

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND )  
TRANSPORTATION COMMISSION, )  
Complainant, )  
vs. )  
PUGET SOUND POWER & LIGHT )  
COMPANY, )  
Respondent. )  
..... )

CAUSE NO. U-78-21

SECOND SUPPLEMENTAL  
ORDER  
(Rejecting Tariff Filings  
but authorizing new Filings)

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) ORDER  
PUGET SOUND POWER & LIGHT ) (Rejecting Tariff Filings  
COMPANY, ) but authorizing new Filings)  
Respondent. )  
. . . . . )

Cause No. U-78-21 concerns proposed revisions filed by the Puget Sound Power & Light Company to its tariffs WN U-53 and WN U-58 for electric service rendered in certain areas of the State of Washington. The matter came on regularly for hearing, pursuant to notice duly given, on June 21, 22, 23, and 27, September 19, 20, 21, and 22, November 8 and 17, December 11, 12, 13, 14, 15, and 18, 1978, in Olympia, Washington, December 19, 1978, in Bellevue, Washington, December 21, 1978, in Bellingham and Mount Vernon, Washington, and January 15, 16, 17, 18, 19, and 24, 1979, in Olympia, Washington, before Chairman Robert C. Bailey, Commissioners Elmer C. Huntley and Frank W. Foley, and Administrative Law Judges Tony Cook and John von Reis.

The parties were represented as follows:

COMPLAINANT: WASHINGTON UTILITIES AND  
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## I. SCOPE OF PROCEEDINGS

### A. Purpose and Governing Principles

On April 28, 1978, Puget Sound Power & Light Company, hereinafter identified as "Puget", "company", or "respondent", submitted certain revisions to the rates, charges, and rules in its tariffs WN U-53 and WN U-58 (the submitted revisions are sometimes identified hereafter as "the filings", "the proposed tariff", or "the proposed rates"). The company intended the filed revisions to provide it an annual increase of approximately \$46,500,000 in gross revenues for electric service in Washington.

It appearing that the increased rates and charges the company proposed for electric service rendered might injuriously affect public rights and interests, the Commission suspended the revisions by order dated May 4, 1978. In that same order, the Commission stated its decision to hold such public hearings as might be required concerning the reasonableness and justness of the proposed rates.

By its First Supplemental Order issued May 10, 1978, the Commission instituted an investigation of respondent's books, accounts, practices, records, and activities related to electric service, rates, and revenues. The Commission deemed it necessary to make evaluation or appraisal of respondent's property and to investigate and appraise various phases of respondent's operations.

The company had last filed general rate increase revisions to its tariffs on January 2, 1976. The Commission treated those filed revisions in Cause No. U-76-1. By its Second Supplemental Order issued September 27, 1976, in that cause, the Commission determined that the company was entitled to raise its rates sufficiently to permit an annual gross revenue increase of \$28,175,382. Those rates went into effect in October, 1976.

The ultimate question to be determined in this matter is whether the rates and charges proposed in respondent's revised tariffs WN U-53 and WN U-58 are fair, just, sufficient, and reasonable. The resolution of this question depends on establishing the fair value of respondent's property, determining

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<sup>1</sup> Jolene Unsoeld was the principal representative of Fair Electric Rates Now. At certain points in the proceeding Fair Electric Rates Now was represented by Hank Henry, Chairman, or by Martha Russell.

the proper rate of return permitted respondent on that property, and then ascertaining the appropriate spread of rates charged company customers to recover the return.

In determining the fair value to be ascribed to a utility's property in service (rate base), the Commission measures rate base components according to average original cost established during a recent 12-month actual operating period and then compares the rate base measurements with pro forma results of operations conducted during the same test period. Rate of return expressed as a percentage of rate base is the amount of income a company is permitted to earn after taxes and operating expenses. Determination of a fair rate of return must be aimed at providing satisfactory and efficient service to the public at the lowest rates consistent with protection of the company's capacity to function, progress, and provide that measure of service. The company must be authorized a return sufficient to enable it to maintain its financial integrity, attract capital on reasonable terms, and appropriately compensate investors for the use of their money.

A public service company is entitled to earn net operating income equivalent to the product of the rate base times the fair rate of return. A net operating income deficiency from a level fairly prescribed, when that deficiency is raised to gross revenue, indicates the deficiency to be corrected by a rate increase. Any such increase must be equitably allocated among ratepayers.

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

- (1) An appropriate rate base;
- (2) The fair rate of return thereon;
- (3) Results of operations from an appropriate test period;
- (4) The amount of gross revenue deficiency, if any, to be corrected by a rate increase; and
- (5) The spread of such increase through the company's rate and tariff structures.

The burden of proving that the proposed increase is just and reasonable is upon the public service company (RCW 80.04.130). The burden of proving that the presently effective rates are unreasonable rests upon any party attacking those rates, State Ex Rel, Seattle v. Public Service Commission, 76 Wn 492, 136 P. 850 (1913); North Coast Power Co. v. Kuykendall, 117 Wn 563, 201 P. 780 (1921); State Ex Rel, Model Water & Light Supply Company v. Department of Public Service, 119 Wn 24, 90 P. 243 (1939).

B. Witnesses

Puget, having had the burden of proof at the hearings held in this cause, presented evidence intended to show that the proposed rates and charges were just and reasonable. Mr. John W. Ellis, president and chief executive officer of the company, Mr. Bruce M. Holm, controller, Mr. David H. Knight, vice president for power supply, Mr. John H. King, vice president for finance, and Mr. Richard H. Swartzell, director of marketing and rates, testified on Puget's behalf during the company's case in chief. Mr. Holm, Mr. Knight, Mr. Swartzell, and Mr. King, as well as Robert V. Meyers, company director of nuclear plant operations-planning, and Dr. Kent Anderson, senior consultant at National Economic Research Associates, testified for the company during its rebuttal case.

Mr. David A. Kosh, president of Kosh, Louiselle, Lurito and Associates, Incorporated, public utility consultants of Arlington, Virginia, Mr. George F. Hess, a public utility consultant, Mr. Michael P. McElliott, and Mr. Fred Jala, staff accounting analysts, and Mr. Lester Leslie, utilities engineer, testified on behalf of the Commission staff.

Intervenor People's Organization of Washington for Energy Resources (hereinafter identified as "POWER") produced three witnesses, Dr. Robert Halverson, professor of economics at the University of Washington, Dr. Frederick Wells, an economist from Bethesda, Maryland, and Dennis Bloom, a community organizer for POWER. Intervenor Fair Electric Rates Now (hereinafter referred to as "FERN") offered two witnesses, Ronald Knecht, senior engineering economist for the California Energy Commission, Sacramento, California, and Dr. Neils Skov, a professor from The Evergreen State College, Olympia, Washington. Intervenor Weyerhaeuser Company offered the testimony of Dr. Herschel Jones, from the Bellevue, Washington, consulting firm of CH2M Hill; the bulk of Dr. Jones substantive testimony was excluded.

Counsel for the public offered the testimony of two witnesses, Dr. Joseph Rothberg, a professor of physics from the University of Washington, and Dr. W.R.Z. Willey, a staff economist with the Environmental Defense Fund, Berkeley, California. Counsel for the public also sponsored the testimony of 107 below-listed public witnesses:

Terence Wold	Ed Gerrick	Jim Lazar
David Groves	Jerry Graser	Dave Howard
George L. Barner, Jr.	Cally Wilson	Virgil Keller
Darwin Droddy	Charles Stephens	Martha Russell
Becky Liebman	Jolene Unsoeld	Frank Lacy
Thomas F. Sparling	Walter S. Gordon	A. D. Worthington
Daniel Gene Bolser	Joan Hohl	Harold E. Jones
Joan O. George	Fred Daniells	Alan B. Shepard
Beverly Johnson	Lenus Westman	Thorun Robel
Lloyd Martin	Vearlee Call	Joseph I. Ritschel
James A. Pettit	James Benham	Domenick J. Romeo
John Affolter	D. F. Plummer	Patrick Burns
Earl McIntosh	Bob Waters	John Foley
Dennis Bloom	Brian Siebel	Herb McElroy
Harold Bartram	Ralph Rogers	Freida Hoops
Dean Kahn	Sandy Bishop	Robert G. Merth

Jon Steven Schaller	Tom Hiegler	Mary Kay Becker
Don Keenan	Joseph Green	Scott Rushing
Don Irby	Glen Sims	Denise Read
Dobbs Anderson	Michael Waite	Lucinda Hites
Chris Swift	Lloyd Halladay	Hue Beattie
Truston Cannon	Roy Gillespie	Harvey Pottle
Thomas Stitt	Ernest W. Limbacher	Charles C. Johnson
Mrs. T. Cummings	Ruth Hilliard	C. Wendy Williams
Rennie Kessler	Owl Swan Free Eagle	Paul C. Reimers
Darlene Cody	No Guns Antoinette	Bob Eastman
George Davis	Radice	Lari Kackman
Sherry Jancaitis	Mark Heckman	Dennis Smith
Michael T. Downes	Rita Sodt	Kaye Herzer
Joseph Murphy	Ron Carstens	Richard Dildine
Cheryl Harrison	John Smith	Stan Knapp
Nick Luvera	Mary Steel	Ralph Young
Pat Chaves	Gene Schuh	Dean Benston
Chilton Ryan	Olaf Olsen	Zell Young
Helen Day	Helen Murphy	Steve Overstreet
Phil Watson	Carl Pearson	Robert Matthews
Sophie Neble	Gretchen Williams	Al Swan

### C. Issues

In the course of this proceeding the company raised issues concerning its rate base, its fair rate of return thereon, its results of operations, and its rate structure. In its main case, the company contended that it should be authorized to raise rates by an amount sufficient to produce added annual gross revenues of approximately \$46,500,000. In its rebuttal case, the company modified its initial position to the extent that it now requests authorization to raise rates by an amount sufficient to produce added annual gross revenues of approximately \$41,900,000.

The company seeks the largest portion of the instant rate increase to permit it to recover increased purchased power costs for eight electric generating units coming into service from mid-1978 to mid-1979 at the Rock Island Dam. Though the company does not own these eight units, it has contracted to obtain 100 percent of their output through the year 2000, together with certain rights to the units' output after that year. Puget requests that the Commission recognize these increased power costs as of January 12, 1979, the average in-service date for the eight units. The company also contends that its cost of money, and therefore its cost of necessary financing, has increased significantly. The company also seeks to increase the allowable amount for carrying costs, including construction work in progress, ("CWIP") of thermal projects which the company represents as being now under construction but not anticipated to generate power in the near term future. The rate request also includes increases intended to offset the effects of inflation, to reflect increased expenditures for employee wages and benefits, and to parallel increases in items such as depreciation and postage costs.

Staff challenged certain company contentions regarding rate base, fair rate of return thereon, results of operations

during the test year, and rate structure. The summary recommendation of the staff case is that the company be authorized to increase annual gross revenues by no more than \$31,692,036 or \$30,606,820, depending on alternate staff propositions for treating Rock Island generating facility expenses.

One major item in the staff case was a challenge to the company's proposal that the level of return on the company's job development investment tax credit be set at a rate equivalent to the company's allowed return on equity rather than, as the staff contended, at the company's overall rate of return. Another item opposed by staff was a substantial increase in the amount of revenues the company might be expected to derive from construction work in progress. Staff contended that the company had likewise understated revenues or overstated expenses on major items such as sales for resale, power costs, various tax costs and benefits, and other items listed on Table VI. On rebuttal, the company conceded many staff adjustments but maintained contentions on five updated items, with the effect that the company's test year net operating income stated in its rebuttal case was some \$550,000 lower than that proposed in its case in chief.

Staff and company disagreements on rate base components reflected in Tables I and II below and including disputes on such major items as construction work in progress, customer advances for construction, accumulated deferred income taxes, and a recently purchased transmission line, result in the somewhat unusual circumstance that staff contends the company's rate base is substantially larger than the company represents it to be. The apparent anomaly results from divergent positions on construction work in progress and is more than offset by elements included in results of operation and rate of return.

On rate of return, company and staff initially disagreed on percentage components of capital structure and on resultant cost and weighted cost rates. After completion of the rebuttal case, the only substantive return issue remaining is the treatment of average accumulated deferred investment tax credits. Company and staff also differ on the amount of demand charge the company may properly levy against various customer classes.

Intervenor POWER'S major issues were rate design and spread, and construction work in progress. Though the Commission in Cause No. U-78-05 is presently considering the possible redesign of rates for all private electric utilities providing service in the State of Washington, POWER contends that the Commission not only may consider rate restructuring for Puget in the present case but should specifically consider and implement such restructuring. POWER has contended for lower customer service charges, inverted or flat rate blocks, distribution costs levied on a kilowatt per hour basis rather than on a service basis, LRIC pricing, and a rate structure reflecting the circumstances of low and fixed income people.

In regard to construction work in progress, POWER questions the amount of construction undertaken by the company, the reliability of the company's forecasts, and the propriety of CWIP being authorized for projects not sited, licensed or approved. POWER contends the projects under construction are not "used and useful" and that certain specific items in the Skagit CWIP amount are advertising rather than construction expenses. POWER also contends that certain club dues and similar expenditures are not made for prompt and expeditious service and therefore are not properly expenses chargeable to ratepayers.

Intervenor FERN stresses that investment and construction work in progress for unlicensed thermal generating facilities should be deferred and also advances several issues in regard to conservation: That new electric space heating hookups should be given only on the condition that residences are insulated; that long run incremental cost pricing should be imposed on the rate structure; that space heating should be discouraged; and that conservation efforts should be an element of rate base.

Intervenor Weyerhaeuser Company contends that the rate spread should not impose a disproportionate share of any increase on large general service customers and that rate spread issues should be treated in Cause No. U-78-05 rather than in the instant proceeding. These intervenors also contend that the staff recommendation that the customer demand charge be lowered would cause a shift increasing the burden to large general service customers and should similarly be disallowed.

The attorney for the public states that, as a base, the Commission should accept the staff position, and working from that, reject all construction work in progress, disallow expenditures for items such as club memberships, and disallow certain advertising expenditures. The contention most advanced by members of the public testifying individually was that construction work in progress should be abandoned as a charge to customers. Witnesses advanced many grounds for this contention, ranging from the position that construction work in progress represents an improper shift of risk from investors to rate payers, drawing from the latter an involuntary capital contribution without any ownership, return, or other compensation therefor, to the argument that nuclear generating facilities are inherently unsafe and are therefore impliedly imprudent projects. Some members of the public contended that no increase whatsoever should be granted. Others urged the Commission to consider particularly the circumstances of people on poverty level or fixed incomes. Some members of the public stated that, given the effects of inflation, the company should receive a justifiable increase. Contentions were raised as to seeming disparities between apartment and other residentially oriented rates. Some public members advocated specific conservation measures or alternate energy sources. One witness spoke to the cost of extending service to isolated residences.

On rebuttal, the company, in addition to challenging certain staff positions, opposed certain contentions advanced by intervenors and members of the public, notably regarding CWIP and rate structure.

## II. TEST YEAR

Selecting a recent actual 12-month period as the test year and making restating, normalizing, and pro forma adjustments for that year is an approach consistent with the Commission's past practice in cases involving electric and other public utilities. The Commission has accepted the 12-month period ending December 31, 1977, as the test year for examining Puget's operations. The record indicates that this test year is appropriate. The Commission will analyze a properly restated and proformed test year. The Commission considers this method of analysis to be a reliable and consistent basis for establishing rates in electric and other utility cases, because it presents comparison of actual results of operations for a specified period with actual rate base values outstanding for the same period.

## III. RATE BASE

### A. Rate Base Comparison

Staff advanced a regular and an alternate form for rate base treatment of the added Rock Island generating facilities. Table I below shows differences between main case company and staff positions. Table II shows differences between the company and staff remaining after completion of the rebuttal cases. Each table at the bottom reflects the result which would obtain if the staff alternate treatment of Rock Island expenses were accepted. Should the contention that CWIP be completely eliminated from rate base be adopted, the figure in the staff column for adjustment P-23 on Table I would become \$000.00 with resultant changes in pro forma rate base in the two tables. Should the other outstanding CWIP contention, that CWIP be granted only for licensed, sited and approved plants be granted, the staff column figure would change dependent on the plants included, again with resultant rate base changes. Specific rate base items are treated in following subsections.

TABLE I

RATE BASE - ACTUAL AND PRO FORMA (Avg. of Mo. Avgs.)  
For the Year Ended December 31, 1977

	<u>Company</u>	<u>Staff</u>	<u>Difference Staff Greater</u>
ility Plant in Service, ant Held for Future Use, WIP in Service	\$828,008,699	\$828,008,760	\$ 61
Less:			
Accumulated Provision for Depreciation and Amorti- zation	131,975,285	131,975,285	-
Accumulated Deferred In- come Taxes	7,723,625	8,838,000*	1,114,375
Liberalized Depreciation Customer Advances for Construction	-	5,306,741	5,306,741
Rate Base - Actual	688,309,789	681,888,734	(6,421,055)
Adjustments			
RA-1 Health Insurance Re- fund	-	(61,037)	(61,037)
RA-4 Overhead Expense in Prior Cases	-	(24,313)	(24,313)
RA-9 Property Not Held For Future Use	-	(61,543)	(61,543)
P-5 Power Costs	400,000	400,000	-
P-15 Depreciation Reserve	-	(931,893)	(931,893)
P-22 Production Property	(20,993,485)	(20,993,485)	-
P-23 CWIP Major Projects	42,996,172	86,978,518	43,982,346
Non Revenue Items	2,076,983	-	(2,076,983)
Rate Base - Pro Forma	<u>\$712,789,459</u>	<u>\$747,194,981</u>	<u>\$34,405,522</u>
Alternative Treatment for Rock Island		(6,810,000)	(6,810,000)
Rate Base - Pro Forma - Alternative	<u>\$712,789,459</u>	<u>\$740,384,981</u>	<u>\$27,595,522</u>
Year End Balance			

TABLE II

RATE BASE - PRO FORMA PER REBUTTAL  
12 Months Ended 12-31-77

	<u>Company</u>	<u>Staff</u>	<u>Difference Staff Greater</u>
Actual Average Rate Base - Pro Forma	\$ 747,194,981	\$747,194,981	\$ -
Pro Forma Adjustments per Rebuttal			
I.P. Transmission Line	1,558,615	-	(1,558,615)
CWIP Major Projects	(53,214,952)	-	53,214,952
Accumulated Deferred Income Taxes	1,114,375	-	(1,114,375)
Contested Pro Forma Rate Base	<u>\$ 696,653,019</u>	<u>\$747,194,981</u>	<u>\$50,541,962</u>
Contested Pro Forma Rate Base - Alternative Rock Island	<u>\$ 696,653,019</u>	<u>\$740,384,981</u>	<u>\$43,731,962</u>

Puget's actual test year rate base, composed of utility plant in service, plant held for future use, and CWIP in service, as corrected by the staff, is \$828,008,760. To this figure, the company proposed adjustments for accumulated provision for depreciation and amortization, power costs, and production property, in which staff concurred. Staff proposed adjustments for customer advances for construction, health insurance refund, overhead expenses incurred in prior rate cases, property not held for future use, and depreciation reserve, and also proposed elimination of a company adjustment for nonrevenue items, all of which, except for the I.P. Transmission Line, were acceded by the company. These items, reflected in Table I above, were not challenged by other parties. The Commission, on the basis of the record, accepts the adjustments specified above in this paragraph. The Commission's determinations regarding contested rate base items are set forth in succeeding sections.

B. IP Transmission Line

The IP Transmission Line was originally built by the Chicago, Milwaukee, St. Paul and Pacific Railroad to serve an electric railway operating in the Cascade Mountains. The railroad company discontinued the electric railway and subsequently leased the IP line to Puget for power transmission. In December, 1976, Puget and the railroad company completed an agreement by which Puget purchased the IP line. Ownership of the line changed in August, 1977, during the test year in this case. Before August, 1977, Puget paid rent on the line. Puget used the line throughout the year. Its usage rights to the line did not change during the year. The line produced revenue for Puget in all months of the test year. There has been some growth in areas directly served by the line.

Staff, recognizing no rental expense or operating cost for the line, suggests that the line be included in rate base but proformed for only one month (December) of the test year. Staff suggests that to do otherwise would permit the company to improperly benefit from having the item in the rate base and at the same time collecting for AFUDC on the line.

The company suggests that the item be included in the rate base for the entire test year to avoid a mismatch with revenues. The company claimed no rental or similar expenses for the line in this case. The company takes the position that the amount which staff says is AFUDC is more likely maintenance in plant investment expense associated with the line. The company also alleges that if the item had been included as a leased item through August, 1977, effect on revenue requirement during the test year would not have materially varied.

Aside from difficulty in ascertaining the basis for staff's contention that this item should be included in test year rate base only for December, 1977, it may be said that staff is attempting to treat the IP line as though it were a new revenue-producing major transmission facility constructed by the company and brought on line during the test year. That approach does not fit the facts of the company's involvement with the line. The line is not a new item and has produced revenue throughout the year. The company's power to operate the line has not changed during the year. To adopt the staff position would be to create a mismatch between revenues and expenses for this item and would incompletely and inaccurately reflect Puget's operation and ownership of the line. The Commission accepts the company position on the IP line.

#### C. Accumulated Deferred Income Taxes (Liberalized Depreciation)

The item here at issue between company and staff is the treatment as a rate base deduction of a reserve for deferred taxes due to accelerated depreciation. The company suggests that the reserve should be calculated on an average of monthly averages basis while staff contends that it should be included on a year-end basis. The company contends that there is no justification for including the reserve at its year-end amount if company plant is also not included at its year-end amount. Staff suggests that the reserve exists only because of an Internal Revenue Service constraint on showing actual taxes as a cost of service and that reflection of actual taxes is in this instance of more significance than is adherence to a principle of consistency. Staff also notes that to use year-end plant would assume a nonexistent ability to trace funds from this reserve.

The Commission determined in Cause No. U-77-87, Washington Utilities and Transportation Commission v. Pacific Northwest Bell Telephone Company, that year-end rate base treatment of accumulated deferred income taxes provides an equitable sharing of tax deferral benefits between stockholders and rate-payers, that because of the IRS constraint the treatment is not inconsistent with the goal of proper matching of rate base with

revenues and expenses, and that shareholder interests are not confiscated. The principles stated in Cause No. U-77-87 are applicable to resolution of the accumulated deferred income tax item in the instant matter. The Commission will adopt the treatment advocated by staff.

#### D. Rate Base Treatment of Rock Island

The largest dollar issue the company advances in this case is the necessity of including in the company's rates and charges the costs of additional power provided for the company's system by new hydro generators going into service at the Rock Island Dam on the Columbia River. The company is adding production from eight generating units which have been and are being brought into service on an intermittent basis from mid-1978 through mid-1979. The dam and these eight generating units are owned by the Chelan County Public Utility District. Puget has contracted for all the output of these eight new units from the times they are brought in service through the year 2000. The agreement between Puget and the Chelan County Public Utility District provides that Puget's debt service payments are to be deferred until July 1, 1979, after which date Puget is to begin paying the Public Utility District for annual debt service costs.

The Federal Energy Regulatory Commission established the average in-service date for all eight generating units as January 12, 1979. Under the Federal Energy Regulatory Commission offset method, 100 percent of expenses would ordinarily be charged to operations from the average in-service date. Nevertheless, Puget began accruing debt service charges in 1978, charging these costs to operating expenses. Revenues relating to the accrued debt service charges have been derived from rates established in the company's last previous rate request proceeding, Cause No. U-76-1, though the Commission did not then consider inclusion of the new Rock Island generating facilities in the company's rate structure. The facilities are not reflected in present rates. Rates made effective as a result of determinations in this proceeding will reflect, among other items, costs associated with the new Rock Island generating units, and such rates will presumably go into effect substantially earlier than July 1, 1979. Debt service cost comprises the largest single portion of all costs incurred by the new generating units. Operation and maintenance expenses are approximately one mill per kilowatt hour out of a total price of 23 mills per kilowatt hour.

Staff argues that accumulated deferred credits from company accruals should be credited to ratepayers rather than to investors because expenses charged in excess of actual payments recover from ratepayers amounts not actually paid by the company for long periods of time. Staff contends that inasmuch as Puget's present power cost allowance is greater than one mill per kilowatt hour, ratepayers must be paying at least some debt costs. Staff says that expenses come ahead of profits, that the item is not a working capital item because it is not an operation and maintenance charge and because it will be kept in diminishing amounts for a period of 28 years, and further, that the company has received upward pro forma adjustments in the past in connection with out-of-period events involving major generating facilities.

The company suggests that ratepayers do not pay debt service costs until new rates go into effect and that the accrual is a working capital accrual, that the treatment suggested by staff is contrary to Commission principle, that the funds come from eroded earnings, that power costs have inflated since 1976, and that the challenged item is a prepaid expense which will occur after the present case is closed.

Initially, the Commission commends the company for prudently seeking out, developing, and making available to its customers the substantial new source of hydro power which these generators represent. The enhancement of the company's ability to meet peak demand is consistent with the company's public service obligations.

More specifically, the Commission agrees that the item is, though not working capital, a prepaid expense and that it is an item which was provided by shareholders rather than by ratepayers. In so doing the Commission does not abandon the concept of upward or downward pro forma adjustments to rate base to reflect out-of-period events affecting major generating or transmission facilities in appropriate circumstances. The Commission also rejects as impractical any suggestion in the present case that implementation of new rates be bifurcated in time to coincide with the initiation of Rock Island debt service payments by Puget. The Commission adopts the company treatment of Rock Island power costs and rejects the staff proposed alternate treatment method.

#### E. Construction Work In Progress

To permit a company such as Puget to include construction work in progress in rate base is to authorize it to obtain from present rates and tariffs revenues specifically authorized for allocation to the financing costs of constructing major electric generating or associated transmission projects, the funds to be paid out before the in-service dates of projects so recognized. In recent years, each of the three investor-owned utilities in the State of Washington has begun a massive thermal generating facility construction program. Each utility in the course of its program has incurred unprecedented construction financing costs, and each faces the prospect of continued construction cost escalation for the foreseeable future. The Commission for over three years has recognized the companies' financial burden by permitting partial inclusion of construction work in progress in test year rate base.

The Commission had historically treated rate base as consisting only of plant actually in service, which is that plant used to provide present ratepayers with whatever service the particular utility furnishes. The Commission had likewise used rate base so defined to determine the amount of return permitted a utility's common shareholders. Beginning in Cause No. U-75-24 and continuing to date, however, the Commission has acknowledged the need for an exception to the historic definition of rate base in the case of electric utilities facing massive long-term construction expenditures for production and transmission plant.

The Commission, presented with a comparative analysis of construction work in progress impacts on all major investor-owned electric, gas, and telephone utilities in the state, determined in Cause No. U-75-24 that the Pacific Power & Light Company, respondent therein, should be permitted to include in its test year rate base construction work in progress for major production and associated transmission plant offset by adding to test year operating results a proformed amount representing an allowance for funds used during construction ("AFUDC") of the projects so authorized for inclusion. In doing so, the Commission recognized the necessity of transferring some of the burden of current plant financing from future investors to present ratepayers. The Commission determined that to permit recoupment of the level of earnings necessary to maintain credit adequate for the financing of major production and associated transmission construction programs in the case of certain electric companies, a level not being provided by allowance for funds used during construction, an electric company could include in rate base construction work in progress if offset by AFUDC, but only where the demonstrated cost of such construction stood at a "dramatic" percentage of net utility plant, and where the magnitude of construction costs represented a substantial increase from previous levels of construction financing undertaken by the company. In subsequent cases, the Commission applied the principles set forth in Cause No. U-75-24 to the circumstances of The Washington Water Power Company and Puget Sound Power & Light Company and determined that those two companies should be permitted to include construction work in progress in rate base offset by AFUDC in test year results of operations. In Cause No. U-77-25, the Commission determined the propriety of continuing recognition of an electric company's construction financing burden when such burden continued at levels previously recognized as sufficient to justify the inclusion of construction work. The Commission method of offsetting allowed construction work in progress by recognition of AFUDC apportions financing costs of current plant construction between current ratepayers and future ratepayers, with the great bulk of costs to be borne by future ratepayers. The method does permit shareholders some return on plant under construction.

The inclusion of part of CWIP in rate base, by which the Commission has treated an extant problem in traditional financing of massive electric production and associated transmission facility construction, has come under strenuous attack in the instant case. On the one hand, Puget has contended for a decrease in the AFUDC offset employed in the Commission's calculation method, which decrease would result in a sharp increase in the portion of the construction financing burden borne by present ratepayers. On the other hand, intervenors POWER and FERN and counsel for the public have contended that no construction work in progress whatsoever should be permitted in test year rate base or, alternately, that only construction work in progress for licensed and sited facilities should be permitted. Staff recommends a continuation of the Commission's previously adopted method of treating CWIP. For reasons set forth below, the Commission is of the opinion that its previous method of apportioning the cost of financing Puget's construction program between present and future ratepayers should apply in the present matter.

An effective increase in construction work in progress over the amount the Commission has heretofore authorized could not be permitted absent a showing that included as one element a demonstration that the company could not finance its construction program under the method previously adopted by the Commission. There is nothing in the present record to show that adherence to the Commission's established method of treating construction work in progress would render the company unable to finance its construction program.

The company in its rebuttal case contended that retention of the present method of allocating CWIP costs would prevent the company from earning the rate of return advocated by staff in this proceeding. The company based its contention on a 1979 cash flow demonstration depicted in Exhibit 115. That exhibit, tantamount to a forecast test year, is not readily verifiable and is totally insufficient to meet the company's burden on the issue. The exhibit is a composite of estimates of events, revenues, and expenditures made by persons not offered as witnesses in the instant proceeding. The events included will not occur, in the main, until after this order issues; moreover, the events cannot be precisely calculated from present data. No meaningful comparison between the events hypothesized in Exhibit 115 and known and measured events from prior periods can be made. Details of expenses are lacking and, contrary to Commission rule, effects of anticipated inflation are included. Demonstration of an insurmountable construction financing burden, given application of the present Commission CWIP method to an electric utility's test year rate base, is an indispensable element of any demonstration of the present method's unacceptability, and no such demonstration has been reliably made in the instant record.

Intervenors POWER and FERN and counsel for the public contend that construction work in progress should not be included as a rate base item. They advance several reasons in support of the position. Some of the reasons are concerned with the nature of the charge to be allocated to present ratepayers, while others focus on the propriety of the projects to be built. Concerns with the type of charge levied against ratepayers include construction work in progress as a form of present payment for future use, the uncertainty attendant upon contribution for a project not yet in service, the inefficiency of the method as a fund raiser due to tax effect, and characterization of the item as an involuntary capital contribution offering no ownership or return to the contributor.

Concerns related to the projects include a contended lack of need for the projects, the posited existence of alternate energy producing or conserving methods and a specific objection, on safety grounds, to nuclear power. It is true that not all present ratepayers will benefit from power produced by the projects for which Puget herein seeks rate base inclusion. However, the continuation of the construction program and the company's ability to finance that program, including its ability to maintain debt coverages, reflect generally on the company's ability to finance for present as well as for future customers.

It is not arguable that a plant in service is a more reliable object of funding than is a plant under construction, and service from projects under construction cannot now be flatly guaranteed. However, the likelihood of a needed project's being timely completed is influenced by a utility's ability to raise capital for the project and by a regulatory body's creating a climate which is not inhospitable to the funding of such necessary construction. In other words, the act of funding financing costs of CWIP in some measure enhances the certainty of the project's completion.

As to rate base inclusion of CWIP being an inefficient method of raising funds the criticism is no different from that which could be levied at any other item in the present case. Having for over three years acknowledged the exceptional circumstances of electric utilities which require the inclusion of construction work in progress in rate base, the Commission is nonetheless powerless to accord this item any separate treatment as to tax consequences.

Increased revenues resulting from construction work in progress have been termed an involuntary capital contribution. The Commission recognizes the involuntary nature, but once the propriety of the contribution has been determined it is in no sense more an involuntary item than is any other item leading to an increase in the company's rates. Also, the Commission notes that some benefit does flow from the contribution in that company financing is given stability, and that gradually ascending contributions during the course of construction of major generating and associated transmission projects not only avoid sharp increases at future in-service dates but will result (as has been described in previous Commission orders) in lower overall rates than would be the case should no project costs be recovered before in-service dates.

Relying notably on a forecast presented by Dr. Robert Halverson, intervenor POWER contended that there was no need for a construction program of the magnitude which Puget has undertaken. Assuming without so deciding that the contention has a proper legal base for Commission decision, the forecast presented by Dr. Halverson is unreliable on several grounds. Dr. Halverson's forecast is not an independent forecast for Puget but rather a composite of a review of a Puget forecast and certain statewide projections. More specifically, Dr. Halverson projected energy loads for 1980 and peak loads for 1984 which accorded with actual 1978 energy and peak load demands experienced by the company. Even if Dr. Halverson's forecast were taken at face value, there would be very little margin afforded the company in meeting its service obligations.

The determination that investment in a particular generating project under construction is a prudent investment is implied in any determination that construction work in progress should be included in rate base. In light of those projections available to the Commission which build most closely on the company's actual operating experience, the Commission must conclude that the investment herein proposed is prudent. In regard to the Skagit project, the Thermal Power Plant Site

Evaluation Council of the State of Washington has previously determined a specific need for the project in meeting future demand from company customers. It is conceivable, though remote, that circumstances might arise wherein a project for which a need had been determined could at a later point be found to be not a prudent object of investment, but certainly no such showing has been made on the instant record.

Regarding alternate methods, the Commission heard evidence both as to alternate sources of electricity and as to conservation. In regard to methods and devices, discussion was had on some sources which may prove functional in warmer, sunnier climates such as California but which in climatological conditions such as those experienced in Puget Sound were not demonstrated to be effective. Solar power, wind power, and other such alternatives remain objects of keen interest to the Commission, but no reliable cost effective method was demonstrated on the instant record.

Puget has increased its activities in the conservation area, having recently embarked on a program to fund energy saving improvements in the homes of residential customers. The Commission does not see in the instant record any specific improvement in the company conservation program which can be implemented with sufficient rapidity to offset the urgent need for completion of the company's construction program. However, there is a considerable effort which should be made in both conservation and in alternate generation for which the Commission could offer the company additional direction. Consequently, this order will require that the company submit to the Commission within six months an inventory of all presently unused or underused electric generating or cogenerating sites having existing untapped sources of power at or exceeding a capacity of 5 MW and situated in the company's service area or within 50 miles thereof. The Commission further requires as part of the inventory a specific statement from the company as to the prospect (including company plans for utilization) and cost-effectiveness of obtaining electric power or other power which may be substituted for electric power from such sites and sources. Examples might include industrial facilities producing sufficient quantities of now unused steam, moderately sized hydroelectric sites, or under-utilized accumulations of wood chips. As to conservation, the Commission is concerned with and mindful of the company's residential space heating conservation program. In Cause No. U-78-05, frequently mentioned in the instant record, the Commission is considering a general restructuring of the rates charged by private electric utilities in the state with conservation being one of the goals primarily considered in any such restructuring. In its inventory to be submitted in six months, the company should specify any methodologies for further improved savings in residential electrical consumption or especially in commercial and industrial consumption that may be implemented, as well as a discussion of the feasibility of residential and commercial reverse meter cogeneration. |

Many of the objections raised to the inclusion of construction work in progress in the rate base were advanced

on the ground that nuclear power is inherently unsafe and therefore imprudent. The Commission has no jurisdiction to determine the safety of nuclear as opposed to nonnuclear generation. The field has been preempted by the Federal Government and, consequently, the Commission will not address the question of safety.

Counsel for the public and intervenor POWER alternately contend that, should the Commission not exclude the entirety of construction work in progress from rate base, it should include only those CWIP costs associated with licensed and sited plants. The prime justifications for this position are (1) that licensing is a reasonable guarantee that a project will be built and therefore an assurance that the ratepayer's money will go to the proper expense, (2) that the licensing process serves as an independent test of the company's judgment as to siting, magnitude, design, need for, and timing of a project, and (3) that construction costs incurred before licensing are small in comparison to those incurred after licensing. The Commission is well aware of the special concern that attaches to any portion of a rate increase which is levied for exceptional circumstances, but must also consider the urgency of the ongoing construction program and the company's ability to finance that program without inclusion of CWIP in rates. The Commission has recognized the company's exceptional circumstances to assure adequate generating capacity for the future. The company's construction program has not been lightly undertaken, and the Commission sees in the company's effort an unbending commitment toward completion of the projects.

The second and third reasons advanced in support of including CWIP only for licensed and sited plants should be discussed in common as they are to some extent interrelated. The amount of funds required before licensing and siting a project is normally small in comparison to funds required between a project's licensing and its service date. Unavailability of a construction work in progress contribution at crucial early stages of a project's funding, however, risks impediment of the company's capacity to initiate financing and licensing procedures essential for the realization of needed projects. Given that the expenditures for licensing are small in relation to those which may be made after licensing any project, the Commission specifically determines that the added risk to those funds by virtue of their having been expended before licensing is outweighed by the assistance given to the completion of major construction projects.

In summary, the Commission recognizes that continuation of the company's construction program is necessary to assure adequate future generating capacity and that the company's ability to finance its construction program would be endangered absent inclusion of CWIP in authorized rates. Benefits to present ratepayers from inclusion of CWIP include stabilization of Puget's financial circumstances and present service capacity at a time when the company is undertaking a massive construction program to meet future service obligations, and the prospective avoidance of harsh cost increases after various in-service dates, as well as a general overall reduction in post in-service rates from that which could be expected absent present inclusion of

CWIP. By adopting the AFUDC offset method, the Commission has recognized that the present ratepayer should not bear the full financing cost of construction work in progress, but that the cost should be fairly apportioned between present and future ratepayers, inasmuch as the plants in question are not now producing power.

The Commission in prior cases has calculated the spread between construction work in progress and an AFUDC offset as being approximately .78 except in circumstances where an actual smaller AFUDC spread has been demonstrated. An examination of previous Commission treatment of the AFUDC offset reveals some minor variation from the .78 figure. The Commission notes the history of successful ongoing financing with the offset established in this range. In keeping with the determination stated in the Commission's analysis of rate of return (Section IV below) the Commission is increasingly skeptical of the efficacy of this type of calculation when carried to two decimal points. The Commission therefore, for purposes of the present case, will establish a .80 spread between rate of return on CWIP and the offsetting allowance for funds used during construction with the AFUDC rate established at 9 percent, treating the inclusion in the case of the amount determined by the spread as representative of that portion of the rate of return on construction costs which should be allocated to present ratepayers.

The Commission notes and agrees with the contention made by counsel for the public that \$402,000 of the funds allocated for construction work in progress for the Skagit Project are in fact monies devoted to a public informational center at the project site and similar promotional activities, and that such expenditures are not appropriately part of an allowance for construction work in progress, inasmuch as expenditure for these purposes is not essential to financing of the company's ongoing construction program.

#### F. Rate Base Summary

Table III summarizes the company's 1977 test period rate base calculated in accordance with the Commission's disposition of rate base items considered in this matter.

TABLE III

RATE BASE - PRO FORMA  
AVERAGE OF MONTHLY AVERAGES  
12 Months Ended December 31, 1977

Utility Plant in Service, Plant Held for Future Use, CWIP in Service	\$828,008,760
Less:	
Accumulated Provision for Depreciation and Amortization	131,975,285
Accumulated Deferred Income Taxes - Liberalized Depreciation	8,838,000*
Customer Advances for Construction	<u>5,306,741</u>
Rate Base - Actual	681,888,734
3 Restating and 4 Pro Forma Adjustments	(20,113,656)
CWIP Major Projects	<u>89,210,308</u>
Rate Base - Pro Forma	<u>\$750,985,386</u>
End of Period	

IV. RATE OF RETURNA. Rate of Return Comparison

Table IV below sets out a comparison of the company's initial contentions on rate of return with those advanced by the staff. The company, through its witness Mr. King, treated rate of return on the basis of company capital structure at the end of the test year, while staff, through its witness Mr. Kosh, addressed rate of return based on a capital structure imputed to the company as of December 31, 1979. With the exception of resolution of one disputed adjustment (discussed below) pertaining to average accumulated deferred investment tax credits, the company calculated rate of return varies from the staff determination only by 1/100 of one percent. Also, with the exception of the one disputed adjustment, the company on rebuttal acceded to the staff position and described financing plans consonant with the capital structure proposed by Mr. Kosh. No other parties offered evidence on rate of return.

TABLE IV

## RATE OF RETURN

	COMPANY (12-31-77)			STAFF (12-31-79)		
	Capital Structure (%)	Cost Rates (%)	Weighted Cost Rates (%)	Capital Structure (%)	Cost Rates (%)	Weighted Cost Rates (%)
Long Term Debt	51.0	7.88	4.02			
Short Term Debt	5.0	8.89	0.44			
Long & Short Term Debt				51.9	7.84	4.07
Preferred Stock	9.0	8.59	0.77	12.8	8.81	1.13
Common Equity	35.0	13.00	4.55	35.3	13.00	4.59
Sub Total			9.78			9.79
Adjustment						
Average Accumulated Deferred Investment Tax Credit 12-31-77		13.00	*			
Requested Rate of Return			9.90			
Recommended Rate of Return						9.80

\* Adjustment calculated on a Relationship of Rate Base

Cost Rates and Operating Income Requirement (Exhibit 6,  
Chapter 2, Page 17)

### B. Average Accumulated Deferred Investment Tax Credits

The dispute over average accumulated deferred investment tax credits is whether that item should be costed at a rate equivalent to the company's cost of equity or the Company's overall rate of return. If costed at the equity rate, the credits would cause the overall rate of return to rise by 1/10 of one percent.

The company contends that to set the return on these tax credits at the company's overall rate would go against principles stated in certain Internal Revenue Service information and ruling letters cited in the instant case, as well as a decision of the Indiana Public Service Commission. The company contends that it is the intent of the Internal Revenue Service only to permit such tax credits if utilities attribute the credits to shareholders rather than to ratepayers. Staff contends that nothing in the Internal Revenue Service code requires that the return on average accumulated investment tax credit be set at the equity rate rather than at the overall rate of return, points out that certain of the ruling letters cited by the company were signed by engineers, argues that none of the items cited by the company have general applicability to utilities but are relevant only to the cases in which they arose, and posits that the Indiana Public Service Commission might not have been aware of the limited authority vested in the various letters and statements of intent cited by the company. Staff relies in part on 1972 proposed IRS regulations which have not yet been implemented.

The Commission, in two recent causes (U-77-47 and U-78-38) resulting from rate requests filed by the Washington Natural Gas Company, resolved similar issues in a manner in accordance with the position advocated by staff in the present issue. While the likelihood is waning that the 1972 IRS proposed regulations will be implemented, the company has failed to point out any code provision or ruling of general applicability which would cost the company credits should average accumulated deferred investment tax credits not be costed at an equity rate. The Commission does not see any threat to the tax credits as sufficiently clear to warrant consideration of equity costing treatment for these tax credits. The Commission, adopting the staff position, will continue to adhere to its treatment of the item at an overall rather than an equity rate of return.

### C. Rate Base Summary

In his testimony, Mr. Kosh indicated that data approximations inherent in calculations made results imprecise when such calculations were carried to 1/100 of a percentage point. Mr. Kosh suggested that his 9.79 recommended rate be rounded to 9.80. The Commission accepts that recommendation as an appropriate safeguard in the instant matter. Table V below sets forth the

fair rate of return which the Commission concludes the company is entitled to earn on its test year rate base.

TABLE V

## RATE OF RETURN

	Capital Structure (%)	Cost Rates (%)	Weighted Cost Rates (%)
Long & Short Term Debt	51.9	7.84	4.07
Preferred Stock	12.8	8.81	1.13
Common Equity	<u>35.3</u>	<u>13.00</u>	<u>4.59</u>
Total	<u>100.0</u>		<u>9.79</u>
Authorized Rate of Return			9.8

V. RESULTS OF OPERATIONA. Results of Operation Comparison

Puget and staff agree that actual net operating income for the test year ending December 31, 1977, was \$57,423-382. No other party indicated disagreement with that figure. The company proposed one restating and twenty-two pro forma adjustments to net operating income. Staff proposed seven additional restating adjustments, a modification of the one restating adjustment the company had proposed, modification of all but one of the company's pro forma adjustments, and an additional pro forma adjustment. The alternative treatment of Rock Island power cost expenses proposed by staff and for reasons stated in Section III (D) above rejected by the Commission would also have had consequences for results of operation. Table VI below sets forth company and staff main case positions in regard to restating and pro forma adjustments to net operating income. Notes below the table describe additional adjustments offered or objected to by intervenors or counsel for the public.

TABLE VI

## RESULTS OF OPERATION - ACTUAL AND PRO FORMA

For the Year Ended December 31, 1977

	Company	Staff	Difference Staff Greater
Net Operating Income - Actual	\$ 57,423,382	\$ 57,423,382	\$ -
<u>Restating Adjustments</u>			
RA-1 Health Insurance Refund	-	58,911	58,911
RA-2 Bremerton B & O Tax	-	156,589	156,589
RA-3 Nonrecurring Outside Service	-	10,218	10,218
RA-5 Nonrecurring Cloud Seeding	-	16,067	16,067
RA-6 Storm Damage	-	(28,338)	(28,338)
RA-7 Seattle Club Memberships	-	2,732	2,732
RA-8 Central Surveys and Overaccrual	-	6,739	6,739
RA-10 Unbilled Revenue Adjustment	(887,930)	(923,572)	(35,642)
<u>Pro Forma Adjustments</u>			
P-1 Sales for Resale - Other	2,331,443	4,024,930	1,693,487
P-2 Sales for Resale - Firm	171,243	177,829	6,586
P-3 Temperature and Curtailment	3,854,301	4,003,271	148,970
P-4 Schedule Changes	268,502	279,135	10,633
P-5 Power Costs	(11,269,025)	(12,048,102)	(779,077)
P-6 Wages and Salaries	(1,156,935)	(1,212,262)	(55,327)
P-7 Retirement Plan	(16,556)	(15,869)	687
P-8 Employee Insurance	(90,690)	(84,990)	5,700
P-9 Investment Plan	(44,048)	(25,550)	18,498
P-10 Rate Case Expense	(84,671)	(7,953)	76,718
P-11 Storm Damage	(115,145)	5,361	120,506
P-12 Property and Liability Insurance	(18,861)	(19,587)	(726)
P-13 Payroll O/H Reversal	(34,979)	(36,325)	(1,346)
P-14 Postage Increase	(31,244)	(32,445)	(1,201)
P-15 Depreciation Expense	(1,863,786)	(1,863,786)	-
P-16 State Unemployment Tax	(16,768)	(10,627)	6,141
P-17 Federal Unemployment Tax	(5,071)	(4,662)	409
P-18 FICA TAX	(29,968)	(33,068)	(3,100)
P-19 Montana Generation Tax	(52,949)	(166,944)	(113,995)
Property Tax	(81,062)	-	81,062
P-20 Pro Forma Federal Income Tax	(244,644)	22,679	267,323
P-21 Tax Benefit Pro Forma Interest	(203,566)	10,572	214,138
P-22 Production Property	408,637	426,125	17,488
P-23 CWIP Major Projects	-	7,041,081	7,041,081
Net Operating Income Pro Forma	<u>\$ 48,209,610</u>	<u>\$ 57,151,541</u>	<u>\$ 8,941,931</u>
FIT - Alternative Rock Island		<u>(116,980)</u>	<u>(116,980)</u>
Net Operating Income Pro Forma - Alternative	<u>\$ 48,209,610</u>	<u>\$ 57,034,561</u>	<u>\$ 8,824,951</u>

Note 1. Intervenor POWER and counsel for the public contend that all club memberships should be items paid by stockholders rather than by ratepayers. This position if implemented for the test year would produce a result of \$5,684.00 greater than would the company position on that item. These parties also objected to certain civic memberships and advertising expenses described below.

Note 2. Should CWIP for major projects be denied in its entirety as recommended by certain parties and witnesses in the case, no adjustment for CWIP major projects would result. Should only licensed projects obtain CWIP, a variable adjustment would result, depending on treatment of the Skagit facility as licensed or unlicensed.

Table VII sets forth company and staff issues remaining after completion of the company's rebuttal case. Staff, on rebuttal, acceded the company's position on taxes other than FIT adjustments. Issues noted above which have been raised by intervenors remained after completion of the rebuttal case. Resolution of unresolved issues is stated in the sections immediately following.

TABLE VII

RESULTS OF OPERATIONS  
PRO FORMA ADJUSTMENTS PER REBUTTAL  
12 Months Ended 12-31-77

	<u>COMPANY</u>
Pro Forma Net Operating Income per Exhibit 62	\$57,151,541
Adjustments per Rebuttal	
Sales for Resale	(912,830)
Power Costs	305,309
Taxes-Other Than FIT	(44,114)
CWIP-Major Projects	(7,041,081)
Pro Forma Interest	<u>(1,774,631)</u>
Total	<u>\$ (9,466,747)</u>
Adjusted Pro Forma Net Operating Income Before Rates	<u><u>\$47,684,794</u></u>

B. Sales for Resale

This item and the immediately following item, power costs, are quite closely interrelated. Calculation of the power cost adjustment treated in Section V(C) below depends on the Commission's determination regarding the propriety of an adjustment for sales for resale. For reasons set forth below, the Commission rejects the company proposed adjustment to sales for resale and accepts the position advocated by staff.

Puget and other Northwest utilities on occasion sell excess power to customers outside their systems. The most important secondary markets for such sales are Bonneville Power Administration interruptible customers and high-paying customers served by the California tie line. Once the needs of these customers are satisfied, sales may be made to other secondary markets, but the price obtained from such other sales will normally drop below that obtained from the above-mentioned BPA interruptible and California tie line customers. The effect of lowering the test year amount allocated for sales for resale is to increase Puget's net power costs. An important determinant in Puget's test year allocation of sales for resale is the amount of excess power available from Puget's competitors, because increased general availability of excess power will more readily satisfy demands of the high-priced resale market.

The company has proposed a sales for resale adjustment intended to reflect excess power sales competition from four utilities, BC Hydro, West Kootenai, Idaho Power, and Montana Power, which are part of the Northwest Power Pool but not members of the West Group. Commission determinations of the effect of competition on sales for resale have heretofore been based largely on assessment of potential competition from other West Group utilities.

Because of the availability of more data, Puget has been able to move from a 30-year to a 40-year water study as the basis for its general power supply adjustment. The 40-year study includes available surpluses from within the West Group. No issue is herein drawn as to sales competition from within the West Group. The 40-year study Puget presents does not, however, include a historical study of the availability of excess power from BC Hydro, West Kootenai, Idaho Power, and Montana Power. Staff objects to the adjustment the company claims for sales competition from these four last-named utilities.

What Puget has done to account for the four utilities (instead of presenting an historical study) is to take available West Group surpluses at median water and add to those a 35 percent factor. The company has calculated that at median water, BC Hydro, West Kootenai, Idaho Power, and Montana Power have 35 percent of the capacity of other Northwest power pool utilities. Puget has apparently assumed, without explanation, that the median water capacity comparison can be translated into an equivalent excess power competition ratio for the four utilities as against West Group utilities. In its main case, the company contended that the total surplus available to interruptible customers for test year purposes should be 135 percent of that made available by West Group utilities.

Puget does not attempt to compensate for lack of historical data concerning the four utilities by presenting a study of the comparative storage capacity of the four utilities and the West Group utilities. Similarly, the company advances no reason for its assumption that the four utilities will sell to the same customers under the same conditions as do West

Group utilities. On rebuttal, the company proposed that its added 35 percent competition factor for BC Hydro, West Kootenai, Idaho Power, and Montana Power be halved, with the resultant effect that, if the company rebuttal proposal were adopted, total surplus power available for Puget's secondary customers would be set at 17.5 percent of available test year excess West Group power. Staff contends that both Puget's main case adjustment for competition from the four utilities and its halved rebuttal adjustment are inaccurate, speculative, and unreliable, and that both should be rejected.

BC Hydro, West Kootenai, Idaho Power, and Montana Power do compete with West Group utilities in some secondary markets. The extent of the four utilities' competition in low priced secondary markets in recent years is unknown on the record, and Puget has not convincingly demonstrated that such low-priced competition presently exists. One possible method of demonstrating competition from the four utilities might have been a load and water study integrating the four named utilities with those of the West Group over a sufficient period for evaluation. Seventy-two percent of the four companies' capacity is held by BC Hydro and West Kootenai; these Canadian utilities have no obligation to sell in U.S. markets.

There is no necessary relationship between energy capacity and excess power availability. The relationship may be affected by storage capacity, water conditions, market conditions, and many other factors. The record contains no acceptable rationale for Commission adoption of either the 35 percent factor or the 17.5 percent factor described above. The Commission cannot assess the company's result, and therefore accepts the staff position, because the absence of any rationale or data base precludes the Commission from measuring the adjustment's validity.

The Commission does not intend by its determination on this issue to totally reject the concept of considering competition from electric utilities in the Northwest Power Pool but outside the West Group. The company in the instant case cannot be said to have met its burden of proof on the point absent an offering of valid historical data and a demonstrably reliable methodology for applying such data to the test year.

### C. Power Costs

Disagreement on power costs exists between company and staff; the dispute is centered on treatment of certain circumstances of power generation and power sales in the State of Wyoming. As noted in Subsection V(B) above, the dollar amount of the disagreement in part depends on resolution of the issue of sales for resale.

Pacific Power & Light Company (hereinafter identified as "Pacific" or "PP&L") operates two large thermal generating facilities, the Jim Bridger facility and the Dave Johnson facility, in the State of Wyoming. A substantial secondary market for excess power also exists in Wyoming. PP&L has historically served this secondary market, but other West Group utilities

including Puget have not. Issues regarding this item are the extent to which PP&L's Wyoming thermal power will be displaced to serve Wyoming markets, and the availability of the Wyoming secondary market to Puget and other West Group utilities who heretofore have not served the market.

The staff presentation on Wyoming power costs assumed a 50 percent displacement of PP&L Wyoming thermal generation, though no rationale for the 50 percent figure was presented. On rebuttal, the company substantially modified its main case position regarding Wyoming power costs, the modification having been prompted by criticism contained in the staff case. Staff had suggested that a more appropriate method than adoption of a 50 percent Wyoming thermal generation displacement figure would be an integration of relevant PP&L and Puget studies including a subtraction of actual PP&L Wyoming sales. The company performed such a study and presented results in its rebuttal case. The integrated study demonstrated that very little PP&L Wyoming generation could be displaced from markets in that area and that PP&L would not buy from other utilities to displace Wyoming thermal generation.

Staff contended that the Wyoming secondary market should be treated as though available to West Group utilities other than Pacific. Pacific serves the Wyoming secondary market at a price substantially higher than the 3 1/3 mill price Puget claims for much of its excess power sales.

The company has presented data supporting its contentions that very little Wyoming thermal will be displaced and that the secondary Wyoming market is available to Pacific and not to other West Group utilities. Staff has countered with certain well-delineated assumptions but has not buttressed them with substantial evidence or cogent rationale. As recalculated to reflect the decision in Section V(B) above, the Commission accepts the company power cost adjustment.

#### D. Pro Forma Interest

Puget, as any other taxpayer, is permitted to deduct interest payments from income in calculating its federal income tax. The greater the test year interest expense the company may claim, the lower will be taxes paid, and the higher will be test year operating income. An increase in test year rate base increases pro forma interest because a rate base increase raises the amount of rate base funded by debt, which in turn raises interest expenses. In calculating the federal income tax effect of pro forma interest, staff would include and the company would exclude several specific rate base items. Commission decisions noted above regarding company, staff, and intervenor differences regarding construction work in progress, and disputes between company and staff as to the IP Transmission Line and deferred tax reserves resolve the issue of inclusion or exclusion of these items in rate base for tax purposes. The tax effect of those decisions is reflected in the pro forma interest entry set forth below in Table VIII, which table summarizes the Commission's disposition of results of operation.

Also reflected in the same Table VIII entry are the results of Commission determinations regarding inclusion or exclusion of accumulated deferred investment tax credit reserve (including job development investment tax credit) and nonmajor CWIP. For reasons now set forth, the Commission determines it proper to include both items in rate base for federal income tax interest calculation purposes.

The company claims that staff treatment of major and minor CWIP could result in a net reduction of company revenue requirements over the figure resultant if the company were permitted no CWIP. The company also states that it may lose investment tax credits if the Commission treats the particular funds as though not contributed by the common shareholder. The company further argues that the exclusions it advocates are necessary for consistency with staff's recommended capital structure.

What the company proposes regarding tax rate base exclusions is a departure from previous Commission treatments of the topic and a departure not warranted by the instant record. The challenged staff method was in effect and was not overthrown when Puget recently underwent an Internal Revenue Service audit. Current ratepayers do pay the cost of capital used to finance construction programs, and all interest herein treated is deductible for tax purposes. Future ratepayers will receive recognition from an AFUDC tax benefit. It should be noted that the company does not propose a job development income tax deduction for rate base when rate base is used to determine revenue requirements, and that the company proposed method implies an ability to trace funds inconsistent with the fungible nature of money. The Commission adopts the staff position on pro forma interest treatment of accumulated deferred investment tax credit reserves and nonmajor CWIP.

#### E. Club Dues

In the course of the case, staff and intervenors took varying positions regarding treatment of club dues and similar membership and social expenses as above the line expenses attributable to ratepayers. Both partial and total elimination of the item were advocated. The Commission mindful of the recent Supreme Court decision in Jewell v. Washington Utilities and Transportation Commission, 90 Wn 2d 755, (1978), which both stated and implied certain limits upon the Commission's discretion in attributing expenses to ratepayers, is of the opinion that none of the club dues and similar expenses challenged in this item should hereafter be attributable to ratepayers, and that if the company chooses to continue to make such expenditures it should record the same as below-the-line items attributable to shareholders.

#### F. Construction Work In Progress Major Projects

The disagreement between company, staff and intervenors on this item is resolved by mathematical computation based

on the Commission determination stated in Section III(E), above. Determination in that section resolves the calculation of CWIP for purposes of results of operation. No separate results of operation issue is raised. The resultant amount is set forth below in Table VIII.

#### G. Advertising and Civic Contributions

Intervenors POWER and FERN and counsel for the public alluded to the need for excluding from test year expenses certain company contributions to civic organizations and certain advertising expenses, notably money spent for the Edison Electric Institute. The Commission finds the assertions made as to exclusion of these expenses insufficiently specific to justify discounting the company expenditures. Evidence and argument offered in support of the exclusion are not sufficiently related either to the Supreme Court holding in Jewell v. Washington Utilities and Transportation Commission, 90 Wn. 2d 755 (1978), or to any other identified principle for the Commission on the record of this case to deny the expenses for test year purposes.

#### H. Results of Operation Summary

Table VIII set forth below summarizes the Commission's determination of the company's results of operations during the 1977 test year.

TABLE VIII

#### RESULTS OF OPERATION

Net Operating Income - Actual	\$57,423,382
10 Restating and 23 Pro Forma Adjustments	<u>(271,841)</u>
Subtotal	\$57,151,541
Additional Restating Adjustments	
Social Club Memberships	2,952
Additional Pro Forma Adjustments	
Net Sales for Resale - Other and Power Costs	(119,577)
Taxes other than F.I.T.	(44,114)
Pro Forma Interest	74,623
CWIP Major Projects	<u>(3,256)</u>
Net Operating Income - Restated and Pro Forma	<u>\$57,062,169</u>

#### VI. GROSS REVENUE DEFICIENCY

The Commission has previously found the proper test year rate base to be \$750,985,386.00. It has determined the fair rate of return to be 9.80 percent. The test year net operating income requirement is therefore \$73,596,568.00. Subtraction of the 1977 test year results of operations reveals a \$16,534,399.00 net operating income deficiency. Previous determinations establish the propriety of a .50718 conversion factor.

Puget Sound Power & Light Company's 1977 test year gross revenue deficiency for electric operations in the State of Washington is \$32,600,653.00. Table IX below sets forth the gross revenue deficiency calculation.

TABLE IX  
GROSS REVENUE DEFICIENCY

Rate Base	\$750,985,386
Rate of Return - %	9.8
Net Operating Income Requirement	\$ 73,596,568
Net Operating Income	<u>57,062,169</u>
Net Operating Income Deficiency	16,534,399
Conversion Factor	<u>.50718</u>
Gross Revenue Deficiency	<u>\$ 32,600,653</u>

#### VII. TARIFF STRUCTURE

In the instant matter parties presented two major tariff issues for the Commission's consideration:

(a) Whether any increase granted the company should be applied partly to a demand component of the rates paid by certain customer classes; and

(b) Whether or not general restructuring of the company's rate structure should be accomplished in the instant case to promote certain goals such as conservation, protection for low and fixed income citizens, and allocation of cost of future energy facilities. The Commission is mindful that in a separate proceeding, Cause No. U-78-05, it is presently considering revisions for various purposes of the rate structures of all private electric utilities operating in the state. However, the Commission will consider those issues which have been properly raised in the instant matter.

#### A. Demand Charge

The company proposes a spread of increased rates including an increase in demand charges for some classes, including residential customers. Staff advocates spreading any increase throughout customer classes on a uniform cents per kilowatt hour basis. The staff proposal is in accord with the spread authorized in the last Commission decision regarding

Puget, Cause No. U-76-1. The company's specific proposal entails an increase in the demand component which would be implied in the energy charge levied against residential customers. The effect of the company proposal would be to increase cents per kilowatt hour charges more markedly to residential customers than to any other class. The particular increase for residential customers is one which the company has labeled a demand charge, but the amount of the charge would actually be determined by consumption. Rapidity of consumption would not be reflected in the charged amount. The charge is structured, to the extent that it recognizes demand at all, to reflect demand by the residential customer class rather than by individual customers. Staff also makes the point that the overall increase sought in this cause is not related to demand sensitive items. The record does not reflect that a uniform cents per kilowatt hour increase amounts to a subsidization of residential customers. The company has not proven any need to depart from spreading the cost of any rate increase to all Puget customers on a uniform cents per kilowatt basis. Those rate increases authorized hereinbelow to permit the company to recoup the gross revenue deficiency established in Section VI above should be spread among all customer classes on a uniform cents per kilowatt hour basis.

It should be noted that in the Commission's opinion there is no persuasive evidence in the record supporting elimination or reduction of basic charges levied by Puget on its various customer classes.

#### B. Rate Restructuring

Parties to the instant proceeding have requested that the Commission implement a general restructuring of respondent's rates as a part of the Commission's disposition of the case. Goals such as conservation, rate relief for low and fixed income ratepayers, and proper allocation of short and long run costs among various customer classes have been advanced as goals to be accomplished by such restructuring. The Commission in accordance with its mandate has made rate structure an issue in the present proceeding. Mindful of the burden placed on any party attacking rate structure by State Ex Rel Seattle v. Public Service Commission, (Supra), Northcoast Power Company v. Kuykendall, (Supra), and State Ex Rel Model Water & Light Company v. Department of Public Service, (Supra), the Commission declines to order a general restructuring of respondent's rates in this proceeding because an insufficient amount exists in the record of the case to serve as a basis for any specific restructuring.

Testimony presented by parties other than respondent and staff may be said to have provided general information to the Commission regarding advantages and disadvantages of possible alternate structures for respondent's rates. The evolutionary history of the Commission's treatment of respondent's rates amply demonstrates the Commission's willingness to modify prior rate structure determinations on the basis of persuasive indications of the benefits of specified change. No witness in the

instant proceeding has, however, put forth a detailed application of any specific alternate rate structure to the circumstances of the company in such a way as to permit the Commission to evaluate rather than speculate on the alternative's potential for improvement over existing rate structure. The Commission's conclusion is that existing rate structures as modified by a uniform cents per kilowatt hour increase to reflect this order's correction of gross revenue deficiency is just and reasonable and has not, on this record, been shown to be otherwise. In reaching this conclusion, the Commission is mindful that resolution of the issues in this case will not coincide in time with resolution of issues in Cause No. U-78-05.

Conservation is one among the goals the Commission strives to achieve in regulation of electric utilities. An unduly high service charge in relation to energy charge may be regarded as anti-conservationist. However, the Commission's action herein, raising the energy charge on a cents per kilowatt hour basis and leaving residential basic charges unchanged, actually lowers the ratio of service charges to energy charges. The record does not demonstrate that present residential basic charges are unduly high. To say that a service charge is per se discriminatory is to ignore the elemental fact that all customers impose service requirements on a regulated utility independent of the amount of the utility's product consumed by the customer. Certain items such as metering, line maintenance, and some labor costs exist independent of the amount of demand a customer may place on a utility's capacity to serve. In regard to lowering service charges specifically to aid low and fixed income ratepayers, the Commission, to make a modification on such a basis, would require either a much more specific showing than the present record contains that a modification would be in the public interest, or a revised mandate from the legislature.

Parties advocated the control of demand increases, especially residential demand, through restructuring by techniques such as the use of ascending blocks to dampen customer urges toward heavy consumption, or the implementation of long run incremental cost pricing. The testimony of Dr. Wells constituted the most cogent presentation in favor of general rate restructuring. Dr. Wells' presentation lacked a comprehensive marginal cost study, an element essential to permit the Commission to evaluate the effects of changes such as those advocated by Dr. Wells. No other witness supplied a marginal cost study of Dr. Wells' proposed changes. Without a thoroughgoing marginal cost study, any Commission attempt to select specific break points in a radically altered tariff structure would amount to uninformed guess work. Consequently, the Commission is forced to conclude without judging the overall merits of general rate restructuring that no basis exists in the present record for specific implementation of such restructuring.

#### VIII. PUBLIC TESTIMONY

Approximately 12 times as many members of the public testified in the instant proceeding as did public witnesses in Cause No. U-76-1, the last Commission proceeding on a Puget rate request. The position by far most frequently advocated by

members of the public was that the Commission should not grant Puget any rate increase imputed to major project construction work in progress. Interest in this issue was intense and the Commission was presented with a large and divergent set of rationales aimed at obviating any CWIP increase. Over 7,000 opposing signatures were presented. Commission analysis and resolution of the issue is delineated in Section III(E) above.

Many members of the public contended that Puget should receive no rate increase whatsoever, or that any such increase should be limited to amounts reflecting Federal wage price guidelines. Reasons advocated for so denying or limiting the increase included the circumstances of low and fixed income ratepayers and the need to combat inflation.

Specific concerns regarding investment in nuclear generating facilities because of safety concerns were also pressed on the Commission in the course of public testimony. The Commission is aware of the uncertainty that exists in the minds of some members of the public concerning the safety of nuclear power, as well as the active opposition thereto, but were the Commission disposed to do so, it could not rule on the safety of nuclear generating projects, inasmuch as safety matters have been preempted by the Federal Government. This Federal preemption precludes direct state determinations on nuclear safety.

Conservation, cogeneration sources, and alternate generating sources such as solar energy and plant and animal wastes, were called to the Commission's attention by members of the public. In addition to the inventory required of the company in Section III(E) above, the Commission notes its continuing interest in innovative methods of saving or producing electric energy. In the instant record, however, no conservation or alternate generation or cogeneration source was sufficiently specified for the Commission to reasonably require that the company implement such methodology, assuming the Commission's power to do so.

The Commission's attention was also called to differentials between rates charged apartment dwellers and rates charged customers living in single-family homes. The concern advanced on behalf of apartment owners and apartment dwellers was as to whether or not any justifiable rationale existed for imposing different rates on two subclasses of residential customers. The concern of apartment rate customers is apparent, but the record on the point again states no basis for finding that the present differentials are improper or, beyond that, for establishing any rate realignment which could be said to be an improvement over the present structure. The matter of the need for reconciling the differential existing between rates charged single-family residential and apartment residential customers may properly be dealt with in the Commission's presently ongoing generic rate proceeding, Cause No. U-78-05. Specific concerns advanced by public witnesses about the propriety of rates charged a specific group of apartment customers mentioned in testimony will be referred to appropriate Commission personnel for investigation and treatment.

The position advanced that Puget should receive either no increase or an increase limited to Federal wage price guidelines is treated in Sections III, IV, V, and VI of the instant order, wherein the value of the company's property and service is calculated, a fair rate of return thereon is determined, the company's test year operating income is delineated, and a revenue deficiency is identified. The revenue deficiency stated in Section VI above is the minimum amount sufficient to permit the company to provide adequate service to its customers. Specifically, the Commission notes that the largest factor in the instant case is the circumstance of inclusion of the cost of power produced from the new equipment at the Rock Island Dam, an addition entitled to specialized treatment under the guidelines, taking into account the company's requirement to meet debt coverages. The increase conforms to the Federal wage-price guidelines as they apply to those electric companies.

#### FINDINGS OF FACT

Having heretofore discussed both the oral and documentary evidence concerning all material matters inquired into and having stated our findings and conclusions, we now make the following summary of facts. The portions of the preceding detailed findings pertaining to the ultimate facts are incorporated herein by this reference.

1. The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, practices accounts, securities, and transfers of public service companies.
2. Puget Sound Power & Light Company, respondent herein, is engaged in the business of furnishing electric service within the State of Washington as a public service company.
3. On April 28, 1978, respondent filed with this Commission revisions to its tariffs WN U-53 and WN U-58, which were designed to effect an increase in rates and charges made by respondent for service provided in this state. On May 4, 1978, the Commission suspended respondent's filing and ordered public hearings held on the reasonableness and justness thereof.
4. The 12-month test period ending December 31, 1977, is appropriate to examine operations of respondent for ratemaking purposes in this proceeding.
5. The net original cost for ratemaking purposes of properties of respondent used and useful for rendering electric service in the State of Washington is \$750,985,386.00.
6. Authorization of gross revenues sufficient to achieve a rate of return of 9.8 percent on that portion of respondent's rate base applicable to its electric operations in

the State of Washington will maintain respondent's credit and financial integrity, will enable it to raise sufficient new capital at reasonable rates to meet its service requirements, and also constitutes a fair rate of return.

7. The test year net operating income resulting from respondent's electric operations on a pro forma basis under present rates is \$57,062,169.00.

8. A deficiency of \$32,600,653.00 exists in test period annual gross revenues from respondent's operations.

9. The increased annual gross revenues of approximately \$46,500,000.00 sought by respondent in its suspended April 28, 1978, tariff filing would produce a rate of return exceeding the proper rate as named in Finding of Fact No. 6.

10. The tariff revisions filed by respondent should be rejected. Respondent should be authorized to refile tariff revisions which will provide additional revenues in an amount not to exceed \$32,600,653.00.

11. The design of tariffs WN U-53 and WN U-58, if such tariffs are revised and filed pursuant to the authorization of this order, shall allocate increased charges on a uniform cents per kilowatt hour basis among all customer classes.

#### CONCLUSIONS OF LAW

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

2. The existing rates for electric service named in respondent's Tariffs WN U-53 and WN U-58 are insufficient to yield reasonable compensation for electric service rendered in the State of Washington. The tariff revisions previously suspended in this proceeding name rates and charges which are excessive, unjust, and unreasonable and which should be rejected. Revisions of rates and charges made in accordance with findings herein will yield a fair return on that rate base found proper herein and, if filed pursuant to the authorization herein made, will be fair, just, reasonable, and sufficient, and will not be unduly discriminatory or preferential.

3. All motions made in the course of the hearing and any made subsequent to the close of the hearing which are consistent with the findings and decisions herein should be granted. Those inconsistent should be denied. All exhibits not previously limited, denied, or withdrawn should be admitted into evidence.

From the foregoing findings of fact and conclusions of law, the Commission enters the following order.

O R D E R

THE COMMISSION THEREFORE ORDERS:

1. The tariff revisions filed herein by Puget Sound Power & Light Company on April 28, 1978, now under suspension and docketed as Cause No. U-78-21, are hereby rejected in their entirety.
2. Respondent is authorized to file tariff revisions in accordance with Section VI, gross revenue deficiency, Section VII, tariff structure, and Findings of Fact Nos. 8, 10, and 11, set forth hereinbefore.
3. The tariff revisions authorized herein shall bear an effective date which allows the Commission at least five (5) working days following the day of the Commission's receipt thereof to consider same. They shall reflect no retroactive treatment and shall bear the notation on each sheet thereof, "by authority of order of the Washington Utilities and Transportation Commission, Cause No. U-78-21".
4. Material in support of the manner in which the additional gross revenue authorized herein is obtained shall be submitted along with the tariff filings related thereto.
5. A notice of the filing of the tariff revisions authorized herein, on the same date as filed or immediately prior thereto, shall be posted at each business office of respondent in the territory affected thereby, stating that the tariff revisions are to become effective on the date inserted as the effective date in keeping with the foregoing and advising that a copy of each such revision is available for inspection at each such office. The notice shall remain posted at least until the Commission has acted on the revisions.
6. All motions consistent herewith are granted, those inconsistent are denied.
7. Respondent shall within six (6) months of the effective date of this order submit to the Commission at its offices in Olympia, Washington, an inventory and study addressing the topics set forth in Section III(E) above, incorporated herein by this reference.
8. Jurisdiction is retained to effectuate the provisions of this order.

DATED at Olympia, Washington, and effective this 8<sup>th</sup> day of March, 1979.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

*Robert C. Bailey*  
ROBERT C. BAILEY, Chairman

*Elmer C. Huntley*  
ELMER C. HUNTLEY, Commissioner

*Frank W. Foley*  
FRANK W. FOLEY, Commissioner