BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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<tr><td>AIR LIQUIDE AMERICA CORPORATION, AIR PRODUCTS AND CHEMICALS, INC., THE BOEING COMPANY, CNC CONTAINERS, EQUILON ENTERPRISES, LLC, GEORGIA-PACIFIC WEST, INC., TESORO NORTHWEST CO., and THE CITY OF ANACORTES,

Complainants,
v.

PUGET SOUND ENERGY,

Respondent.</td><td>DOCKET NO. UE-001952
(consolidated)</td></tr>
<tr><td>In re: Petition of Puget Sound Energy, Inc. for an Order Reallocating Lost Revenues Related to any Reduction in the Schedule 48 or G-P Special Contract Rates</td><td>DOCKET NO. UE-001959
(consolidated)</td></tr>
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PUGET SOUND ENERGY, INC.'S

PREHEARING BRIEF

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Puget Sound Energy, Inc. ("PSE" or "Puget") submits this prehearing brief in advance of the evidentiary hearing to consider the Amended Complaint ("Complaint") and request for emergency relief sought by Air Liquide America Corporation ("Air Liquide"), Air Products and Chemicals, Inc. ("Air Products"), The Boeing Company ("Boeing"), CNC Containers ("CNC"), Equilon Enterprises, LLC ("Equilon"), Georgia-Pacific West, Inc. ("G-P"), Tesoro Northwest Company ("Tesoro"), and the City of Anacortes, Washington ("Anacortes") (collectively referred to herein as "Complainants")[1].

I. INTRODUCTION AND SUMMARY OF ARGUMENT

These Phase I proceedings were established to determine if Complainants suffered an "emergency" as defined in the applicable statutes and regulations, and if so what relief might be available as a result of that emergency. As is discussed below, and as PSE will show at trial, there is no emergency at all. No one disputes that wholesale electric prices have gone to extraordinarily high levels in recent months, higher than projected by either PSE or the Complainants several years ago. This is a problem that will affect everyone in the region, particularly if current projections of energy scarcity in the coming year due to low water levels turn out to be true. But, as the Chair acknowledged at the pre-hearing conference, this Commission does not have the power to solve that problem – the high prices in wholesale power markets are subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC). The Complainants, PSE, and even the Commission itself, have all submitted pleadings at FERC and sought relief at FERC to address the wholesale market situation. FERC is the only forum that has the jurisdiction and authority to address these issues.

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[1] On December 28, 2000, a Second Amended Complaint was filed, purporting to add Intel as an additional Complainant. As is explained in Puget's Motion to Strike Second Amended Complaint, the Complainants did not receive leave to submit their amended complaint and Puget is prejudiced by the addition of an additional Complainant at this late date, at a time when it is essentially impossible to obtain discovery from the new Complainant prior to hearing. At the conference on January 2, 2001, Complainants offered to withdraw Intel as a Complainant. This prehearing brief will not address Intel.

The Complainants attempt to evade the issue of legal authority by citing to the emergency adjudicatory procedures statutes. But they face no emergency. They are large, financially healthy businesses, who entered into contracts for market-priced electricity because they thought it would save them money. In their contracts, they explicitly accepted the risk of market price volatility -- they knew it was a bet, but they thought it was a good one. It was a winning bet, at first, and Complainants saved money for years. In recent months, of course, that bet has not been as favorable.

None of the Complainants, however, is in danger of bankruptcy, or even close. For virtually all of the Complainants, electric power provided by PSE is only a small factor in their cost structure. Many of the Complainants are experiencing record years, and the cost of power provided by PSE will be only a blip on their balance sheets, offset by gains in other aspects of their business. It is true that some of the Complainants have laid off employees, but these same Complainants reduce or increase their workforce all the time to reflect seasonal and market conditions (the markets they sell in – not the power markets), and no one suggests that those corporate decisions reflect or demonstrate an "emergency". Moreover, virtually all of the Complainants have used forms of self-help (such as installing their own generation) to mitigate their exposure to the markets and to keep employment at optimal levels. And virtually all of the Complainants are able to pass their costs on to their own customers, so they may not suffer at all in the long run. In sum, there is no emergency.

To the extent that the Commission concludes that any of the Complainants is suffering from high electric prices, they are not entitled to relief from that suffering. The Complainants are parties to contracts, and the Commission reviewed those contracts when they were entered into, concluding that they were premised on a fair, just, and reasonable methodology. The Commission has been clear in its orders through the past years that the rates in the contracts are not tied to PSE's actual costs, and that PSE would not generally be able to seek relief from the contracts if the costs of its portfolio of resources varied from the amounts recovered in the contracts. By entering into the contracts, the Complainants

relinquished any right that they may have had to complain about the rate levels yielded by the market. Moreover, the contracts all include the option of acquiring Optional Price Stability from PSE that would eliminate the fluctuating price risk. So, if the Complainants had simply availed themselves of the options in their contracts or acquired hedges or other price stability products on their own, they would not be paying the prices that they are paying.

The Complainants and PSE are not the only parties impacted by this proceeding. As is explained in the Petition consolidated with the Complaint, the contracts at issue were entered into in conjunction with the Merger Rate Plan Stipulation, arising from the Puget/WNG Merger, and the contracts form a package, in which PSE established revenue certainty, and was in return given the right to manage its resource portfolio in the manner it found optimal. The change in rates requested by Complainants is not a rate change permitted, authorized, or contemplated by either the Merger Rate Plan Stipulation or the Order approving the Stipulation. Therefore, the revenue change that results from the change in rates would have to be paid by the same industrial customers who chose market-based rates or, ultimately, re-allocated among all of PSE's customer classes, including its commercial and residential customers. The effect of the Complaint is to unfairly and unjustly shift revenue responsibility to customers who are not parties to the current proceedings (since they do not take service under Schedule 48 or the G-P Special Contract), but who will end up bearing the impact of the requested relief.

Ultimately, it is fair to hold the Complainants to their contracts. It is undisputed that the market-based contracts did save the Complainants money, for years, and would have continued to save them money if they had locked in low power prices through the Optional Price Stability option, or on their own with hedges or other risk management tools. All of the Complainants had plentiful opportunities over the past years and months to lock in low power prices available on the markets, but chose not to do so, preferring to roll the dice on the market. Having benefited substantially from their gamble in the early years,

Complainants now ask the Commission to abrogate the deal in the later years, when they feel the deal is no longer to their advantage. The Complainants should not be allowed to shift the burden of their mistaken business decisions onto PSE or its other customers.

II. STATEMENT OF FACTS

Complainants' current claims and requests for relief cannot be properly considered[2] without a full and complete recognition of the genesis of the Settlement Agreement, attached as to this brief as Exhibit (**Ex.**) 1,[3] the resulting Rate Schedule 48, a current version of which is attached as **Ex.** 2, and its subsequent implementation and interpretation by the Commission.

A. History Of The Contracts And Schedule 48

1. 1996: The Merger of Puget Power and Washington Natural Gas

On February 20, 1996, Puget Sound Power & Light Company ("Puget") jointly applied with Washington Natural Gas ("WNG") for an order from the Commission approving the merger of Puget, WNG, and WNG's parent company, Washington Energy Company, into Puget Sound Energy ("PSE").[4] Industrial Customers of Northwest Utilities ("ICNU") and some of its individual members, such as Air Liquide, Bellingham Cold

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[2] In the very short time available for discovery in these proceedings, PSE has sent out discovery requests to Complainants in an attempt to evaluate their claims. To date, however, Complainants have been unresponsive to literally dozens of requests. In a hearing on PSE's Motion to Compel, held on January 3, 2001, the Administrative Law Judge found that Complainants' relevance objections were ill-founded, and ordered that Complainants respond to PSE's discovery. Because PSE has not yet received the responses that were ordered, it must necessarily reserve the right to update the record and this Statement of Facts when the requested information becomes available.

[3] All referenced materials are compiled and provided in a separate document attached to this brief. PSE is filing the depositions separately, under seal, pursuant to request for confidential treatment.

[4] WUTC Docket No. UE-960195 (consolidated under UE-951270). The surviving corporation was named midway through the merger proceedings and the negotiations leading to the Schedule 48 and the special contracts. For that reason, this brief refers interchangeably to "Puget" and "PSE."

Storage and Georgia Pacific, intervened in the merger docket, espousing fears that the proposed merger could have detrimental impacts on electric rates and conditions. *See e.g.*; Petition to Intervene of Air Liquide, at 2, attached as **Ex.** 3.

Puget and WNG negotiated with ICNU and the industrial customers to find a rate solution that would eliminate the industrial customers' opposition to the merger. Canon Aff., at ¶ 2 (Attachment A to Complaint). The industrial customers wanted open access to competitive energy markets. *Id.* at ¶ 5. Consequently, in April 1996, Puget proposed negotiating a market-based tariff for large industrial customers in exchange for the industrial customers' support for the merger. *Id.* at ¶ 2. From this idea, Puget and the industrial customers negotiated Schedule 48 and, ultimately, a "Settlement Agreement," executed by Puget and numerous industrial customers on May 22, 1996.[5] *See* **Ex.** 1. The chief negotiator for the industrial customers states:

> There was a direct relationship between the Schedule 48 tariff and the Merger Application. Puget and WNG agreed to submit, support and pursue approval of Schedule 48 in exchange for the industrial customers' agreement to not oppose the merger. Without Puget's and WNG's commitment to provide market based rates through Schedule 48 and a commitment to provide open access, industrial customers would have opposed the merger.

Canon Aff., at ¶3; *see also* Memo re ICNU's Conference with WUTC Staff re Schedule 48, dated August 21, 1996, attached as **Ex.** 4.

The Settlement Agreement and Schedule 48, as well as the "Special Contracts" that Puget negotiated contemporaneously with some industrial customers (*see, e.g.*, G-P's contract, **Ex.** 5), were part of several inter-related rate settlements that were part of the "market transition plan" which Puget and WNG accepted in order to secure approval of the merger.

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[5] The following parties signed the Settlement Agreement: Puget, WNG, ICNU ("on behalf of and together with each of its following members, Air Liquide, Air Products, The Boeing Company, Shell Anacortes Refining Company"), and Texaco Refining and Marketing, Inc., and Air Liquide, individually.

2. The Deal For Non-Core (Industrial) Customers: Schedule 48

The Settlement Agreement and Schedule 48 required that Puget allow its large industrial customers to avoid paying for PSE's cost-based rates on its generation portfolio, which apparently the industrial customers no longer desired at that time. In essence, the industrial customers that chose to take service under Schedule 48 are no longer dependent on, beholden to, or entitled to, PSE's generation resources. In so doing, this service and these customers became known as "non-core" service and customers.

Energy costs for non-core customers under Schedule 48 reflect prevailing power prices at a market-based rate index, rather than cost-based rates. As attached to the Settlement Agreement, Schedule 48 expressly warned: "Customers taking service under this Schedule assume risks of variability in energy prices and availability of energy to Customer, except as otherwise provided in this schedule." **Ex.** 1, Exhibit A, ¶ I.4 (emphasis added); *see also* same provision in current Schedule 48, at **Ex.** 2, ¶ I.4. Notably, in addressing such risk, the then-proposed Schedule 48 provided for optional firming and price stability services, as it still does today. *Id.* at III.2 & III.3.

Originally, Puget and the industrial customers desired that Schedule 48 become effective contemporaneous with the merger. But the industrial customers were unwilling to wait for the merger proceeding to reach a conclusion. Thus, after Schedule 48 was filed, Puget and the industrial customers interested in taking service under Schedule 48, asked for and received expedited consideration of Schedule 48 in Commission Docket UE-960696.

The Commission reviewed the elements of the market transition plan and reported: "Schedule 48 would introduce a new class of non-core service for PSE's largest customers. These customers would assume risk in both variability of non-firm energy prices and the availability of energy." Commission Order Approving Schedule 48 With Conditions, Docket UE-960696 (Oct. 30, 1996), at 2, **Ex.** 6. The Commission also noted that Optional Price Stability and Optional Firming services were offered as part of Schedule 48 service. *Id.* Ultimately, on October 30, 1996, the Commission approved Schedule 48 with conditions

based upon the following conclusion of law: "Schedule 48, subject to the conditions imposed by this Order and the findings herein, will result in rates, terms, and conditions which are fair, just, reasonable, and sufficient, and not unlawfully discriminatory." Id. at 12 (emphasis added).

One of the most important conditions imposed by the Commission was a prospective bar on any cost shifting due to existence of Schedule 48. In other words, the cost risks associated with Schedule 48 should not be shifted to other rate classes. *Id.* at 7. PSE expressly accepted to following condition:

> (1) **No cost shifting** – The revenue difference between Schedule 48 rates and the effective rates that would otherwise be applicable to current Schedules 31, 46, 49 or other special contract customers (*i.e.* lost revenues) shall not be shifted to other customer classes and shall be borne by shareholders until a future Commission determination regarding allocation of costs and cost savings, and then on a prospective basis only.

Id. at 5.

The Commission also approved the Schedule 48 Service Agreement (and the requirement that each customer taking service under Schedule 48 must execute it). *Id.* at 2. The Schedule 48 Service Agreement requires sworn acknowledgment of the following statement:

> Customer understands and agrees that it is assuming certain risks by voluntarily choosing to take service under Schedule 48 and electing not to take service under otherwise applicable Puget tariffs. Customer understands that depending on a number of uncertainties, including but not limited to the market for power (including supply and price), the resolution of various outstanding regulatory issues (including the availability of, and terms for providing, open access tot electric retail customer and, in connection therewith, the treatment for recovery of stranded costs, and re-entry fees upon termination or expiration of this Service Agreement, as providing in Paragraph 6 above, Customer may (i) experience a shortage of electricity or (2) pay more for electricity than it would have otherwise. Customer has had an opportunity to consult its own legal counsel and power market experts in its evaluation of the risks associated with taking service under Schedule 48.

Schedule 48 Service Agreement, attached to Schedule 48, at 2-3, **Ex.** 2 (emphasis added).

While several of the Complainants have negotiated and obtained Optional Price Stability over the years, they have all let those payments lapse, and instead take service under the market index provisions of the contract. Schedule 48 also provides that customers may serve their needs through self-supply such as "self-generation" or "on-site generation." *See* Ex. 2. Rather than seeking optional price stability, many of the Complainants are now self-supplying all or a portion of their loads, and they are thus not taking service pursuant to Schedule 48 for those portions of their load.

3. The Deal for Special Contract Customers

Contemporaneous with the discussions that led to the Settlement Agreement and Schedule 48, Puget entered into negotiations with other customers, including G-P and Bellingham Cold Storage (BCS), that led to the Special Contracts, which have the same essential characteristics as Schedule 48. In particular, as was true of Schedule 48, G-P agreed that it would be served with energy prices based on the Mid-C market index, and that "Customer bears all the risk for price movements in the market price." *See* G-P Power Sales Agreement, at 5, **Ex.** 5. G-P, like the Schedule 48 customers, agreed to end its other litigation with Puget, suspend its efforts to bypass, and not to interfere with the Puget/WNG merger, in return for the market rate commitments in its Special Contract.

As was true of Schedule 48, Staff and Public Counsel were concerned that the market-based pricing elements of the Special Contracts could lead to cost shifts to Puget's core customers. Pursuant to Staff recommendation, the Commission imposed the same no-cost-shifting requirement on the Special Contracts, essentially identical to that found in the Schedule 48 Order. Order Imposing Conditions on Special Contract Allowed to Go into Effect, Commission Docket UE-960612 (June 7, 1996), at 3, **Ex.** 7. In essence, the Special Contract and Schedule 48 were identical, allowing the customer to take service at rates based on a market index, but shifting the customer to a non-core class that was no longer entitled to benefit from, or be burdened by, Puget's long-term resource planning decisions.

Like Schedule 48, the Special Contract with G-P provides that the parties could negotiate an Optional Price Stability service, if the customer wishes to have certainty on price or availability of service that is not otherwise available. And like Schedule 48, the Special Contract permits self-generation when it is economic in comparison to market prices, an option G-P is now pursuing.

4. The Deal for Core Customers: Merger Rate Plan

Commission Staff and Public Counsel initially opposed Schedule 48. But when PSE agreed to the "no cost shifting" from non-core customers, PSE was able to negotiate a stipulated rate plan for core customers with Public Counsel and Commission Staff. *See* Merger Rate Plan Stipulation, filed in Consolidated Docket Nos. UE-951270 and UE-960195, **Ex.** 8. The Merger Rate Plan Stipulation has two important elements: (1) an immediate rate reduction from then current rates (~ 4 %) (including Schedule 48 non-energy rate components), escalating at one or 1.5 percent per year thereafter during the five year rate plan period; and (2) an opportunity for PSE to realize potential savings from the merger. **Ex.** 8, at 4. The Merger Rate Plan Stipulation provides: "The rate plan is designed to provide the management of PSE with a five year window of opportunity to achieve [direct and indirect] merger savings. Within this five-year window, PSE's financial results will be a function of management's ability for achieve these savings in order to provide shareholders with an opportunity to earn a reasonable rate of return." *Id.* at 4.

Importantly, neither PSE, Public Counsel, nor Commission Staff would have agreed to this rate plan if the other ratepayers or PSE's shareholders had been placed at **any** risk by and for the market-based rates under Schedule 48 or the Special Contracts. That risk was understood to be borne solely by those non-core customers that chose to divorce themselves from PSE's generation resources. In supporting Schedule 48, Air Liquide stated "Customers that would be eligible for Schedule 48 are situated differently that other customers because of a higher risk of discontinuing regular tariff service from Puget . . . . The risks of power

unavailability, cost volatility, and especially the loss of "core" status are more appropriately assumed by large customers, which can achieve total benefits to justify such risks." Reply Comments of Air Liquide in Docket UE-960696, dated July 26, 1996, at 3, **Ex.** 9. In reviewing the balance of interests, ICNU reiterated the connection of pricing and risk: "The movement of competitive, electric cost sensitive industries to a non-core status, with pricing based on equivalent margin rates. This will allow industry to assume more risk in the type of power supply that is purchased." ICNU's Comments on Schedule 48 in Docket UE-960696, July 15, 1996, at **Ex.** 10.

Ultimately, after the Merger Rate Plan Stipulation was filed and analyzed, the Commission approved the merger on February 5, 1997.[6]

5. UE–9801410: Schedule 48 Rates Don't Track Costs

For over a year and a half after Schedule 48 was established, its implementation was without significant controversy. In September 1998, PSE filed an advice letter to adjust the rate for optional firming service from $0.50 to $0.46/kVa per month within Schedule 48. *See* Docket UE-981238. This service is one of several methods by which PSE offers to assist its Schedule 48 customers with greater certainty in the cost and level of electric power service. The terms and conditions of optional firming service were eventually negotiated and approved in November 1999.

A controversy arose in November 1998, however, when several Schedule 48 customers filed a complaint about the index PSE used to calculate rates for its Schedule 48 customers. Initially, Schedule 48 power rates were tied to the California-Oregon Border ("COB") index rates. When the Mid-Columbia ("Mid-C") index was created, PSE changed to that index (as was originally contemplated in Schedule 48). PSE combined the Mid-C firm and non-firm power indices into a single composite index to more accurately reflect the

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[6] *See* Fourteenth Supplemental Order Accepting Stipulation; Approving Merger, in Consolidated Docket Nos. UE-951270 and UE-960195 (February 5, 1997) ("Merger Order").

actual costs of acquiring power. Air Liquide, Air Products, Boeing, Equilon, and Tesoro complained to the Commission that this violated the tariff. *See* Docket UE-981410.

In response to PSE's contentions that the Mid-C non-firm rate index in Schedule 48 would not allow the PSE to recover the costs it actually incurred to acquire power, the Commission stated:

> We . . . believe it is important to eliminate any potential for misunderstanding here and on a going-forward basis on two points. PSE argues that that the concept of compensatory rates requires a match between energy acquisition costs and the energy component charged under Schedule 48. <u>This argument is not credible. Our review of the Commission's deliberations in the Schedule 48 approval process and the Commission's Order approving the rate schedule shows that no such cost tracking was contemplated.</u> It is clear from the record of the Commission's earlier proceedings that the Commission understood that the rates with market-based cost components tied to indices for non-firm power might result in a revenue loss to PSE. The potential problem appeared particularly significant when the projected market rates were juxtaposed against PSE's energy supply portfolio costs.

Fifth Supplemental Order Granting Complaint, Ordering Refunds and Other Relief, Docket UE-981410 (August 3, 1999), at 24-25 (citations omitted, emphasis added), **Ex.** 11. In other words, the Commission specifically ruled that PSE's actual energy supply portfolio costs are of no consequence to Schedule 48.

The Commission order in UE-981410 also reflects a reality of PSE's energy supply portfolio that dates back to the creation of non-core service customers on Schedule 48 and the Special Contracts. PSE does not buy power, or incur power procurement costs, for the Schedule 48 or Special Contracts customers alone. On a day-to-day basis, PSE manages its power purchases and supply to meet its total system load, regardless of the identity of an individual customer or set of customers. Thus, it is inappropriate to determine the costs associated with serving the Schedule 48 or Special Contract customers alone. The agreement that PSE would be free to manage its portfolio on an integrated basis is embodied not only in Schedule 48 and the Special Contracts, but also in the 1996 Merger Rate Plan.

PSE is operating under a five-year Merger Rate Plan Stipulation approved by the Commission in 1996 with the agreement that PSE would be free to manage its resources to maximize its revenues consistent with sound utility operation:[7]

> The Stipulation recognizes cost pressures facing Puget during the five-year Rate Plan due to increases in purchased power, production, and transmission expenses, and is based upon recovery of various power cost components for 1997-2001. Considering these cost pressures and the potential for savings associated with the merger, the Rate Plan reflects the implicit balance struck by the stipulating parties between five years of "rate certainty" for customers, and five years of opportunity for the company to manage its resource cost pressures. Within the five-year window, PSE's financial results will be a function of management's ability to achieve savings in order to provide shareholders with an opportunity to earn a reasonable return on investment.

On a longer term basis, it is possible to see differences as PSE's lower-cost fixed price resources are dedicated to core customers. But on a short term basis, there is simply no way to disaggregate the power purchase costs for the Schedule 48 and Special Contract customers. PSE's energy supply portfolio is not managed in such a manner.

6. Year 2000: Power Prices Increase

Commencing in about May 2000, prices in wholesale power markets in the Western United States started to escalate. Most observers tie the wholesale power price increases to a variety of sources, including increasing electric demand in Western states, insufficient new electric supply coming on line in recent years, increased demand for natural gas leading to higher natural gas prices, a poor water year leading to reduced hydroelectric resources, and the unique design of the California power markets which impact markets throughout the western United States. Since May 2000, power prices have been highly volatile, reaching peaks in June, ebbing in July, reaching peaks again in August, ebbing for several months,

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[7] Merger Order, at 21.

and reaching unprecedented levels in November and December 2000. All buyers in wholesale power markets have been dramatically impacted by these events.

FERC, which regulates wholesale power markets, initiated an investigation of wholesale power markets generally in July 2000.[8] In August 2000, San Diego Gas & Electric Company initiated a complaint at FERC against all sellers into the California power markets.[9] On August 23, 2000, FERC directed its Staff to perform a more detailed investigation of Western power markets, and it initiated its own formal investigation of the situation in California.[10] PSE submitted an intervention and comments in that proceeding at FERC, as did ICNU. *See* **Exs**. 12 (PSE's Comments) and 13 (ICNU's Intervention).

The market situation in California clearly had impacts throughout the western United States. On October 26, 2000, PSE submitted its own complaint at FERC, seeking FERC recognition of the region-wide impacts of the California market problems, and region-wide relief. FERC Docket No. EL-01-10-000. **Ex.** 14. ICNU intervened in that proceeding as well, supporting PSE's proposed relief. **Ex.** 15. The Commission also intervened in support of PSE's proposed relief.

On November 1, 2000, FERC found that there were market design flaws in California power markets, and proposed a set of solutions, seeking comments by November 22, 2000. [11] Numerous parties submitted comments. On December 15, 2000, FERC issued an order requiring revisions to the California markets.[12] That order also addressed the PSE complaint, finding that there was insufficient basis in the record for ordering region-wide

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[8] Order Directing Staff Investigation, 92 FERC ¶ 61,160 (July 26, 2000).

[9] *See* FERC Docket EL00-95-000.

[10] Order Initiating Hearing Proceedings To Investigate Justness And Reasonableness Of Rates Of Public Utility Sellers, 92 FERC ¶61,142 (August 23, 2000).

[11] Market Order Proposing Remedies on Wholesale Electric Structure, 93 FERC ¶ 61,121 (2000).

[12] Order Directing Remedies to California Wholesale Electric Markets, 93 FERC ¶ 61,294 (2000).

relief. Parties have until January 16, 2001 to seek rehearing of the FERC order. Several parties have sought rehearing already, and an appeal has already been filed.[13]

7. Summer 2000: G-P/BCS Complaint

Against the backdrop of higher prices, Georgia Pacific and BCS filed an emergency complaint at this Commission in July 2000, seeking relief from the rates found in their Special Contracts. In a proceeding that looked a lot like the current proceeding, the Complainants urged that they faced an unprecedented emergency, and they demanded relief from the market prices required by their contracts. However, the Commission denied the Complainants any relief from their contracts. Noting that there was no legal authority to order interim relief or other emergency measures, the Commission found that the appropriate remedy for the customers was to negotiate Optional Price Stability service, as called for in the contract.[14]

8. Recent Events: Offers of Optional Price Stability

In recent months, as in past periods, PSE negotiated with the Schedule 48 and Special Contract customers to offer them price stability. *See* **Ex**. 16 (a sample of recent PSE's weekly correspondence with Schedule 48 and Special Contract customers re price stability options). Price stability is easily accomplished – any number of power marketers and traders will sell a hedge product, in which they will agree to pay to the customer the index price, if in return the customer agrees to pay to the marketer a fixed price. By agreeing to a hedge on this basis, the customer can assure price certainty. Of course, the "problem" with such a contract from a customer perspective is that, while it eliminates the downside risk of price

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[13] *In re: Southern California Edison Co*., Docket No. 00-1543 (D.C. Cir.) (filed December 26, 2000).

[14] *See* Order Directing Parties to Negotiate; Denying Motion, Docket No. UE-001014 (July 31, 2000), at 9-10.

increases, it also eliminates the upside risk of price decreases in the market. Financial products that eliminate the downside risk but not the upside risk are available as well, but at a price. Whatever the reason, the Complainants all decided that they would forgo the option of price stability during the winter 2000 period.[15]

PSE has likewise sought other forms of relief for the customers, searching for tools that would offer price stability to the customers, but would not shift costs to PSE's other customers. One option that PSE has reviewed is the buy-sell option. PSE has worked with the customers to develop Schedule 448, which would offer customers the ability to designate third-party resources that would be used to supply the customer. There are complexities to this relief, because FERC has found that such service includes FERC jurisdictional transmission service, and requires that the transmission portion of the service be provided under a FERC open access tariff. In general, some Complainants here have rejected this relief, because the prices available from third parties today are typically market prices, and thus do not serve the Complainants' purpose of obtaining power at below-market rates.

The immediate predicate for the Complaint was apparently the price spikes in wholesale power markets on December 11, 2000. Prices went over $1000/MWh that day on the Mid-C non-firm index, and over $3000/MWh on the Mid-C firm index. Prices since that day have moderated to dramatically lower levels comparable to the period prior to December 2000. While those prices are very high by historical standards, they are much lower than the situation that initially triggered the complaint.

B. Individual Customers

While the procedural background explains the genesis and interpretation of Schedule 48 and the Special Contracts, the backgrounds of each of the individual Complainants color whether any emergency really exists.

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[15] *See* Transcript of December 14, 2000 Prehearing Conference in Docket Nos. UE-001952/UE-001959 ("Hearing Transcript"), at 36:11-13.

1. Air Liquide

Air Liquide is the largest industrial gas manufacturer in the world. A multibillion dollar company that employs 29,000 people, operating in 60 countries worldwide, Air Liquide is sophisticated in the purchase and sale of commodities in a fluctuating worldwide economy. *See* Press Release, dated September 23, 2000, **Ex.** 17. Air Liquide's sales of gas and services have increased in excess of 26.8% worldwide and over 30% in the Americas during 2000. *See* Press Release, dated October 30, 2000, **Ex.** 18.

Power costs assessed by PSE are only a tiny percentage of the dollars that flow through Air Liquide, and have a negligible effect on its bottom line. But Air Liquide manages its power costs, just as it manages the myriad of other expenses it experiences. Air Liquide has embarked on several initiatives to address power issues. First, Air Liquide recovers increasing "energy costs through price and surcharge increases" to its customers. **Ex.** 17 and Press Release, dated October 18, 2000, at 2, **Ex.** 19. Second, "Air Liquide's leading portfolio of onsite generation technologies gives Air Liquide America competitive advantages, which should allow continuous profitable growth in that segment for years to come." *Id.* at 3, **Ex.** 19. Indeed, Air Liquide's parent company forms joint ventures to finance, construct, and operate innovative generation technology. *See* Press Release, dated October 23, 2000. **Ex.** 20. Finally, as an international company that operates in many different countries, Air Liquide knows how to hedge and take sophisticated financial positions against volatile currency and commodity market fluctuations. Obviously, Air Liquide has the means and the sophistication to manage rising energy costs.

Air Liquide's focus on energy supply costs led it to intervene in the Puget-WNG merger, negotiate and become one of the original signatories of the Settlement Agreement that gave rise to Schedule 48, and sign up for Schedule 48. **Exs.** 1 and 21 (Air Liquide's Service Agreement). Since that time, PSE has had numerous communications with Air

Liquide about options for firming up, capping and/or hedging the price of energy under Schedule 48.

After operating under Schedule 48 since 1997, however, Air Liquide has joined in this Complaint alleging that Schedule 48 – as negotiated and accepted by Air Liquide -- is causing injury to the public health, safety, and welfare, sufficient to merit emergency action by the Commission. Yet, Air Liquide has provided no evidence of any harm or damage to Air Liquide. Initially, Air Liquide provided a brief affidavit alleging such harm; however, Air Liquide withdrew that affidavit rather than subject the company's representative to cross-examination. And when PSE asked for data related to Air Liquide's alleged injury by Schedule 48, Air Liquide produced nothing. Based upon the financial strength of the company, there can be little doubt that Air Liquide can pay its electric power bill for its facility in Kent, Washington.

Because Air Liquide avoided depositions and evaded meaningful discovery, we do not know all the efforts that Air Liquide has employed to control costs at the Kent facility. We are aware of one effort -- Air Liquide has breached its service agreement with PSE by employing illegal self-help measures. Apparently, Air Liquide has wired its load from its Schedule 48 meter connection to its Schedule 46 meter connection, shifting its load away from Schedule 48 to the less costly Schedule 46. Air Liquide then requested that PSE change the Schedule 46 meter to Schedule 49 to complete the transition from non-core customer back to core-customer under the rate freeze. While such matters are not yet before the Commission, Air Liquide's violations of numerous provisions of its service agreement and PSE's tariff demonstrate that Air Liquide is not honoring its obligations under Schedule 48 and the Settlement Agreement.

2. Air Products

Air Products is another multibillion dollar company engaged in the business of sales of industrial gas, chemicals, and related industrial process equipment. A Fortune 500

company, with revenues in 1999 in excess of $5 Billion and profits of $ 450 Million, Air Products is having another profitable year in 2000 as it has announced record sales and profits for the most recent quarter. Air Products' Press Release, dated **Ex.** 22 ("Net income from operations is up 20%").

Like Air Liquide, Air Products is knowledgeable about electric power. Indeed, the corporation has a corporate energy department in its headquarters in Pennsylvania assigned to monitoring its corporate energy supplies and costs. Clancy Dep., at 28.[16] Air Products has on-site generation and/or cogeneration facilities at its numerous facilities around the United States. Air Products' facility in Stockton, California has a capacity of 50 MW and may sell its net power output into the California power market. Clancy Dep., at 8. Locally, Air Products has investigated on-site generation. Clancy Dep., at 25.

As an international company, Air Products also is sophisticated in the purchase and sale of commodities in a fluctuating worldwide economy. PSE and Air Products have corresponded quite often about optional energy price risk instruments, such as hedges and caps. *See* **Ex**. 23. PSE introduced Air Products to several well-established energy market brokers who sell hedging instruments. Clancy Dep., at 30. Air Products declined such hedges in favor of letting the market prices rise and fall.

Like Air Liquide, Air Products also insulates itself from rising power prices by passing its energy costs along to its customers. Air Products exacts a surcharge from its long-term, steady demand customers. Clancy Dep., at 18. Air Products has also arranged to have some of its customers pay directly for power associated with Air Products' on-site gas services. *Id*. at 10.

Air Products has demonstrated no injury as a result of Schedule 48. Despite energy prices in the range of $150 to $200 per MWh, Air Products is in full production as it has been through the whole time it has been on Schedule 48. No lay-offs have occurred, and no

[16] Copies of all depositions conducted by PSE are being file contemporaneously with this brief, subject to the a confidential designation pursunat to the Commission Protective Order.

contracts have been lost. Rather, production has actually increased during the past 6 months and employees have worked longer hours and collected more overtime pay.

3. Boeing

With annual sales in excess of $57 Billion, Boeing ranks #10 on the Fortune 500 list. In 1999, Boeing had *net income* of $2.3 Billion – which is more that PSE's $2.06 billion in *gross revenues*. And 2000 is looking even better: in December 2000, Boeing's President announced record earnings and the fact that Boeing's Board of Directors had decided to boost the shareholders' dividends. **Exs.** 24 and 25.

Such financial success requires sophistication in the management of its costs and risks. Boeing has policies in place encouraging prudent management of price risk through financial derivatives. Since Boeing became the first Schedule 48 customer, Puget and Boeing have worked together to assist Boeing in obtaining several power price hedging and power swap arrangements. *See e.g.* **Ex.** 26. Boeing is fully capable of locating and negotiating a hedging deal to reduce its price exposure due to Schedule 48. Boeing is also able to pass along some of its rising energy costs to its customers. *See* Boeing Response to PSE's DR 12, **Ex.** 27.

When Boeing joined in the present complaint against PSE, its Company Energy Manager stated that Boeing was "very concerned" about the current high electric power rates. Boeing alleged no injury, however, much less any imminent harm to health, safety, or welfare warranting emergency relief.[17] And when it was faced with cross-examination of its Company Energy Manager, Boeing withdrew his affidavit, leaving the record devoid of any factual basis upon which the Commission could find either emergency or significant harm to Boeing.

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[17] In oral argument held on January 3, 2001 to consider PSE's Motion to Compel, counsel for Complainants asserted that Boeing has no plans or intentions to reduce production or to reduce employment at its facilities as a result of power prices.

4. CNC Containers

CNC is a privately held corporation with net annual revenues of over $100 million and 750 employees. It manufactures and sells plastic bottles for such liquids as soft drinks. Its principal customer in Washington is PepsiCo. Franz Dep., at 5.

CNC claims it has reduced its operations recently in response to energy prices and started moving some of its equipment to its other facilities outside of Washington. *Id*. at 17. While the plastic bottle business operates on tight margins, CNC's Tumwater facility is still operating at about 90% of total capacity. *Id.* at 32. Several years ago, CNC started investing in lower-cost off-shore facilities in Peru, and it now appears to be shifting some operations to those low-cost facilities. Demand in the business is volatile, varying by season, and CNC lays off workers based on shifting demand. The purported power-layoffs involve fewer personnel than the past seasonal fluctuations in employment relating to variations in business demand. *Id.* at 22.

In the past, Puget has arranged pricing hedges to limit CNC's exposure to the high costs. Indeed, CNC, in a deal arranged by Puget, bought a forward contract with Duke Luis Dreyfus. CNC came out ahead. Franz Dep., at 42-43. Even after the prices increased this last summer, Puget in August 2000 found and offered CNC the opportunity to purchase a financial hedge at about $65 per MWh for a long-term period. *Id.* at 46-48 and **Ex.** 28. According to Mr. Franz's affidavit, the bottling plant could make money at that price. *See* Attachment F to Complaint. CNC declined the offer, however, figuring it would rather gamble on low prices in the spot market. CNC is now investigating on-site generation with a cost of about $110-$150 per MWh, which is less than the current Mid-C index prices.

5. Equilon

Equilon is a joint venture of two of the largest multinational petroleum corporations in the world: Texaco Inc. and Shell Oil Company. **Ex.** 29. Based in Houston, Equilon had

gross revenues of $29 Billion, and total assets of $11.4 Billion, centered around 4 refineries with a refining capacity of 480,000 barrels per day, 9,600 service stations, pipelines, and products terminals. *Id.* Equilon, like its parent companies, is currently very profitable due to high petroleum prices. Far from layoffs, its local facility is boosting its production to meet demand. *See* **Ex.** 30.

Like its industry peers, Equilon is sophisticated in the areas of hedging currency and managing commodity risk. Petroleum is one of the most commonly hedged commodities in the world today. Equilon is also sophisticated in the energy arena. Equilon's local facility produces 43 aMW on a daily basis. Maxwell Dep., at 21.

Despite its joining the other Complainants, Equilon has offered no sworn testimony in support of its claims, no witnesses, no evidence that demonstrates any threat to public health, safety, and welfare, or any other basis for emergency relief.

6. Georgia Pacific

Georgia-Pacific is another multi-billion dollar Fortune 500 company, which takes power for its Bellingham facility under the Special Contract discussed above. Georgia Pacific's revenues in 1999 approached $18 Billion, with profits in excess of $700 million. Such results are impressive considering that pulp and paper prices have been low for the past several years. And Georgia Pacific is having another solidly profitable year this year according to its financial filings. *See* **Exs.** 31 and 32.

At first blush, such financial success appear to conflict with the recent press about the temporary shut down of its mill in Bellingham, allegedly due to escalating power prices. Financial success of large multinational corporations depends, however, on wise operational decisions. Having recently merged with Fort James Paper, and with a down market for pulp products, Georgia Pacific is consolidating operations and looking for efficiencies wherever it can find them. The Bellingham facility was a low margin operation last year, prior to the increase in power prices. Cunningham Dep. Georgia Pacific concedes that it has laid off at

least 50 employees in the past year in cost-saving efforts unrelated to power issues. Cunningham Dep. Georgia Pacific has also experienced downtime at the plant because it had to install new environmental equipment. Cunningham Dep. Apparently, some 250 employees are laid off today. It is impossible to tell whether this relates to market-related downtime, efforts to improve efficiency, consolidation efforts by a newly merged company, or something else. But, while employees have been laid off, the company is making hundreds of millions of dollars in profits. Georgia Pacific has demonstrated no emergency.

Georgia-Pacific's management is sophisticated with respect to power prices. First, Georgia Pacific entered into its special contract with PSE in order to gain market-based rates. Then, with PSE's assistance, Georgia Pacific investigated and entered into hedging arrangements. Cunningham Dep. At one point, shortly before the 2000 power price increases, PSE located a hedging instrument that would have locked in Georgia Pacific power prices at just $28 - $32 per MWh for the three-year term. Ultimately, Georgia-Pacific decided against the fixed price in favor of rolling the dice on the power markets.

Now that Georgia Pacific lost its gamble, it is looking for other ways to mitigate its potential losses due to escalating power prices. Georgia-Pacific has leased generators, operating at costs of $110-$150/MWh to partially eliminate its dependence on volatile power market prices. Cunningham Dep. Georgia Pacific has made some bad business decisions, but it faces no emergency.

7. Tesoro

While Tesoro is relatively smaller than most of the other Complainants, it too is a multi-billion dollar petroleum corporation. According to its press releases, Tesoro has enjoyed high margins through the Third Quarter of this year, as a result of the thriving petroleum products market and a tightness of supply in the refining industry on the West Coast. *See* **Ex**. 33. In the Fourth Quarter, margins will still be high. Throughputs have been marginally impacted by the electric prices at Tesoro's Washington refinery, but

throughput in Tesoro's other operations have been increased to make up the difference. Ex. 34.

At his deposition, Tesoro witness Russell Crawford conceded that all Tesoro's employees are still working. He also conceded that Tesoro has found ways to deal with the situation through self-help, shifting some of the load to steam power, and shifting some of the load to leased diesel generators. When asked why Tesoro had not acquired hedges to stabilize the electric prices it pays, Mr. Crawford said: "No. I don't understand them real well. And until I understand it, I wouldn't pursue it." Crawford Dep. at 33, line 13-14.

8. City of Anacortes

The City of Anacortes is not a Fortune 500 company, but like the other Complainants, it will have no problem paying its electric power bills. The City's Schedule 48 load is just around 1 MW. Maxwell Dep., at 6. It uses that Schedule 48 energy for only one purpose: to power its wastewater treatment facility *Id.* About 70% of the plant's capacity serves only two industrial customers: Tesoro and Equilon. *Id.* at 23.

The City can unilaterally raise its rates to cover its rising energy costs. *Id.* Moreover, the City has used self-help. It has acquired diesel; generation and no longer takes power under Schedule 48. Clearly, the City is suffering no injury that constitutes an emergency.

9. Other Schedule 48 Customers

It is important to note that more Schedule 48 customers exist than have complained. Indeed, PSE is aware that some other Schedule 48 and Special Contract customers have taken steps to mitigate high prices.

C. PSE ENERGY RESOURCE MANAGEMENT AND FUTURE RESOURCE NEEDS

As discussed above, the Commission has already held that PSE's actual costs and its energy resource management are irrelevant to the prices charged under Schedule 48 and the Special Contracts. But it is apparent from discovery requests, and the rulings that have resulted, that Complainants intend to put PSE's energy resource management on trial. PSE objects to the inquiry, but if the inquiry is to be conducted, it must respond. Without waiving its objections, following is a review of PSE's energy resource management.

Simply stated, energy resource management involves a balancing of long term procurement to assure the ability to serve core customers at least cost, coupled with shorter term buying and selling to meet the needs of all customers – both core and non-core – in the most efficient manner possible. If, in any hour, PSE has extra resources beyond those needed to serve its load, and if it can sell the output of those resources at more than the incremental cost, then it would be irrational and inefficient not to make the sale. Likewise, if in any hour PSE can purchase extra resources at a cost lower than the marginal cost of operating its existing resources, then it would be inefficient and irrational not to make the purchase.

The situation is complicated further in that sales and purchases can be of different durations. For instance, if PSE expects to be short for a month, it may buy on the market to meet that need. But in a given hour during that month, PSE may find itself long, and thus sell on the market. If the market price in that hour is higher than the monthly price there is an apparent profit for the hour. But if the market price in that hour is lower than the monthly price, there may be an apparent loss for the hour (or is it a gain – it all depends on whether the hourly price is compared to the monthly purchase, or to some other resource in PSE's portfolio). Given such a mix of sales and purchases of varying durations, it is not particularly meaningful to analyze an hourly, daily, or even monthly snapshot of PSE revenues or earnings.

Complicating the mix are numerous elements of variability and risk. The cost of running PSE's thermal resources depend on the price of natural gas or other fuels, prices that have been quite volatile in recent periods. Hydro resources are dependent on water conditions. Any unit can go out, sometimes for a prolonged period, leaving PSE to fend for itself in the market. The bar graphs (originally submitted to the Commission on December 12, 2000 in another docket) reveal some of these potential variations were illustrated. *See* **Ex.** 35. The graphs show PSE's ability to serve its core and non-core loads in both average (A) and critical (C) water conditions. In the case of average water conditions, PSE can generally serve its core customers in 2001 using its lowest-cost resources in the summer, but must resort to resources that vary with market prices in the winter. *See* Deposition of Bill Gaines (PSE), which will be produced by Complainants when it becomes available. To meet the needs of the non-core customers as well in 2001, if it is an average water year, PSE will have to resort to using its highest cost resources – or to purchases on the market. The situation is more difficult in a critical water year – in such a year PSE will have to resort to market-priced resources in virtually all months to serve even its core customers – put another way, PSE could lose money serving its core customers. In such a circumstance, service to non-core customers demands extra resources that can only be had in the market.

If the Commission requires analysis of PSE costs, PSE will introduce evidence showing that this is expected to be a critical water year with limited availability of hydro resources. If those predictions hold up, PSE may well sustain significant unrecovered costs in power procurement and sales in 2001, as it will be obligated to purchase significant amounts of power in the market, but is limited to selling power at the rates specified in the Merger Rate Plan to retail customers. A shift in revenue collection from Schedule 48 and Special Contract Customers would exacerbate that situation. This would be unsustainable, and some mechanism would have to be established to maintain PSE revenues.

III. STATEMENT OF APPLICABLE LAW

A. Emergency Adjudication (RCW 34.05.479 & WAC 490-09-510)

WAC 480-09-510 **Emergency adjudicative proceedings**.

(1) The commission may use emergency adjudicative proceedings pursuant to RCW 34.05.479 to suspend or cancel authority, to require that a dangerous condition be terminated or corrected, or to require immediate action in any situation involving an immediate danger to the public health, safety, or welfare requiring immediate action by the commission. Such situations include, but are not limited to:
(a) Failure to possess insurance;
(b) Inadequate service by a gas, water, or electric company when the inadequacy involves an immediate danger to the public health, safety, or welfare; and
(c) Violations of law, rule, or order related to public safety, when the violation involves an immediate danger to the public health, safety, or welfare.

(2) The commission shall hear the matter and enter an order. If a majority of the commissioners is not available, a commissioner shall hear the matter. If no commissioner is available, a commission administrative law judge shall hear the matter.

(3) The commission's decision shall be based upon the written submissions of the parties and upon oral comments by the parties if the presiding officer has allowed oral comments. The order must include a brief statement of findings of fact, conclusions of law, and justification for the determination of an immediate danger to the public health, safety, or welfare. The order is effective when entered. The commission must serve the order pursuant to WAC 480-09-120.

RCW 34.05.479 **Emergency adjudicative proceedings.**

(1) Unless otherwise provided by law, an agency may use emergency adjudicative proceedings in a situation involving an immediate danger to the public health, safety, or welfare requiring immediate agency action.

(2) The agency may take only such action as is necessary to prevent or avoid the immediate danger to the public health, safety, or welfare that justifies use of emergency adjudication.

(3) The agency shall enter an order, including a brief statement of findings of fact, conclusions of law, and policy reasons for the decision if it is an exercise of the agency's discretion, to justify the determination of an immediate danger and the agency's decision to take the specific action.

(4) The agency shall give such notice as is practicable to persons who are required to comply with the order. The order is effective when entered.

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(5) After entering an order under this section, the agency shall proceed as quickly as feasible to complete any proceedings that would be required if the matter did not involve an immediate danger.

(6) The agency record consists of any documents regarding the matter that were considered or prepared by the agency. The agency shall maintain these documents as its official record.

(7) Unless otherwise required by a provision of law, the agency record need not constitute the exclusive basis for agency action in emergency adjudicative proceedings or for judicial review thereof.

(8) This section shall not apply to agency action taken pursuant to a provision of law that expressly authorizes the agency to issue a cease and desist order. The agency may proceed, alternatively, under that independent authority.

B. Commission Standards for Changing Rates (RCW 80.28.020)

RCW 80.28.020 **Commission to fix just, reasonable, and compensatory rates**.

Whenever the commission shall find, after a hearing had upon its own motion, or upon complaint, that the rates or charges demanded, exacted, charged or collected by any gas company, electrical company or water company, for gas, electricity or water, or in connection therewith, or that the rules, regulations, practices or contracts affecting such rates or charges are unjust, unreasonable, unjustly discriminatory or unduly preferential, or in any wise in violation of the provisions of the law, or that such rates or charges are insufficient to yield a reasonable compensation for the service rendered, the commission shall determine the just, reasonable, or sufficient rates, charges, regulations, practices or contracts to be thereafter observed and in force, and shall fix the same by order.

IV. THE COMMISSION’S QUESTIONS

A. Is the financial ability of individual ratepayers to pay increased costs for electricity a consideration relevant to determine whether there exists an immediate danger to the public health, safety, or welfare? What indices of proof are required to show an individual ratepayer is financially incapable of paying increased costs for electricity so that there exists an immediate danger to the public health, safety, or welfare?

Inability of an individual industrial customer to pay its electric bills does not constitute an emergency under the statute. In any case, all of these customers can pay their

bills. Electric power is only a small factor in Complainants' cost structure. Many of the Complainants are experiencing record years, and the cost of power provided by PSE will be offset by gains in other aspects of their business. Since they are capable of paying the costs, there is no immediate danger to the public that requires Commission action. *See* discussion in Section V.B. of this brief.

B. Must the circumstances that Complainants assert constitute an immediate danger to the public health, safety, or welfare be circumstances beyond the ability of Complainants to cure?

There is no emergency if the affected party has other feasible options. The Complainants could have locked in low power prices, and thereby "cured" the problem they claim exists today, simply by availing themselves of the Optional Price Stability option under their service agreements, or by acquiring hedges or risk management tools on their own. The Complainants also have numerous other opportunities to address their problems, including self-generation, leased generation, improving efficiency, and the buy-sell option which is being offered by PSE. Any "emergency" is of the Complainants own making. *See* Section V.B of this brief.

C. What legal authority does the Commission possess to take the minimum action necessary to prevent or avoid the asserted immediate danger to the public health, safety, or welfare? What does each party assert is the minimum action necessary to prevent or avoid the asserted immediate danger to the public health, safety, or welfare?

The Commission does not possess authority to address the real problem here, which is high prices at the wholesale level. That issue is properly before FERC and is being addressed there by numerous parties, including the Complainants. Further, the Commission should not take action in these proceedings even if it believes it has jurisdiction over the Complaint, since the relief requested would abrogate the Schedule 48 service agreements, the G-P Special Contract, and the Merger Rate Plan, all of which the Commission approved after extensive hearings. Even if the Commission finds an emergency, there is no legal authority to offer interim relief to utility customers. *See* Section V.A of this brief.

D. Is a finding that the rates charged by PSE are unjust, unreasonable, unjustly discriminatory, or unduly preferential a necessary predicate to ordering the relief Complainants request? What indices of proof are required to show the Schedule 48 or Special contract rates are unjust, unreasonable, unjustly discriminatory, or unduly preferential?

The Commission has already found, after extensive hearings in 1996, that Schedule 48 and the G-P Special Contract produce just and reasonable rates. It is Complainants' burden to show otherwise in these proceedings, and it is a significantly heightened burden, as it would require the Commission to unravel and abrogate contractual obligations. Further, as a predicate to ordering relief, the Commission cannot rely on the existence of an "emergency," even assuming one exists (which PSE denies). Any such "emergency" only accelerates adjudication of the Complaint; it does not, by itself, warrant relief. *See* Sections V.B and VI.A of this brief.

E. Is a determination of what rate is a "sufficient" rate a predicate to ordering the relief Complainants request? What rate does each party contend is a sufficient rate to be charged? What indices of proof are required to show the sufficiency of the proposed rate?

The Commission found in 1996 that Schedule 48 and the G-P Special Contract would produce sufficient rates. However, the relief that Complainants request now may well produce rates that are not sufficient. If the Schedule 48 service agreements and the G-P Special Contract are abrogated, and if Complainants are permitted to move to a different rate class such as Schedule 49, the effect of that move on PSE's rates and resources, and the sufficiency of those rates and resources, will be significant. The rate adjustments necessitated by such a move would have to be determined, in these proceedings, by a full-fledged cost inquiry concerning rates charged to all customer classes. *See* Section IX of this brief.

F. By what legal authority can the Commission order an interim, or temporary, rate subject to refund when the regulated company has not filed for a rate change? On what basis(es) may the Commission determine what should be the interim, or temporary, rate?

The Commission does not possess statutory or other authority to order the interim rate relief that Complainants seek. Longstanding precedent in this state holds that such relief is available to utilities only, not to their customers. *See* Section VI of this brief.

G. By what legal authority can the Commission order an interim, or temporary, rate subject to surcharge?

The Commission does not possess statutory or other authority to order the interim rate relief that Complainants seek. Longstanding precedent in this state holds that such relief is available to utilities only, not to their customers. *See* Section VI of this brief.

H. Must an interim, or temporary, rate decrease be determined to be a just, fair, reasonable, and sufficient rate before it is placed into effect?

The Schedule 48 and G-P Special Contract rates have already been determined to be fair, reasonable, and sufficient. Any change to those rates would require new determinations on these standards. However, any such redetermination would abrogate the contracts that were signed in 1996 and the Merger Rate Plan that the Commission approved. *See* Section VII and VIII of this brief.

I. Does the Commission possess any legal authority to require customers of regulated utilities to take specific actions to protect themselves from circumstances such as those Complainants contend now constitute an immediate danger to the public health, safety, or welfare? For example, does the Commission have the authority to order Complainants to seek financial or physical hedges against increased prices when they have elected to purchase power under a rate schedule that includes market-indexed rates?

PSE believes that the Commission may order customers to first seek hedges against price risk before complaining that the prices are too high – such as Complainants are alleging here. The Commission ordered Georgia Pacific this summer to attempt to negotiate Optional Price Stability, and PSE offered price stability options that would have protected against the recent price spikes. The Schedule 48 customers likewise have the option of negotiating Optional Price Stability under their contracts. An appropriate resolution of this proceeding would be the same resolution reached this summer, requiring the customers to avail themselves of the reasonable options that already exist in their contracts.

V. THERE IS NO EMERGENCY UNDER APPLICABLE LAW.

A. While wholesale markets may be yielding unprecedented prices, WUTC has no authority to remedy that situation; FERC does and is investigating and taking steps to resolve the situation.

The core of the Complaint is simple. Back in 1996, Complainants chose to negotiate and take service under Schedule 48 and the Georgia Pacific ("G-P") Special Contract. As Complainants and PSE agreed, each arrangement sets a contract price for energy that is tied to the Dow Jones Mid-Columbia indices. If the Mid-Columbia price is low, Complainants pay less to PSE; if it is high, they pay more. This sharing of risks and benefits between PSE and many of its largest, most sophisticated customers made sense to the Commission when it approved Schedule 48: "[S]ubject to the conditions imposed by this order and the findings herein, [Schedule 48] will result in rates, terms, and conditions which are fair, just, reasonable, and sufficient, and not unlawfully discriminatory."[18]

Analysis of the Complaint depends, therefore, on the level of the Mid-Columbia prices. That is Complainants' entire focus, in fact; they claim that "too high a price" in itself "creates an emergency."[19] But the Mid-Columbia price for electricity is a <u>wholesale</u> price,

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[18] *See WUTC v. Puget Sound Power & Light Company*, Docket No. UE-960696, Order Approving Schedule 48 With Conditions (October 31, 1996) ("Schedule 48 Approval Order"), at 13.

[19] Hearing Transcript, at 73:24-25.

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not a retail price, and Federal law confers exclusive jurisdiction upon the Federal Energy Regulatory Commission ("FERC") to review issues concerning wholesale energy prices in this country.[20]

This is not an abstract notion. As the Commission is aware, FERC is actively considering the issue of escalating wholesale prices right now, in Docket Nos. EL00-95-000, and Docket No. EL01-10-000, discussed above. In fact, Complainants' trade organization, ICNU, has placed before FERC the very issue that it urges this Commission to decide. In a motion filed just recently, ICNU asked FERC to issue an order: "[f]inding that the wholesale prices comprising the Dow Jones Mid-Columbia Indices in the Northwest are unjust and unreasonable."[21] This is the same complaint that Complainants make here, before the Commission.

Since Complainants have placed the Mid-Columbia issue squarely before the FERC, where it belongs, the Commission should decline to consider the issue here. At the December 14, 2000 Prehearing Conference, Chairwoman Showalter commented that "it is beyond the scope of this proceeding or our ability to actually bring those prices down," whereas "it's not beyond FERC's ability."[22] Her observation is correct. Only FERC -- not this Commission -- can remedy high wholesale prices that lead to high Mid-Columbia indices. Any concern about the indices can be voiced before FERC, which is exactly what Complainants are doing right now. Moreover, by deferring to FERC's decision in this regard, the Commission can avoid the possibility of inconsistent determinations – at the Federal and state levels – concerning what qualifies as a just and reasonable Mid-Columbia rate.

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[20] 16 U.S.C. Sec. 824 (1994)

[21] ICNU Motion to Intervene in Docket No. EL00-95-000 (November 22, 2000) at 9.

[22] Hearing Transcript at 41:1-3.

B. Complainants have not shown "immediate danger to public health, safety or welfare requiring immediate action by the Commission."

1. Rising power costs, and resulting cutbacks at a few plants, do not constitute an emergency.

Complainants use the word "emergency" quite liberally to describe their situation.[23] But whether or not an "emergency" might exist at the wholesale level (see discussion above), no "emergency" exists under Washington law.

The Commission's regulation on emergency proceedings (WAC 490-09-510) follows from the statutory authority in RCW 34.05.479. Both the rule and the statute refer to an "immediate danger" to the "public health, safety, or welfare." This test has two components: first, that a danger is immediate, and second, that it threatens the public. It is Complainants' burden, in this proceeding, to show that both components exist.

No such danger exists here. At most, energy prices under the Mid-Columbia inconvenience only a very small group of PSE's customers, perhaps only temporarily. There is absolutely no evidence to suggest that the public is threatened by the current prices under Schedule 48 and the G-P Special Contract. Even if Complainants are feeling a pinch to their bottom line (something that has not been conclusively shown for any of the Complainants), that does not and cannot amount to a public emergency, for the simple reason that only a few customers are impacted. Nothing at all suggests that a slight reduction in profits faced by just a few customers -- all of whom are doing quite well otherwise -- somehow poses the "immediate danger to the Puget Sound area economy" that Complainants argue will occur if the Commission fails to take action.[24]

Moreover, and even if a utility customer's financial condition could somehow qualify as a public emergency, Complainants have not shown that their particular situation is in fact

[23] *See*, *e.g.*, Complaint at 2, l. 8.

[24] *See*, *e.g.*, Complaint at 2, l. 14-15.

dire, let alone that such a predicament has been or will be caused by Schedule 48 or the G-P Special Contract. No evidence suggests that any of the Complainants – most of whom are much, much larger than PSE -- are seriously inconvenienced at all by current rates, much less facing permanent closure or the bankruptcy courts. Certainly a huge company like Boeing, for example, or even a merely giant company like Air Liquide, can easily withstand the "hiccups" presented by the current energy market. Many of the Complainants, ranging from the petroleum refiners, Equilon and Tesoro, to those like Air Liquide and Air Products that operate their own generation facilities, are likely net winners from the increases in energy prices over the past year.

Because they understand that their financial situation does not make a compelling story, the Complainants have attempted to focus attention on the purported energy-related layoffs at several companies. Most of the companies do not report layoffs – many have increased employment and labor costs – but some have reduced employment at local facilities. While we are sympathetic to the plight of any employee who does face hard times, there is no compelling claim that any layoffs flow from power prices alone. The facilities that report layoffs – CNC and Georgia Pacific – are thin margin facilities that routinely increase or decrease workforce levels depending on a variety of factors including market pressures related to their own product markets. For instance, pulp market conditions may well have induced Georgia Pacific to reduce employment at its Bellingham facility this winter in favor of lower cost locations, even if power prices had stayed constant. The fact that Georgia Pacific chose to reduce employment as a cost saving measure at one of its many worldwide facilities simply does not constitute a legally cognizable emergency.

Despite what the Complainants may think, they do not enjoy a superior entitlement to low-cost power – certainly not when the price they pay stems from the very market-based rate they negotiated. In the absence of more substantial evidence, there cannot be an "immediate danger" under RCW 34.05.479 and WAC 480-09-510 simply because energy costs to a few customers may, for now, be trending upward.

2. Any "emergency" that exists is due to Complainants' own business decisions.

On December 12, 2000, PSE wrote to the Commission in response to questions raised by ICNU concerning prices in the Northwest wholesale energy market. In that letter, PSE noted that Complainants had been afforded numerous opportunities to obtain hedges prior to price peaks. PSE has provided its Schedule 48 customers with ongoing information regarding hedging opportunities. PSE has also provided forward price projections to various customers on a weekly basis since August 2000. After last summer's price peaks, prices fell for a time during the fall, providing new opportunities to obtain hedges at more favorable prices. PSE remains willing and committed to working with customers who desire to arrange hedging transactions. To date, however, the Complainants have declined to pursue these opportunities. Their counsel admitted during the December 14, 2000 Prehearing Conference that "at this moment in time, all seven Complainants do not have hedges in place."[25]

Any "emergency" that exists, therefore, is due solely to Complainants' own business decisions, and should not be used as a guise for them to renege on Schedule 48 or the G-P Special Contract. The Commission addressed a similar failure to hedge just this last summer, in a proceeding strikingly similar to the proceedings here. In denying a request for "emergency" relief, brought by two of PSE's special contract customers (including Georgia Pacific, one of the Complainants here), the Commission stated that those customers needed to "accept responsibility" for their decisions, including the decision to use or not to use hedging instruments to mitigate effects of price swings in the Mid-Columbia indices.[26]

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[25] Hearing Transcript at 36:11-13.

[26] *See Bellingham Cold Storage Company, et al. v. Puget Sound Energy, Inc.*, Docket No. UE-001014 ("*Bellingham*"), Order Directing Parties to Negotiate and Denying Motion (July 31, 2000), at 10.

Similarly, the "emergency" that Complainants assert here is of their own making. The facts are extremely compelling. Georgia Pacific, for instance, has conceded it was offered a long-term price stability mechanism that would have guaranteed power prices of $28-$32/MWh. If there is any truth to the claim that employees have lost their jobs because of high power prices, the blame lies directly with those at Georgia Pacific who chose not to enter into the hedge. Likewise, each and every other Complainant has had hedging opportunities – their contracts provide for Optional Price Stability if a customer requests it, and PSE happily provided such stability by obtaining hedge products for any customer that wanted it.

In sum, any "emergency" the Complainants face now is a circumstance that they and they alone created. Just as market volatility was a *risk Complainants accepted* at the inception of Schedule 48 and the G-P Special Contract, a decision not to hedge against market volatility was a decision *voluntarily made by Complainants*. While Complainants may regret that decision in hindsight, it certainly does not provide a legal basis for the extraordinary and unprecedented measure of interim relief.

VI. EVEN IF AN EMERGENCY EXISTS, EMERGENCY ADJUDICATION MEANS ONLY A FASTER PACE OF LITIGATION AND HEARING, NOT A LOWER STANDARD FOR RELIEF.

A. An "emergency" permits the Commission to accelerate adjudication of the Complaint – not to award relief.

It is not sufficient to order relief simply because a problem exists in the power markets. Complainants take this position, i.e., that merely because the Mid-Columbia rates may be "too high," that fact alone creates an emergency and – by itself --requires the Commission to take action.[27] But Complainants are wrong. Staff, Public Counsel, and PSE all assert that an emergency – even if one exists, which PSE denies – simply speeds up the

[27] Hearing Transcript at 73:24-25.

process of determining relief. The emergency does not, by itself, warrant or authorize relief, particularly the remedy that Complainants request of slashing the contractually determined rate to below PSE's cost (see discussion below).[28]

B. The Commission grants interim relief to utilities, not to customers.

The Commission's criteria for granting interim relief apply only to *utilities* when the criteria have been satisfied. Complainants are not a utility, and even if they were, they have not carried the heavy burden to satisfy, and cannot satisfy, those criteria.

These principles are long supported. For years the Commission has referred to utilities in the criteria for granting interim relief: "[t]his Commission has authority in proper circumstances to grant interim relief to a utility" and "the financial health of a utility may decline."[29] The public policy underlying the opportunity for interim relief ensures that *the utility itself* is not in jeopardy, and that interim relief is available to avoid detriments that the emergency would cause *to the utility's ratepayers and shareholders*.[30]

Complainants, however, turn this policy justification upside down. In order to prevent an (unsubstantiated) hardship to their businesses, caused by their <u>own failure</u> to take advantage of the Optional Price Stability mechanisms that PSE would have arranged through the G-P Special Contract or the service agreements under Schedule 48, or that others could have arranged as well for Complainants' benefit, Complainants now seek emergency relief designed to shift the consequence of their bad business decisions over to the <u>utility and its</u>

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[28] Hearing Transcript at 89:9-22, 99: 11-13. For instance, FERC regulations allow expedited proceedings (where expedited action is merited). However, the emergency itself does not create or justify independent relief and relief may only be provided when FERC has found after such expedited proceedings a violation under Section 206 of the Federal Power Act. *See Complaint Procedures,* Order No. 602, III FERC Stats. & Regs. [Regs Preambles] ¶ 31,071, *order on reh'g and clarification*, Order No. 602-A, III FERC Stats. & Regs. [Regs. Preambles] ¶ 31,076, *order on reh'g*, Order No. 602-B, III FERC Stats. & Regs. [Regs. Preambles] ¶ 31,083 (1999).

[29] *Pacific Northwest Bell Telephone Company*, Cause No. U-75-40 at 5, 6 (1975).

[30] *See WUTC v. Pacific Northwest Bell Tel. Co.*, Cause No. U-72-30 (1972).

other customers, including core commercial and residential customers. That is indeed a perverse twist of the criteria concerning interim relief.

Just last summer, in the *Bellingham* proceeding (which also considered the Mid-Columbia indices), the Commission distinguished between utilities and customers for purposes of applying the *Pacific Bell* criteria for interim relief. There, two special contract customers – one of which (Georgia-Pacific) is a Complainant here – sought interim relief after complaining that the Mid-Columbia indices were "broken." However, the Commission found that the customers did not show "that the same basis exists to provide [interim] relief to customers [as to utilities]." The Commission stated that "[its] authority to grant interim relief stems from the constitutional and statutory rights enjoyed by regulated utilities in exchange for their loss of pricing ability and their obligation to provide service." Customers by contrast enjoy no such rights.[31]

The Commission should apply the *Bellingham* rules to these proceedings. The same indices are alleged to be "broken;" the same issues are raised concerning the availability of interim relief; and the same arguments are made that Complainants should be let out of their binding contracts. The Commission should reject these arguments and rely on its precedent, which allows interim relief only to utilities.

VII. COMPLAINANTS HAVE NOT SHOWN THAT THE CHALLENGED RATES ARE "UNJUST, UNREASONABLE, UNJUSTLY DISCRIMINATORY OR UNDULY PREFERENTIAL" AS REQUIRED FOR COMMISSION RATE "FIX[ING]" UNDER RCW 80.28.020.

The Commission already decided that Schedule 48 and the G-P Special Contract are fair, just, and reasonable and in the public interest -- back in 1996. Given the contractual nature of these agreements, and the fact that they provided for an array of costs and benefits that vary over time, with many of the costs having already been incurred, and the benefits

[31] *See Bellingham*, Order Directing Parties to Negotiate and Denying Motion (July 31, 2000) at 9-10.

having already been received, it is utterly inappropriate to perform the just and reasonable inquiry again. If the Commission were to perform that analysis, Complainants have provided no basis for a different finding than the Commission made in 1996.

Schedule 48 was approved as a filed tariff in Docket No. UE-960696. Similarly, the Commission approved the G-P Special Contract in Docket No. UE-960612, with the same force and effect as a filed tariff.[32] These actions have particular legal significance: "Once a utility's tariff is filed and approved, it has the force and effect of law."[33] Thus, when a rate is filed, published and permitted to become effective, it is the only lawful rate until challenged in the manner provided by statute.[34]

Where a complaint challenges the reasonableness of an approved rate, such rate may only be changed if the Commission, after notice and hearing, finds that the approved rates are unjust or unreasonable.[35] The complainants to such a challenge bear the burden of proving that the actions complained of violate the tariff or that the challenged rate is otherwise unreasonable.[36]

In this case, and because the rates under Schedule 48 and the G-P Special Contract represent filed and approved rates, the rates are presumptively just and reasonable despite

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[32] Once the Commission approves a special contract for service, that contract has "the same effect as [a] filed tariff and [is] subject to enforcement, supervision, regulation, and control as such." *See* WAC 480-80-335(3).

[33] *General Tel. Co. v. City of Bothell*, 105 Wn.2d 579, 585 (1986); *Air Liquide America Corp. et al. v. Puget Sound Energy, Inc.*, Docket No. UE-981410, Fifth Supplemental Order Granting Complaint, Ordering Refunds and Other Relief, 1999 Wash. UTC LEXIS 591 at *10-11 (Aug. 3, 1999).

[34] *See Puget Sound Navigation Co. v. Department of Public Works*, 157 Wash. 557, 561-62 (1930), *aff'd.* 160 Wash. 703 (1931).

[35] *See* RCW 80.04.110(1); RCW 80.04.120.

[36] *See, e.g., In re Complaint of AT&T Communications of the Northwest, Inc. v. U S WEST Communications, Inc.*, Docket No. UT-991292, Tenth Supplemental Order, Order Granting Motion to Dismiss (May 19, 2000) at 5; *Kimberly-Clark Tissue Co. v. Puget Sound Energy, Inc.*, Docket No. UG-990619, Fourth Supplemental Order Denying Complaint (May 18, 2000) at 15 ("Kimberly-Clark has failed to show by substantial competent evidence . . . .").

Complainants' unsupported allegations to the contrary. Hence, it is Complainants' burden to offer sufficient evidence to rebut this presumption -- a burden they cannot carry because, in fact, they provide no evidence to substantiate the Complaint. All we know is that Complainants believe that the Schedule 48 and G-P Special Contract rates are too high. That sort of refrain, by a utility customer, is not unusual. But it is a great leap in logic to claim that a high rate somehow equates to an unjust and unreasonable rate, particularly when the customers here negotiated the very rate in question and then signed binding contracts to receive that rate. The Complaint should be dismissed for these reasons.

VIII. COMPLAINANTS HAVE COMMITTED TO CONTRACTUAL OBLIGATIONS THAT PRECLUDE THE REQUESTED RELIEF.

Complainants should not be excused from contractual obligations that they voluntarily negotiated and agreed.

Any financial predicament faced by Complainants, today, arises from a business decision they made in 1996, to request, negotiate, and receive a market-based rate. They negotiated with PSE to develop Schedule 48 and the G-P Special Contract as service offerings, and then freely signed contracts to receive that service. The Complainants' chief negotiator, Mr. Canon, admits that Complainants and PSE negotiated and agreed to Schedule 48 as a "commitment to provide market-based electric rates."[37] That is precisely the point of Schedule 48 and the G-P Special Contract, and what they represented: market-based service offerings, with the force and effect of a contractual commitment on both sides.

The Commission has commented on the scope and purpose of market-based pricing provisions on several occasions, as discussed above, concluding that it was a fair basis for the various contracts. It is of vital importance to recognize that each contract explicitly stated that the risk of market volatility would be put on the customer. And each contract

[37] *See* Affidavit of Kenneth Canon dated December 12, 2000, at Par. 3 (Attachment A to Complaint).

explicitly provided that the purchaser could arrange, if it chose to do so, to acquire Optional Price Stability in order to control the risk of market volatility. This was a fair and balanced arrangement, and the Commission appropriately put it in place.

After Complainants voluntarily sought market rates, and after they assumed the risk of market volatility, they reaped substantial benefits when the market was in their favor. Now they complain when the market is not in their favor. Motivated by self-interest, Complainants want to pull the plug on the deal they struck simply because it suits them financially. PSE believes very strongly that this argument, if accepted, would set a terrible precedent for future contract discussions between PSE and its customers. If a party can back out of a signed contract because it concludes in hindsight that it wishes it had struck a different deal, the contract will be worthless. That is terrible public policy. PSE honors the agreements it signs and expects its customers, including Complainants, to do the same.[38]

IX. THE REQUESTED RELIEF MAY NOT ALLOW PSE TO COLLECT A SUFFICIENT RATE.

In the December 18, 2000 Prehearing Order (at 4), the Commission posed the question of what represents a "sufficient" rate for the service that PSE provides. This issue follows from the Commission's statutory charge, which is to fix just, reasonable, and sufficient utility rates.[39]

The analysis of rate sufficiency is not a simple one, however. If the Schedule 48 service agreements and the G-P Special Contract are abrogated, and if Complainants are

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[38] Basic contract law provides that a party seeking relief under a contract must attempt to mitigate its damages. *See Restatement (Second) of Contracts Sec. 350.* In this case, Complainants all signed service contracts to receive service under Schedule 48 and the G-P Special Contract. They now complain about the "damages" they incur because of contract pricing (based on the Mid-Columbia indices). But as discussed above, Complainants had ample opportunity to hedge against that pricing – in other words, to mitigate their damages. Since Complainants declined to do so for their own reasons, the resulting failure to mitigate losses also bars any relief from this Commission.

[39] *See* RCW 80.28.020 (criterion of sufficiency cited in statute).

permitted to move to a different rate class such as Schedule 49, the effect of that move on PSE's rates and resources may well be significant. As explained above, for example, PSE may well incur significant excess power costs given current and expected hydro conditions and the market's available generation capability. This would come hard on the heels of the relief that Complainants request. Thus, it is very possible that, at the same time that PSE has to spend more for power on a per-unit and absolute basis, it would have to serve that many more customers (the Complainants) with a lot of additional load, since they would all move from non-core to core status. Rates to the overall industrial class, and to other customers, would have to be scrutinized to ensure proper cost recovery and cost allocation. That is usually the purpose of a general rate case, not an expedited proceeding such as this.

The determination of costs is unnecessary in light of the contracts. But, if Complainants want to break their contracts with PSE, move to a different rate, and enjoy the stability of core status, then they have to face the consequences, in these proceedings, of a full-fledged cost inquiry. That is unfortunate, but necessary.

X. THE REQUESTED RELIEF VIOLATES THE FEDERAL FILED RATE DOCTRINE.

In their Complaint, Complainants ask to be placed on Schedule 49, or to have their rates capped at Schedule 49 rates. Under the federal filed rate doctrine, however, the Commission may not shift Complainants to another rate schedule in a manner that does not allow PSE to fully recover its prudently incurred wholesale procurement costs.[40] Shifting Complainants to Schedule 49, or capping their rates at Schedule 49 levels, will not allow PSE to fully recover its prudently incurred wholesale procurement costs, and thus would violate the federal filed rate doctrine.

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[40] *See Nantahala Power & Light Co. v. Thornburg,* 476 U.S. 953, 962-67 ("When FERC sets a rate between a seller of power and a wholesaler as buyer, a State may not exercise its undoubted jurisdiction over retail rates to prevent the wholesaler as seller from recovering the costs of paying the FERC-approved rate"); *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 370-373 (1988) (states "may not bar regulated utilities from passing through to retail customers FERC-mandated wholesale rates").

XI. THE SECOND CLAIM FOR RELIEF IS NOT RIPE FOR ADJUDICATION.

In their Second Claim for Relief, Complainants argue that PSE failed to provide open access to them as allegedly promised. According to the Complaint, they believed that pricing under the Mid-C indices would lead to "complete market access at the end of the five-year service agreements and [the] G-P Special Contract term." Since open access is not yet available, they say, PSE is somehow liable for breach of contract.[41]

There are two major problems with this argument, though: one factual, the other legal. First, it defies credulity for Complainants to claim, as a basis for relief, that PSE failed to deliver open access to them, when what they want now is not access to the open market, but instead a return to core status (via Schedule 49) with the safety and certainty of a fixed rate. This inconsistency in logic became very apparent during the depositions of Complainants' witnesses, when they testified that open access is not really their goal – all they want is lower rates, from PSE.[42]

The second problem is more fundamental. The term of the Schedule 48 service agreements and the G-P Special Contract is not yet over. Thus, even if PSE intends to break some promise relating to the availability of open access (which it denies), we won't know the upshot of that broken promise until after the term ends – and that hasn't happened. A claim that is based on a promise that something will occur, by a date certain, can only be heard if and when that promise has not been kept, i.e. after the date but not before. In these proceedings, at this time, the Second Claim for Relief is most certainly not ready for review. It must therefore be dismissed.

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[41] *See* Complaint at 8-9, Paras. 33-34; Affidavit of Ken Canon, Para. 5.

[42] This inconsistency was also apparent during the December 14, 2000 Prehearing Conference, when Commissioner Hemstad remarked to Complainants' counsel that they probably wouldn't be "very enthused about [open access] at this point," given current market conditions. Counsel agreed that "if we were thrown out on the market today, that would probably not be the best possible day to be thrown out on the market." *See* Hearing Transcript at 67:8-19, 68:14-16.

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XII. **THE REQUESTED RELIEF UPSETS THE MERGER RATE PLAN.**

Complainants would have the Commission upset a decision – the Merger Order in Docket No. UE-960195 -- that (as discussed earlier) carefully balanced the interests of Complainants, PSE, and PSE's other customers, with a "new deal" that blatantly subsidizes Complainants. This is very unfair to PSE and its commercial and residential customers, and is an impairment of PSE's contractual rights.

Schedule 48 and the G-P Special Contract were a key part of the merger proceeding, as ICNU's director, Mr. Canon, admits. The rate plan approved in the Commission's Merger Order – based upon the agreed-upon Merger Rate Plan Stipulation -- factored in very precisely the risks and potential rewards of a five-year rate freeze. In addressing the rate plan, the Commission found that the plan "reflects the implicit balance struck by the stipulating parties between five years of "rate certainty" for [core] customers, and five years of opportunity for the Company to manage its resource costs pressures."[43]

Selectively altering that balance – as Complainants now request – takes away benefits from PSE and its other customers that the Merger Order secured. PSE relied on the Merger Order and agreed to bear (and has borne) the risk of downward market index fluctuations under Schedule 48 and the G-P Special Contract and the other risks inherent in the rate plan under the terms approved in the Merger Order. A change that allows Complainants to keep the benefits they have secured to date under Schedule 48 and the G-P Special Contract, as well as possible benefits in the future (if the index price goes down), but allows them to avoid the current burdens of that rate schedule, is inherently unfair and inequitable.[44]

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[43] Merger Order at 21.

[44] *See FPC v. Sierra Pacific Co.*, 350 U.S. 348 (1955) (the Federal Power Commission was not justified in accepting a tariff filing that abrogated a private contract between the utility and a customer where the utility had voluntarily agreed by contract to a rate affording less than a fair rate of return; having voluntarily entering into such a contract, the party is not entitled to be relieved of its improvident bargain).

In other contexts, the courts have consistently held that, as between shareholders and ratepayers, the "party that bore the risk of loss is the party entitled to the gain" and that "those who bear the financial burden of the particular utility activity should also reap the benefits therefrom."[45] Under the Merger Order, PSE's shareholders have borne and continue to bear the risks of serving Complainants under Schedule 48 and the G-P Special Contract. In exchange, PSE is entitled to the benefits that Schedule 48 and the G-P Special Contract may provide at other times, during periods when PSE is able to manage its resources in a cost-effective manner as contemplated by the Merger Order.

Complainants want PSE to assume a new and different role, however. As noted during the December 14, 2000 Prehearing Conference, Complainants want PSE to become their private banker and bear all of the risk of power market changes, while enormous customers such as Boeing enjoy not only the benefits of risk-free service, but the continued upside potential of possible reductions in wholesale power costs.[46] In essence, Complainants want all of the benefit if the Mid-C goes down, but none of the increased expense if the rate goes up beyond their cap. That's a great deal for these large customers, certainly, but hardly a fair one – and certainly not fair to PSE. While Complainants enjoy risk-free service, PSE will have to bear all the risks of upward movements in the Mid-Columbia <u>and</u> bear the brunt of the continuing rate freeze at the retail level. PSE will be squeezed, much as the large utilities in California are being squeezed.

In fact, it would not be PSE alone that would bear the burdens discussed above. If the various contracts are abrogated so as to reduce the revenues associated with them, the Commission must set up a deferral account, or otherwise devise a mechanism to allocate the

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[45] *Illinois Public Telecom Ass'n v. FCC,* 117 F.3d 555 (D.C. Cir. 1997); *accord Montana Power Co. v. FERC*, 599 F.2d 295 (9th Cir. 1979).

[46] Hearing Transcript at 65:10. Chairwoman Showalter commented during the Prehearing Conference that Complainants' relief, if granted, would essentially make PSE their banker. *See* Hearing Transcript at 80:24-25.

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lost revenues to PSE customers.[47] But such a mechanism would necessarily violate the Merger Rate Plan, by changing the Plan's basic premise: a rate freeze for five years, with a carefully balance of risks and rewards for all of the customer classes. The only way to avoid violating the Plan, then, is to resist Complainants' demand in the first place and not tinker with the Schedule 48 service agreements and the G-P Special Contract long after they were negotiated, signed, and approved.

XIII. CONCLUSION

For the reasons discussed above, the Commission should conclude that there is no emergency justifying invocation of the Commission's emergency procedures. Moreover, as the above discussion makes clear, Complainants also cannot prevail on the merits. Neither PSE nor the Commission and its Staff should be forced to devote endless resources over the coming months to Complainants' repeated attempts to hone these proceedings and find some legal theory that will stick. The Complaint should be dismissed with prejudice.

If the complaint is not dismissed, a full inquiry must be conducted into the impact of Complainants' proposals on rates for all customer classes. The Schedule 48 Order, the Order approving the Special Contract, and the Merger Order created a "non-core" status for these customers. PSE has complied with this Condition by excluding this group of non-core customers in its long-term planning decisions. During the intervening period since these schedules were approved, PSE was under pressure to use the time to match its resource portfolio with the reduced energy needs of the departing class of non-core customers. The Company's current load/resource situation reflects the balance that the Company has been

[47] This is the whole point of the Petition that PSE filed in Docket No. UE-001959, which the Commission has consolidated with the proceedings on the Complaint (for concurrent consideration). As noted in the Petition (at Para. 8), any revenue change would have to be paid by the same industrial customers who chose market-based rates or, ultimately, re-allocated among all of PSE's customers, including its commercial and residential customers. If granted, therefore, the relief that Complainants request would unfairly and unjustly shift revenue responsibility to customers who are not parties to the pending proceedings (since they do not take service under Schedule 48 or the G-P Special Contract), but who will end up bearing the impact of that relief.

able to achieve over time by treating these customers as market-based loads in its resource planning process.

Given the relative balance in the Company's loads and resources -- with the Schedule 48 and Special Contract customers treated as non-core customers priced at market -- and the higher incremental costs of new resources as compared to the costs of the embedded resources (the benefits of which are reserved for the Company's core customers), cost shifting will occur if Schedule 48 and Special Contract customers are allowed to return to "core" status. The PSE resource portfolio belongs to the Company's core customers. If Schedule 48 and Special Contract customers are allowed to share in benefits derived from the resource portfolio, the costs to other customers will have to rise. Such a result would be contrary to the law, and terrible public policy.

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