74,598,263
14	Net Rev. Req. (10 - 13)		29,687,996

XI. COST-OF-SERVICE STUDIES

A. History

Once the Commission has determined a utility's revenue requirement, this revenue requirement must be allocated among the various customer classes. The Commission is Cause No. U-78-05 directed that future rate filings be accompanied by embedded cost-of-service studies to assist in making rate design decisions consistent with the standards of the Public Utility Regulatory Policies Act of 1978 (PURPA).

The Commission has considered over the years since Cause No. U-78-05 a variety of cost-of-service studies submitted by the three investor-owned electric utilities. The Commission in Cause No. U-78-05 considered and rejected the principles of

marginal cost for use in developing rate structures. The Commission concluded in that cause that studies based on embedded costs would be most consistent with other ratemaking determinations. The Commission noted later in its Second Supplemental Order in Cause Nos. U-82-10/11 that embedded cost-of-service studies could be forward-looking by use of historical cost for functionalizing to production and other categories, followed by a classification method which would recognize the current cost relationships between baseload and peak facilities.

Embedded cost-of-service studies analyze the revenue requirements of various customer load classes on the basis of cost incurrence. After direct assignment of any costs which are directly assignable to a particular class, the remaining costs are assigned using three basic steps. First, costs are identified by function as related to production, transmission, distribution, or customer service. Second, the costs within each function are classified as related to demand, energy, or customer service. Third, costs which have been classified to the three cost components are allocated to customer classes of service.

B. Presentations of the Parties

David W. Hoff presented the company's cost-of-service study in Exhibit 530. The study showed the following current positions of the customer classes, relative to parity: residential .93; secondary general service 1.21; primary general service 1.03; high voltage .88; outdoor lighting 1.10; and firm wholesale for resale 1.01. The company did not propose spreading rates solely on cost-of-service study results.

The Commission staff did not present a cost-of-service study. Commission staff witness Bruce Folsom testified he did not take a position regarding the company's cost-of-service study [TR 2202]. The Commission staff indicated on brief it was accepting as fair the company's model results for purposes of this proceeding. Commission staff further recommended methodologies other than this be examined in future proceedings.

Public Counsel witness Jim Lazar did two cost-of-service studies. He recommended adoption of his "Public 2" study which he described as combining Commission-approved methods and allocation of costs for peaking resources based on the 200-hour point on the load duration curve. Mr. Lazar recommended rejection of the company's study because of problems with peak allocation, fuel costs, and distribution costs. The results of Mr. Lazar's preferred study showed high voltage, resale, and primary general service customer classes are underpaying, and the secondary general service, lighting, and residential customer classes are overpaying, in comparison to

their costs incurred. Public Counsel on brief requested the Commission include in its order specific directives regarding methods to be used in future cost-of-service studies.

Intervenor WICFUR presented a cost-of-service study through George Carter. Mr. Carter made several revisions to the company's study, particularly regarding the classification of non-generation-related transmission and the company's peak credit classifier. Mr. Carter's study found that high-voltage customers are contributing a rate of return approximately equal to the average system rate of return.

C. Commission Analysis of Cost-of-Service Studies

As discussed by the Commission in the past, there are many valid methodologies for performing cost-of-service studies. Each methodology has strengths and weaknesses. The Commission in the years since Cause No. U-78-05 has been presented with a variety of cost-of-service variations. Often the Commission has instructed companies to present studies which contain alternative methodologies for the Commission's evaluation and comparison.

Inherent in this approach has been the philosophy that a variety of methodologies may be appropriate, depending on the circumstances of a company and its ratepayers. It is conceivable that different parties might employ equally valid methodologies which would bring about different results.

The Commission in making its rate spread decisions has considered each party's cost-of-service study. The Commission will continue to maintain the view that less emphasis should be placed on arguments regarding the elements of each cost-of-service study and more emphasis placed on the application of the study results.

In this case, the only directive the Commission will give regarding future cost-of-service studies is to repeat its rejection of the inclusion of the costs of a minimum-sized distribution system among customer-related costs. As the Commission stated in previous orders, the minimum system method is likely to lead to the double allocation of costs to residential customers and over-allocation of costs to low-use customers. Costs such as meter reading, billing, the cost of meters and service drops, are properly attributable to the marginal cost of serving a single customer. The cost of a minimum-sized system is not. The parties should not use the minimum system approach in future studies.

XII. RATE SPREAD AND RATE DESIGN ISSUES

Having discussed the various cost-of-service studies offered in this case, the Commission will next use these studies in making rate spread and rate design decisions. "Rate spread" refers to the manner in which any rate increases are allocated among various customer classes. "Rate design" refers to the manner in which rates are structured within any particular tariff schedule.

The following sections will discuss factors which the Commission will consider in addition to the bare cost-of-service study results, as well as the positions of the parties and the Commission's conclusions regarding rate spread and rate design issues.

A. Factors for Consideration in Addition to Cost-of-Service Study Results

In directing the filing of cost-of-service studies with rate filings, the Commission did not manifest an intent to make rate design and rate spread decisions based solely on the mechanical application of cost-of-service study results. Instead, the Commission indicated it would analyze the cost studies presented, as well as other relevant evidence. The Commission stated the following:

> We shall continue to design rates in a considered manner; we shall continue to exercise our own judgment, based upon evidence and arguments in a particular cause, as to an appropriate rate spread, according to conditions present in the prudent management of each of the three regulated electric utilities. There may be times when implementation of designs strictly based upon a given embedded cost study may not, in our judgment, be in the ultimate best interests of the utility, its customers or the public of the state. We shall avoid the mechanical applications of results of a given study and instead, as required by law, exercise our own considered judgment based upon the evidence in each proceeding to establish just and reasonable rates. (Cause No. U-78-05, Commission Decision and Order, Page 6)

When utilized in this manner, a cost-of-service study can be a useful tool in the ratemaking process.

In orders subsequent to Cause No. U-78-05, the Commission discussed a range of factors which would be important in the design and spread of rates, in addition to bare cost-of-service study results. The Commission in Cause No. U-81-41 (Puget) listed factors including acceptability of rate design to customers, elasticity of demand, perceptions of equity and fairness, and rate stability over time, as well as overall economic circumstances within the region. Considering cost-of-service results as well as these factors, the Commission in Cause No. U-81-41 adopted a rate design for Puget which involved a one-third movement toward the relationships demonstrated by the company's cost-of-service study.

In this case, witnesses for the parties and witnesses from the public have raised many of these issues for the Commission's consideration. Customer impact was cited as an important consideration in the company's proposals and in the proposals of the other parties.

B. Rate Spread

Rate spread in this case includes the additional aspect of the transfer of ECAC costs into general rates. ECAC charges in each ECAC proceeding have been spread on an equal cents per kwh basis. The parties also disagree regarding the amount of ECAC-related costs which are to be rolled into general rates. The parties' positions regarding rate spread are set out below.

1. Company

The company calculated $74,598,263 as the amount of ECAC-related costs to be rolled into general rates (Ex. 529). The company proposed to spread this over general rates by an increase of 0.4622 cents per kwh to each kwh in each class. This equal-cents-per-kwh spread was intended to reflect historical ECAC rate impacts on each class.

The company then proposed to spread the increases in general rates on an equal percentage increase of 9.1% to all customer classes except outdoor lighting. No general increase was proposed to the outdoor lighting class because all the cost-of-service studies show this class is paying more than its cost of service. The company noted on brief this spread proposal took into account factors of customer acceptance, continuity, and the recognition of a band of reasonableness around parity, in addition to cost-of-service results.

The company opposed WICFUR's proposal to spread the ECAC-related costs on an equal percentage basis. The company noted this proposal would shift substantial costs from

industrial customers to a smaller base of residential and small commercial/industrial customers.

2. Commission Staff

The Commission staff supported both aspects of the company's rate spread proposal, except for the calculation of ECAC costs to be rolled into general rates. The Commission staff calculated these costs to be $78,565,504, as revised. The calculation was based on 1990 normalized allowable energy costs, which the Commission staff characterized as the level of revenue which would be paid if this case had not been filed.

The Commission staff opposed on brief the intervenor WICFUR proposal to separate the ECAC costs into demand and energy components spread on a cost-of-service basis. Commission staff indicated a different rate spread for general rates would also be required, if the WICFUR proposal were accepted.

3. Public Counsel

Public Counsel opposed on brief the company's two-step rate spread proposal, for two reasons. First, the proposal does not move toward cost-of-service goals. Second, the increase for high-voltage customers would not cover the bare cost of power, which Mr. Lazar calculated to be 3.2 cents per kwh.

Public Counsel recommended rejection of the company's proposal to make the average ECAC surcharge imposed in 1989 permanent. He recommended using the rates from Cause No. U-85-53 as the base, and applying any rate increase approved by the Commission in this case in three steps. First, increase the high-voltage industrial rate to 3.2 cents per kwh, to cover the bare cost of power. Second, apply no increase to the lighting class, which is currently providing more than its actual cost of service. Third, increase rates for all other classes above No. U-85-53 rates on a uniform-cents-per-kwh basis.

4. Intervenors

WICFUR was the only intervenor to take a position on rate spread. WICFUR witness George Carter recommended high-voltage customers receive an increase no greater than the system average percentage rate increase. WICFUR witness Dennis Peseau supported an equal percentage spread of rates, both for the general rate increase and for the transfer of ECAC costs to base rates. In the alternative, if the Commission chose to move toward cost of service, Mr. Peseau recommended correction of the company's cost-of-service study as performed by Mr. Carter. Mr. Peseau calculated the spread of rates on

a uniform percentage basis would result in a 20.7% increase for all classes, if the company's entire requested amount were granted.

5. Commission Discussion and Decision

The Commission accepts the company proposal on rate spread. Increased revenues from transfer of the BUCE from the ECAC to general rates should be spread on an equal-cents-per-kwh basis. The general rate increase should be spread on an equal percentage basis among the classes. This proposal most fairly allocates these increases and is not inconsistent with cost-of-service results. The amount of ECAC costs to be transferred to general rates is the company-calculated figure of $74,598,263.

The ECAC costs have historically been spread on the basis of equal cents per kwh and the Commission continues to feel this method is appropriate for these costs.

The company calculation of ECAC costs is accepted because it was more fully explained in the record and was more easily understandable.

C. Rate Design

The primary rate design issues involved residential rate design. In the following section, residential rate design will be discussed separately. Establishment of a late payment fee and a fee for field service collection calls and changes in the line extension policy were also issues contested among the parties.

1. Residential Rate Design

The company made two rate design proposals, which will be referred to as the "original" proposal and the "alternative" proposal. Both proposals have a basic charge of $6.50 for single-phase customers and $19.00 for three-phase customers. Neither proposal involves a seasonal differential. The company's original proposal had a three-block structure. The first block was 0 to 600 kwh, the second block was 601 to 1,000 kwh, and the third block was over 1,000 kwh. This block structure was called a "J-rate" or "drop-out" block, because the second block was priced lower than the first block.

The company's alternative proposal was offered on rebuttal. The alternative proposal consists of two blocks, the first 0 to 1,000 kwh, and the second over 1,000 kwh. The first block is determined by increasing prices at the average

rate increase, with the remaining increase spread over the second block.

The Commission staff proposal included a basic charge of $3.65 to $4.64 for single-phase customers, with $4.55 as the maximum preferred level in that range. For three-phase customers the basic charge would increase to $19.00. The Commission staff supported a three-block structure with a smaller second block than that currently existing. The Commission staff then increased the existing rates by a uniform percentage. The Commission staff recommended retaining a seasonal differential, with 5% if the ECAC process were retained, and 10% if the ECAC were eliminated.

Public Counsel recommended the basic charge be increased by no more than the class average rate increase, and in no case to more than $4.00 per month. Public Counsel's witness Jim Lazar recommended the initial baseline block not be increased, or, if an increase is necessary, be increased by less than the class average. Mr. Lazar further recommended the company's proposed drop-out block be rejected and the middle block be increased by the average level of increase. The residual amount should then be recovered from the third block. Mr. Lazar also indicated that, if the Commission rejected his proposal, all rate elements should be increased by a uniform percentage.

Public Counsel further recommended either a minimum bill or disappearing minimum bill be adopted if the basic charge were increased above the $4.00 level. Either of these forms includes some electricity in the charge.

The arguments of the parties on issues of basic charge, block structure and seasonal differential are discussed briefly below.

a. <u>Basic Charge</u>

The company contended its $6.50 basic charge was appropriate for several reasons. First, the basic charge has been increased only 20 cents since 1977. Second, a minimum system analysis indicates that a $15.00 basic charge would be justified. Third, the company fears that customer costs will not be recovered if customer costs are allocated to per-kilowatt-hour charges rather than to a basic charge, because of declining usage per customer. Fourth, changes in power cost characteristics require a different rate design because short-term power costs are below residential rates. Fifth, the company proposal is similar to basic charges of other utilities around the country and the region.

Commission staff urged rejection of the minimum system approach as the basis for calculating customer cost. If only appropriate costs are used, such as costs of meter reading and billing, the basic charge range could be $3.65 to $4.64 per month. Adopting the Commission's guideline from Cause No. U-85-53 that any increase in customer charge over 25% could constitute rate shock, the Commission staff recommended $4.55 per month. Commission staff argues the company should not use the results of successful conservation programs as an excuse to raise the basic charge.

Public Counsel witness Mr. Lazar calculated a cost to serve of $3.91 per customer. Public Counsel contended the appropriate costs to include are cost of metering, meter reading, and billing. Public Counsel noted the company's request would result in the highest basic charge for any Pacific Northwest investor-owned utility.

b. Blocks

The company's original rate design proposal modified the existing block structure by changing the second block to include fewer kwh. The current second block includes 601 to 1,500 kwh of usage. The proposed second block would be reduced to include only 601 to 1,000 kwh. The company described its original proposal as attempting to correspond to the three general types of end uses of customers, including lights and appliances only, adding water heating, and, finally, including electric space heating. The company further indicated it had designed the second and third blocks to reflect the marginal costs of a water heater, as contrasted to the marginal cost over the longer period associated with space heating equipment.

The company outlined its alternative proposal on rebuttal. Mr. Hoff characterized the alternative proposal as responsive to the comments received from the company's Consumer Panels. The alternative proposal would eliminate one of the two blocks, to produce a two-block structure. The first block included the first 1,000 kwh, and the second block included 1,001 and over. According the Mr. Hoff, the Consumer Panels had supported a more direct relationship between blocks and end use.

The Commission staff supported the company's original proposal to shrink the second block as correctly based on consumption. The Commission staff brief cited the company's data showing the average lights and appliances customer using 630 kwh, and the average water heat customer using 1,022 kwh. The Commission staff opposed the lower second block "J" rate as not fair, just and reasonable.

The Commission staff opposed the company's second proposal for several reasons. First, although the company characterized the proposal as responsive to Consumer Panel comments, the record does not show that Consumer Panels ever had the chance to comment on the proposal. Second, the alternative proposal abandoned the concept of baseline rates. Third, the alternative proposal was not provided until the rebuttal phase of the proceeding, thereby limiting the amount of discovery, cross-examination, and response available to the other parties. Fourth, the alternative proposal was not cost-based.

Public Counsel supported a three-block rate design with the first block designed according to the principle of baseline rates. Public Counsel supported reducing the size of the second block for new residential customers, although Mr. Lazar suggested for a transitional period existing electric space heat customers should be allowed to continue receiving a larger allocation of power at the second-block rate. Public Counsel opposed the "J" block pricing included in the company's proposal because it would improperly discourage conservation and cost-effective alternatives to electric water heat.

c. Seasonal Differential

Both of the company's proposals eliminated the current 5% seasonal differential. The company characterized it as duplicative, complicated, and not based on costs. Mr. Hoff testified that some reflection of seasonality would be required if the Commission phased out the ECAC procedure. Mr. Hoff had not studied the issue and had no recommendations regarding what form that would take.

The Commission staff on brief proposed a seasonal differential of 5% if the Commission retained the ECAC, and 10% if the Commission eliminated the ECAC. Commission staff contended a seasonal differential correctly reflects that the company's costs of power change by time of year. The Commission staff noted a seasonal differential would be particularly important if the Commission eliminated the ECAC mechanism.

Public Counsel recommended continuing the existing seasonal differential to reflect that winter power costs are nearly twice as high as summer costs. Mr. Lazar recommended that if the seasonal differential were eliminated, a more steeply inverted block structure would be appropriate. Mr. Lazar suggested a seasonal differential of 10% to 25%.

d. Commission Discussion and Decision

The Commission accepts the Commission staff recommendations regarding residential rate design. A three-block structure is appropriate, with a first block of up to 600 kwh, a second block of 601 to 1,000 kwh, and a third block of over 1,000 kwh. The company's "J" rate proposal is specifically rejected. It is not cost-based and would send incorrect price signals to consumers. A three-block inverted rate structure appropriately reflects the average usage of lights and appliance, water heat, and space heat customers. The 5% seasonal differential should be retained. Although the Commission in this order has eliminated the ECAC mechanism, a higher seasonal differential is not appropriate at this time.

The basic charge as recommended by the Commission staff is also accepted. A single-phase basic charge of $4.55 is cost-based when only the appropriate costs are allocated to customers. The company's minimum system method has specifically been rejected elsewhere in this order. Because this basic charge is priced so close to cost, no amount of electricity should be included.

That portion of the revenue requirement spread to the residential class should be apportioned among the three blocks on the basis recommended by the Commission staff. The first, second, and third blocks should receive a uniform percentage increase to the existing rates.

The Commission is concerned that the company waited to present its alternative rate design proposal until rebuttal. This tactic is unacceptable, since it severely limits the opportunity for other parties to examine the proposal. In future cases, the company will be expected to present its proposals in its direct case.

2. Non-residential Rate Design

The company proposed to increase the basic charge for secondary general service class to $9.00 for single-phase service and $21.50 for three-phase service. The company also proposed to increase the basic charge for primary general service customers to $99.00.

The Commission staff proposed increasing the basic charge for non-residential single-phase customers to $63.50, and for three-phase customers to $19.00.

The Commission also accepts the Commission staff recommendations regarding non-residential rate design.

3. Late Payment Fee

The company recommended establishment of a 1% per month fee on delinquent bills. The company listed the reasons for the charge as cost recovery, incentive to customers to pay bills on time, and prevention of a penalty to customers who do pay their bills on time. The company contended existing disconnection rules did not provide the same type of incentive.

The Commission staff opposed the late payment charge as unnecessary. Mr. Folsom recommended the company make better use of existing rules allowing disconnection of delinquent accounts. The Commission staff on brief contended the company had not demonstrated the severity of the problem, that this fee would solve the problem, or that such a fee is the best solution to the problem of delinquent accounts.

Public Counsel recommended a modified late payment fee be adopted. Mr. Lazar suggested the fee not accrue until thirty days after the bill had been mailed, and that imposition of the fee be delayed for 30 days if a customer has made application for aid from a service organization. Mr. Lazar further recommended the proposal be modified to set the interest rate at the same rate the company pays on customer deposits. Mr. Lazar also recommended the late payment fee for large commercial and industrial customers be tied to the prime rate, and set at 2% over the prime rate to make this source of short-term financing less attractive.

The Commission adopts a late payment fee of 1% per month. The late payment fee should not begin to accrue until 30 days after the bill has been mailed. Notice of the late payment fee amount and terms should be printed on customer bills. The Commission will adopt Public Counsel's recommendation that the late payment fee be delayed for 30 days if the customer demonstrates he/she has made application to an organization for financial aid to pay this bill. The company's budget payment plan currently contains procedures which address the effect of a customer on the plan failing to pay a bill in a timely manner, and no separate provisions are necessary here.

The Commission finds the company has demonstrated the need for a late payment fee. The 1% monthly amount is adopted for all customer classes, in part because varying rates for commercial and industrial customers would be administratively cumbersome and potentially confusing to customers. In order to allow the Commission to monitor the effect of this new fee, the company is directed to report in the next rate case about the effects of this fee on working capital. The Commission accepts the company's estimate of revenue associated

with this fee in determining how to allocate revenue requirements among other classes of customers.

4. Field Service Collection Charge

The company proposed it be allowed to impose a $9.00 charge for each visit to a service premises which does not result in a service disconnection. The company calculated the cost at $9.00 of sending a collector to a service address. The company contended this charge would put the burden on cost causers, rather than on the general body of ratepayers.

The Commission staff supported a charge for a visit by a company employee who is sent to disconnect service for customers in arrears. The Commission staff suggested calling the charge a "disconnection visit charge" to increase customer and employee understanding.

Public Counsel opposed the fee for two reasons. First, the company did not properly account for the revenues when filing this case. Second, the burden of this charge will fall on low-income households. Public Counsel also noted the company has proposed no mechanism to credit back an incorrect charge.

The Commission accepts the $9.00 charge, but agrees with the Commission staff that the descriptive title "disconnection visit charge" may avoid misunderstanding and confusion. The cost of an employee visit to a service premises should be borne by the customer when that customer has made the visit necessary. The Commission accepts the company's estimate of revenue associated with this fee in determining how to allocate revenue requirements among other classes of customers.

5. Line Extension Policy

The company proposed revision of the line extension tariffs to provide dollar allowances rather than footage allowances, and to vary the allowances according to end use. The current tariff gives a footage allowance equivalent to two times annual revenues. The company proposal would eliminate the footage allowance and set a dollar allowance of $984 to lights and appliances customers, $1,363 to water heat customers, and $2,089 to space and water heating customers. The company contended this was designed to recover the customer's contribution, and was consistent with the "two times revenue" principle. The company also proposed to delete the non-primary single-family summer home as a category in the tariff.

The company originally proposed changes in its tariff regarding trenching. After comment from the public and other

parties, the company on rebuttal revised its proposal to change tariff language in Schedule 85 to indicate the company would perform trenching on customer request at the company's cost, including a profit margin.

The Commission staff recommended a single allowance for all year-round single-phase residential customers, at a level reflecting two times the average annual revenue. The Commission staff further recommended a simplification of customer classes, to include only residential, commercial and industrial, with only subclasses for residential of single-phase, non-primary single-phase, and three phase. The Commission staff also made recommendations regarding refund of allowances paid in advance, limiting the allowance refund for each lot to the average cost of each lot rather than the stated maximum allowance for each lot.

The Commission staff supported the company's original proposal that all developers be required to pay in advance of construction for electric distribution facilities in new platted single-family developments. The company proposal eliminated the distinction between "developers" and "speculative developers". The Commission staff agreed that trenching should be detariffed, as the company originally proposed. The Commission staff also supported the extension to five years of the payback period for refunds.

Public Counsel opposed the company's differential hook-up allowance according to the type of water heat and space heat. Mr. Lazar recommended a free line extension of $1,000 for any new residential structure using a non-electric heat source or meeting Model Conservation Standards efficiency requirements. Public Counsel supported the Commission staff position if the Commission rejected Public Counsel's recommendations.

The Commission adopts the Commission staff recommendations regarding line extension policy, except on the trenching issue. The Commission will accept the company's rebuttal revision to Schedule 85 to provide that the company will perform trenching at customer request, at the company's estimated cost for the particular job.

The Commission concludes that developers should be required to pay up front for electric facility installations in new single-family platted developments and receive an allowance refund after the line has been energized on a lot-by-lot basis, at the actual average cost of each lot. No real distinction exists between "developers" and "speculative developers" for purposes of this tariff, and all should be required to pay in this manner.

The Commission also concludes a five-year payback period is more reasonable than a three-year period. Any additional bookkeeping requirements for the company should be more than balanced by fairness to customers who may have initially paid substantial sums.

XIII. PUBLIC PARTICIPATION

The Commission was particularly impressed by the level of participation by customers in this proceeding. Ninety-three witnesses testified at the three public hearings in Bremerton, Bellevue, and Bellingham.

Several witnesses expressed confusion after trying to estimate the levels of increase they would receive under the company proposal. Part of the confusion was tied to the mechanics of rolling ECAC costs into general rates.

A majority of the witnesses clearly identified concern with the level of the proposed rate increase. A number also opposed the number of increases involved when the ECAC mechanism is in place, adding to customer confusion. Several witnesses recommended elimination of the ECAC mechanism, although there was some support for a weather-only adjustment mechanism.

Several witnesses described conservation measures undertaken. Many of these also expressed frustration that their cost of electricity was rising in spite of their conservation measures. Some witnesses commented that the company's proposed rate design did not do enough to encourage conservation.

Customers who had participated on consumer panels testified in all three locations. They testified regarding several issues and recommendations, although it was unclear whether the panels had reviewed the company's actual proposals in this case. One representative in Bremerton testified that current rate design is not responsive to the current competitive situation of the company, and recommended changes to rate design including a $5 basic charge. A witness in Bellingham encouraged movement toward cost-of-service rate design to prevent subsidizing other types of customers.

Representatives of organizations working with low-income and elderly segments of the customer population described the hardship that additional rate increases would cause to their clients. These representatives opposed a late payment fee for low-income and senior citizens, explaining that these customers may have late payments because they cannot afford to pay, and that a late payment fee only "adds insult to injury" without solving the late payment problem. Witnesses also opposed a

large percentage increase in the basic charge because of the impact on low-income households. Witnesses urged the Commission not to abandon the concept of baseline rate.

Several witnesses urged the company to increase efficiency rather than requesting higher rates. A number of witnesses contended the company should carry the burden of cost increases caused by poor management decisions, rather than recovering these costs in rates. The majority addressing the issue opposed recovery of costs related to WNP-3.

Not unexpectedly, residential customers testified that business and industrial customers were not paying a fair share, while business customers characterized their rates as already too high.

Many witnesses urged the Commission to look closely at issues which are contested issues in this case. These issues included advertising costs, the water heater rental program, recovery of WNP-3, company efficiency, separation of utility functions from land development or other activities of subsidiaries, property transfers, and rate spread.

The Commission appreciates the level of customer involvement and has taken into account the customer comments in making its decisions on individual issues in this case.

FINDINGS OF FACT

Having discussed above in detail both the oral and documentary testimony concerning all material matters inquired into, and having stated findings and conclusions, the Commission now makes the following summary of those facts. Those portions of the preceding detailed findings pertaining to the ultimate findings are incorporated herein by this reference.

1. The Washington Utilities and Transportation Commission is an agency of the state of Washington vested by statute with authority to regulate rates, rules, regulations, practices, accounts, securities, and transfers of public service companies, including electric companies.

2. Puget Sound Power & Light Company, respondent herein, is engaged in the business of furnishing electric service within the state of Washington as a public service company.

3. On February 17, 1989, respondent filed revisions to the rules, rates and charges named in various schedules of its tariff. Subsequently, the Commission entered an order suspending the tariff revisions and ordered public hearings

held on the reasonableness of the revisions. The filing was given Docket No. U-89-2688-T. The filing would have produced an increase in annual gross revenues of approximately $70,476,506. The company calculated this number by adding average 1989 ECAC revenues to the level of rates approved in the last general rate case, and calling the result "present rates".

4. On May 26, 1989, respondent filed a revision to its Tariff WN U-60. The tariff revisions would move into general rates approximately $75 million in rates which had been included in the company's ECAC proceedings. This treatment was described in Docket No. U-89-2688-T, but not included in the tariff sheet revisions filed with that case. The May 26, 1989, filings were suspended under Docket No. U-89-2955-T.

5. By order dated September 8, 1989, the Commission consolidated the two dockets for hearing and decision.

6. The 12-month period ending September 30, 1988, is the appropriate test year to examine for ratemaking purposes in this cause.

7. Respondent's rate base adjusted for its Washington electric operations is $1,846,664,716.

8. The appropriate capital structure for ratemaking purposes herein is 46.40% long-term debt, 4.40% short-term debt, 7.70% preferred stock, and 41.50% common equity.

9. A rate of return of 10.22% on respondent's rate base will maintain its credit and financial integrity and will enable it to acquire sufficient new capital at reasonable terms to meet its service requirements.

10. Respondent's test year operating net income after all adjustments is $123,811,142 under the rates approved by the order in Cause No. U-85-53.

11. A deficiency exists in adjusted test period gross annual revenues in the amount of $104,161,623 above the rates approved by the order in Cause No. U-85-53, calculated on the rate of return herein found appropriate.

12. The company failed to comply with the Commission's directives in its Sixth and Seventh Supplemental Orders in Cause No. U-81-41 (Reopened), regarding modification of the ECAC procedure. The ECAC procedure should be eliminated.

13. Each of the cost-of-service studies and suggested modifications presented by the parties represents an acceptable

cost study for regulatory purposes. The differences among the proposed cost studies are sufficiently slight and the uncertainties in the judgment calls of each of the discretionary elements of the cost studies sufficiently great that it is not possible to determine that one of the proposed cost-of-service studies is the only such study appropriate to consider as the single standard in the setting of rates. The Commission specifically rejects the minimum system approach as the basis for calculating customer cost. Parties in future cases should not use the minimum system approach in performing their studies.

14. Rate design and rate spread proposals accepted in Section XII of this order will fairly apportion the burden of the additional rates among the customers of the company and will result in rates that are fair, just and reasonable.

15. The tariff revisions filed by respondent on February 17, 1989, and on May 26, 1989, should be rejected in their entirety. Respondent should be authorized to file revisions which will not exceed $104,161,623, as determined in the body of this order. The design of the tariff revisions shall conform with the directions and findings set out in this order. The tariff revisions herein authorized will result in rates and charges that are fair, just, reasonable and sufficient.

16. The exceptional treatment accorded ITC for three years by the Commission in Cause No. U-86-115 has expired. The Commission will not extend the exceptional treatment beyond 1989.

17. It is not proper to treat as a pro forma adjustment to results of operations revenues which the company anticipates will be received from sources such as the late payment fee or disconnection visit charge in this case. These programs had not been approved by the Commission at the time the case was filed. The company should not in future cases include anticipated revenues from new proposed programs as pro forma adjustments to results of operations.

18. Some portion of the activities of the Association of Washington Business is properly characterized as lobbying. The company should account for lobbying expenses incurred by the AWB in a manner similar to that used for the Edison Electric Institute.

19. Sales and transfers of property to affiliates offer the potential for abuse. To allow the Commission to fully monitor sales and transfers of property, the company will be required to file with the Commission a yearly report documenting sales and transfers of property, both to third parties and to

affiliates. The company will in future rate cases be required to establish that sales and transfers to affiliates were made at fair market value.

20. The company should include in its next general rate filing a study calculating "slippage" as part of its management wage adjustment.

21. The finds there may be deficiencies in the company's tariffed water heater rental program as identified by the parties in this case. A review of that program will assist the Commission in evaluation of the program. The company shall file a review of the program by May 1, 1990.

22. Major Accounts program expenses are not properly classified as conservation-related. The company in the future should separate Major Accounts expenses from conservation programs.

23. A one percent late payment fee is reasonable, as discussed in the body of the order. The company's next rate filing should include the effect of the late payment fee on working capital to allow the Commission to monitor the effects of the new fee.

24. The company should in the future immediately distribute updated information relating to discovery requests. This action is necessary to allow all parties full opportunity to explore new information which the company may decide to include in its rebuttal case.

25. The company on December 21, 1989, filed a motion to reopen this record to receive "judicially cognizable facts" included in an affidavit, regarding signing of a union wage contract. The information contained in the affidavit attached to the motion is not properly treated by official notice under WAC 480-90-750(2). The deadline in this case would not allow the parties the opportunity to provide evidence on the issue. The motion should be denied. The Commission will entertain a single-issue filing after an order has issued in this case.

26. A second set of backup disks was received from the company and from Public Counsel, regarding the response to Bench Request No. 4. The backup disks should be entered into the record as Exhibits 834-D and 833-D, respectively.

27. Public Counsel filed a motion on December 3, 1989, to substitute a corrected Exhibit 879. The company by letter dated November 16, 1989, provided transcript corrections and responses to "subject-to-check" items. Both motions should be granted.

CONCLUSIONS OF LAW

1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of this proceeding and the parties thereto.

2. The existing rates for electric service in respondent's tariff are insufficient to yield reasonable compensation for electric service rendered in the state of Washington by respondent. Revision of rates and charges to its tariffs made in accordance with findings herein will yield a fair rate of return on respondent's rate base found proper herein and, if filed pursuant to this authorization, will be fair, just, reasonable and sufficient.

3. The tariff revisions under suspension in Docket Nos. U-89-2688-T and U-89-2955-T name rates and charges which are excessive and inappropriate. They should be rejected in their entirety.

4. The ECAC procedure should be eliminated.

5. The company's December 21, 1989, motion to reopen this proceeding should be denied.

6. All other motions made in the course of these proceedings which are consistent with findings and conclusions made herein should be granted, and those inconsistent therewith should be denied.

7. The company should be required to file the reports and make the changes in accounting practices described in the findings and in the body of this order.

On the basis of the foregoing analysis of evidence, findings and conclusions, the Washington Utilities and Transportation Commission enters the following order.

O R D E R

WHEREFORE, THE COMMISSION HEREBY ORDERS:

1. The tariff revisions filed by Puget on February 17, 1989, under Docket No. U-89-2688-T, and on May 26, 1989, under Docket No. U-89-2955-T, now under suspension, are hereby rejected.

2. Respondent is hereby authorized to file revisions to tariffs herein found appropriate which will produce no more

than the additional annual gross revenues herein found to be proper for respondent's Washington operations.

3. The filings authorized herein shall bear an effective date which allows the Commission at least seven (7) working days following the date of the Commission's receipt thereof to consider them. The filings shall reflect no retroactive rate treatment and shall bear the notation on each sheet: "By Authority of order of the Washington Utilities and Transportation Commission, Docket Nos. U-89-2688-T and U-89-2955-T".

4. Material in support of the manner in which the additional gross revenues herein authorized for respondent's electric operations is obtained, shall be submitted simultaneously with the filing relating thereto.

5. A notice of the filings herein authorized shall be posted at each business office of the respondent in Washington, on or before the date of filing with the Commission. The notices shall state when the filing is to become effective and advise that a copy of the filing is available for inspection at each such office. The notice shall remain posted until the Commission has acted on the filings.

6. All motions consistent with this order are granted. Those inconsistent therewith are denied.

7. The Commission retains jurisdiction to effectuate the provisions of this order.

DATED at Olympia, Washington, and effective this 17th day of January, 1990.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Sharon L. Nelson

SHARON L. NELSON, Chairman

R D Casad

RICHARD D. CASAD, Commissioner

A J Pardini

A. J. PARDINI, Commissioner