

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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| In the Matter of the Application of |) | |
| |) | DOCKET NO. UE-990267 |
| PUGET SOUND ENERGY, INC. |) | |
| |) | |
| For (1) Approval of Proposed Sale of Puget |) | FOURTH SUPPLEMENTAL |
| Sound Energy, Inc.'s Share of the Colstrip |) | ORDER GRANTING |
| Facilities, and (2) Authorization to Amortize |) | RECONSIDERATION OF THE |
| Gain Over a Five-Year Period |) | THIRD SUPPLEMENTAL ORDER |
| |) | |

SUMMARY

PROCEEDINGS: On March 4, 1999, Puget Sound Energy, Inc. (PSE), filed its application in the above captioned and docketed matter under chapter 80.12 RCW for a Commission order authorizing the sale of its ownership interest in the Colstrip Generating Units 1, 2, 3, and 4 to PP&L Global, Inc., together with associated transmission assets. The application also seeks authorization for a five-year amortization of any gain realized from the proposed sale. The Commission, in the Second Supplemental Order in this matter, conditionally approved treatment of PP&L Global, Inc.'s ownership of the facilities as an exempt wholesale generator (EWG).

On September 30, 1999, the Commission entered the *Third Supplemental Order Approving Sale; Ordering Deferral of Gain and Deferral of Power-Cost Changes* (Third Order) authorizing PSE to sell its ownership interest in the Colstrip facilities to PP&L Global on condition that PSE defer the gain from the sale and from any power cost savings and pass those through to ratepayers in its next general rate request filing. The Commission ordered PSE to file a least-cost plan no later than December 31, 1999, and to make a general rate request filing no later than March 31, 2002.¹

The Staff of the Washington Utilities and Transportation Commission (Staff) on October 11, 1999, filed a petition for reconsideration of the Third Order. On October 22, 1999, PSE and Public Counsel filed their answers to the Staff petition.

COMMISSION: The Commission grants the *Petition of Commission Staff for Reconsideration of Third Supplemental Order*.

¹ *In re the Application of Puget Sound Energy, Third Supplemental Order* (September 30, 1999). We will refer to this as "the Order" through the rest of this order.

MEMORANDUM

Staff “requests reconsideration solely for the purpose of clarifying the Commission’s Order on four issues.” Specifically, Staff asks the Commission:

- (1) to amend the Third Order to make the requirement of a general rate request filing a condition for approval of the sale;
- (2) to amend the Third Order to delete as unnecessary the requirement for a calendar 2001 test year;
- (3) to clarify its expectations for a least-cost planning analysis in future property transfer applications; and
- (4) to clarify the methodology by which PSE must defer the gain and power supply benefits which result from the sale.

We address below, in turn, each issue raised by Staff in its petition and the answers of PSE and Public Counsel.

I. Condition Approval of the Sale on the Requirement to Make a General Rate Request Filing.

The Commission in the Third Order required PSE to file a rate case:

In addition, the Commission should require PSE to file a general rate request no later than March 31, 2002. The test year should be calendar year 2001, in order to capture the new level of Bonneville Power Administration exchange benefits provided to PSE ratepayers. Third Order at 23. (See also Order paragraph 3 at 25.)

A. Parties’ Positions

Staff notes that this requirement is not specified as a condition for approval of the sale, but appears as a separate determination unrelated to Commission approval of the Colstrip application. Staff contends that the Commission does not have legal authority to order a company to file a general rate case where no prior obligation exists. Staff cites RCW 80.28.020 and RCW 80.04.110 for the proposition that the Commission may “tee-up” a rate case only upon its own motion or upon complaint. Staff recommends that the Commission amend the Third Order to remove the

requirement that PSE file a general rate request, or condition approval of the sale upon PSE filing such a request. Staff maintains that its proposed amendment is not simply a distinction without a difference but rather would change who will bear the burden of proof in that future rate proceeding.

PSE agrees with Staff that the Commission does not have the authority to require the company to file a rate case. The Commission may only initiate a complaint proceeding on its own motion, thereby assuming the burden of proof in the proceeding. PSE asks the Commission to amend the order to remove the requirement that it file a general rate request filing.

Public Counsel also supports Staff's position that a general rate case filing be made a condition for approval of the sale. Public Counsel does not advocate that the company be required to file a rate case. However, if the Commission requires the filing of a rate case as a condition of its approval of the sale, the burden of proof would be borne by PSE rather than the Commission.

B. Commission Discussion and Decision

The Commission believes that a rate case filing is essential in order to timely implement the requirement of the Third Order that Puget defer the gain from the sale and all power- cost savings, with a return of 7.16 percent, and pass those benefits to ratepayers. Timely implementation will properly align those benefits with the current customers of PSE. The Commission determined that the proposed transaction, as conditioned in the Third Order, would not be injurious to the public interest; failure to timely file a rate case to pass those benefits to the ratepayers could result in harm to the current customers of PSE and to the public interest. The Commission therefore grants the request for reconsideration and further conditions its approval of the sale of Colstrip on PSE's acceptance of the requirement that it file a general rate request no later than March 29, 2002.

II. Delete As Unnecessary the Requirement for a Calendar 2001 Test Year

A. Parties' Positions

If the Commission requires PSE to file a general rate case as a condition of approval of the sale, Staff recommends that the Commission not specify the test year underlying the rate filing. Staff claims that the rationale expressed in the Third Order for specifying a test year -- to capture the new level of Bonneville Power Administration exchange benefits -- is not necessary since exchange credits are frozen until the Residential Exchange contract expires on June 30, 2001, whereupon PSE will transfer the then-current exchange credit to general rates. Therefore, there is no need for a

general rate case after the rate plan period to capture exchange benefits for ratepayers.

If the Commission intended to address subscription (rather than exchange) benefits, there is again no reason to specify a test year according to Staff. Any rate-setting proceeding will ensure that subscription benefit amounts will be captured for ratepayers through a *pro forma* adjustment, regardless of the test year that is utilized by PSE.

PSE agrees with Staff that the requirement for a calendar 2001 test year is unnecessary because the need to make *pro forma* adjustments for power supply will be necessary irrespective of the test year utilized. PSE urges that because the requirement for a rate case filing is inappropriate, a test year designation is likewise inappropriate.

PSE contends that Staff's explanation of the treatment of the Residential Exchange program is inaccurate. PSE committed to cover any shortfall created by reductions in the Residential Exchange only during the Rate Plan. The Commission cannot consider this question since it is not part of the application to sell Colstrip. Staff's attempt to raise the issue now is a violation of due process.

Public Counsel agrees with Staff that a particular test year is not required. Public Counsel supports the notion that all parties have an interest in which test year is utilized in rate-setting proceedings. The party initiating the rate case selects the test year to be utilized, which can create an advantage in that party's position. However, this advantage can be narrowed through the use of accounting adjustments to make the test year representative.

B. Commission Discussion and Decision

The Commission agrees with the overall assessment of the parties that designating a test year is unnecessary and inappropriate. We agree with the parties that regardless of the test year utilized, adjustments for power supply and other known and measurable events will be proposed to make the selected test year representative. The Commission grants Staff's petition for reconsideration and removes the requirement for use of a calendar 2001 test year.

III. Commission Expectations for a Least-Cost Planning Analysis in Future Property Transfer Applications

A. Parties' Positions

Staff cites the following passage from the Third Order:

In general, the burden of proof for outlining the business plan justifying the transaction, and for proving that no harm will occur, remains the burden of the company. In any future applications, we expect to see a least-cost-planning analysis. Third Order at 22.

Staff contends this “strong emphasis” on least-cost plans appears inconsistent with prior Commission orders where resource-acquisition decisions have come under scrutiny. Staff cites a Commission order in a prudence-review proceeding² where the Commission rejected the assertion by the predecessor company to PSE that power contracts were prudent because they were consistent with its least-cost plan filed with and accepted by the Commission. Staff notes that the Commission rejected that argument:

Although a least-cost plan may contain information helpful in determining the prudence of resource decisions, this is only one consideration in the analysis. Additional information is required to prove prudence, as indicated in the least-cost planning rule itself. The Commission’s acceptance of a company’s least-cost plan does not represent a finding of prudence of a particular resource. The least-cost planning process is not sufficiently rigorous or specific to support an independent finding of prudence.³

Staff asks the Commission to clarify whether the Third Order constitutes a change from prior practice, and what least-cost-plan analysis it expects to receive in an application for the transfer of property. Clarification will help parties understand what shortcomings the Commission found with PSE’s numerous resource scenarios in Exhibit 7. Clarification is also necessary to advise Staff and PSE whether to postpone consideration of the Centralia plant sale until after a least-cost plan has been filed.

² *In the Matter of the Petition of Puget Sound Power & Light Company for an Order Regarding the Accounting Treatment of Residential Exchange Benefits*, Docket No. UE-920433, *Washington Utilities and Transportation Commission v. Puget Sound Power & Light Company*, Docket No. UE-920499, and *Washington Utilities and Transportation Commission v. Puget Sound Power & Light Company*, Docket No. UE-921262, Nineteenth Supplemental Order (September 27, 1994), [PSP&L Prudence Proceeding].

³ *Id.* at 12.

PSE answers that it will file a least-cost plan by the end of 1999. PSE believes the analysis offered in support of the Colstrip application is in many ways more informative than any least-cost plan. If the Commission disagrees, clarification would be helpful.

Public Counsel does not agree with Staff that there is a lack of clarity or inconsistency with past decisions of the Commission, but has no objection to the Commission providing more guidance on its expectations. Public Counsel offers a distinction between the PSP&L Prudence Proceeding and the Colstrip case. The prudence review required the Commission to judge the prudence of a resource decision after the fact. The Commission properly rejected the argument that acceptance of a least-cost plan automatically meant acceptance of any resource acquisition. In Colstrip, PSE failed to support its position with a least-cost plan that demonstrated how the sale would lead to a least-cost future. Public Counsel understands the Commission position as holding that a least-cost plan is a necessary element but not sufficient by itself to judge a specific acquisition or sale.

B. Commission Discussion and Decision

The Commission intended no change in precedent in its comments on least-cost planning. Generally, the Commission in the Third Order indicated that while least-cost planning models today “may be less useful analytical tools,...the Commission still considers it the responsibility of any utility to demonstrate what future it sees as possible, and how it plans to meet its obligation to serve.” Third Order at 21. The Third Order indicated that “various market alternatives will need to be considered, with the sensitivity of each explored.” *Id.* at 22.

The same considerations that go into a least-cost plan are useful, perhaps essential, in evaluating a sale of assets. While a least-cost plan is not necessarily a pre-condition to approval of a sale, it is an obvious—and already legally required—way to satisfy the need for information critical to evaluation of a sale.

In this case, PSE had not timely filed a least-cost plan, but stated in the record that it would file a plan in December. *Puget Sound Energy’s Answer to the Petition of Commission Staff for Reconsideration of Third Supplemental Order* at 5. In order to proceed responsibly in purchasing replacement power, PSE needs to perform the analysis required in a least-cost plan. Therefore, because a least-cost plan is legally required and overdue, because the analysis contained in the plan is important to responsibly buying replacement power, and because PSE agreed in this case to file a plan, the Commission ordered it to do so.

The Commission did not comment on, and there is no change in precedent to, the interplay between least-cost planning and a prudency review. Treatment of this subject is the PSP&L Precedence Proceeding cited above is unaffected by the Third Order.

The Commission finds that the Third Order is not inconsistent with prior Commission orders but grants the Staff petition for reconsideration to clarify the point as discussed above. As for pending similar cases, they will need whatever analysis is required to make an informed decision. Insofar as PSE has already promised a least-cost plan no later than December 30, 1999, the information provided in it may well be relevant to other proposed transactions.

IV. Methodology by which PSE Must Defer the Gain and Power Supply Benefits which Result from the Sale

A. Parties' Positions

Staff posits that Attachment A to the Third Order, a spreadsheet analysis, is the basis of the Commission's conclusion that the sale of PSE's ownership interest in Colstrip "will approximately break even." Staff further points out that the attachment "is a presentation which compares what is expected after the sale of Colstrip to what would be expected if the sale did not take place." This analysis is appropriate when measuring known and potential avoided costs by the sale. The analysis is not appropriate when calculating the amounts to be deferred. Staff recommends that the Commission clarify that Attachment A should not be used specifically for deferral calculations. Instead, Staff recommends that the Commission amend the Third Order to require that the deferral amounts equal the difference between market cost of replacement power and the embedded costs of the Colstrip facilities.

Staff also recommends that all deferred amounts be based on estimates of the market cost of replacement power rather than PSE's actual market cost of power in the ensuing periods. This recommendation avoids future controversy and true-up calculations. It also holds PSE responsible for obtaining these savings at a minimum to ensure that the benefits go to the ratepayer. In calculating the deferrals, Staff supports the use of the nominal values from Attachment A: deferrals should equal the non-discounted amounts for replacement power costs less the Colstrip costs.

PSE strongly encourages the Commission to use actual (or a reasonable calculation of) costs for measuring Colstrip costs and replacement power costs. Colstrip costs could be measured using the actual costs incurred by the buyer (with the buyer's cooperation) or a best estimate using PSE's actual historical cost of operation. Replacement power costs should be the actual costs.

PSE alleges that Staff's method for calculating power cost savings is arbitrary and improper. Staff proposes to use outdated Colstrip costs from the company's 1992 rate case proceeding, and an arbitrary estimate of the market cost of replacement power. PSE claims that this may cause it to pass on savings that may never occur. The record shows that a wide range of possible market scenarios exists. To choose one scenario as a basis for measuring the savings is unjust and a blatant violation of the merger order. PSE is also troubled by the fact that Staff's proposal will confiscate power cost savings PSE has already achieved for Colstrip. Using 1992 embedded costs, the savings PSE has achieved since the merger would be included in the amount deferred. PSE points out that rates must be based on known and measurable costs. Staff's recommendation does not meet this requirement.

Public Counsel concurs in the Staff recommendation because it will lessen future disputes, and places appropriate responsibility and rewards on Puget.

B. Commission Discussion and Decision

Attachment A merely gives support to the reference in the Third Order of a net cost of the transaction of \$4 million. The Commission made one change to a scenario in the record, and used the attachment to support the reference which appears in the Order. The attachment shows how the negative \$4 million was calculated.

As is obvious from the many scenarios presented in the record, the exact amount of the deferral cannot be known at this time. Scenarios only speculate about power costs, whereas power cost deferrals should be based on the actual cost of replacement power compared to the cost of continuing ownership and operation of Colstrip. The methodology for determining the cost of keeping Colstrip is straightforward. The starting point, for deferral purposes, will be the cost of Colstrip at the time of the sale of the facility. A true-up will be necessary because the cost of replacement power may fluctuate, while the cost of Colstrip will steadily decrease. Nonetheless, the actual costs of replacement power will be known and measurable.

In order to ensure that the calculation of the deferral amount is accurate, it is essential that the actual cost of replacement power be tracked and recorded. PSE must therefore track its costs of replacement power on a monthly basis and report those costs to the Commission. Consistent with the Commission's discussion above on least-cost planning, the company must act aggressively to ensure that replacement power is acquired consistent with its least-cost planning responsibilities. The prudence of those purchases will be evaluated in the upcoming general rate case.

The Commission grants the Staff petition for reconsideration on the deferral of the gain and power supply benefits and clarifies the Third Order. The deferral will be calculated as the difference between the actual market cost of replacement power and the embedded costs of Colstrip depreciated over time.

ORDER

The Commission grants the Staff petition for reconsideration as fully described in the text of the instant Order.

DATED at Olympia, Washington, and effective this day of
November, 1999.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

MARILYN SHOWALTER, Chairwoman

RICHARD HEMSTAD, Commissioner

WILLIAM R. GILLIS, Commissioner