

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petition of)	DOCKET UE-121373
)	
PUGET SOUND ENERGY, INC.,)	ORDER 03
)	
For Approval of a Power Purchase)	FINAL ORDER GRANTING
Agreement for Acquisition of Coal)	PETITION, SUBJECT TO
Transition Power, as Defined in RCW)	CONDITIONS
80.80.010, and the Recovery of Related)	
Acquisition Costs)	
.....)	

Synopsis: The Commission approves a power purchase agreement between Puget Sound Energy, Inc. (PSE), and TransAlta Centralia Generation LLC that provides for PSE’s acquisition of an average 346 MW of coal transition power, as defined in RCW 80.80.010, over a contract term of 133 months. The Commission determines that PSE is authorized by statute to recover, in addition to its costs of power, equity return in the amount of \$1.49 per MWh for all deliveries of power under the contract. This “equity adder,” a unique contract incentive provided by statute exclusively for the purchase of coal transition power, will result in PSE receiving \$44.12 million in nominal return on equity, having a net present value of \$34.15 million over the full term of the contract, without requiring any capital investment by the company.

The Commission’s approval of the agreement is subject to a condition that PSE will file an annual report allowing the Commission to fulfill its obligation on an ongoing basis to regulate in the public interest, as provided by the public service laws, including specifically to effect the purposes of the statute establishing the legal concept of “coal transition power,” which has the purpose, among others, of preserving family wage jobs. The report will enable the Commission to evaluate whether the subject power purchase agreement may be found to have lost its character as an agreement for the sale and delivery of coal transition power due to changed circumstances in plant operations, or a failure to satisfy the provisions of RCW Chapter 80.80 on an ongoing basis.

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SUMMARY

- 1 **PROCEEDING:** On August 20, 2012, Puget Sound Energy, Inc. (PSE or Company) filed with the Washington Utilities and Transportation Commission (Commission) a Petition for Approval of a Power Purchase Agreement for Acquisition of Coal Transition Power, as Defined in RCW 80.80.010, and the Recovery of Related Acquisition Costs (Petition). The subject Coal Transition Purchase Power Agreement (Coal Transition PPA) is between PSE and TransAlta Centralia Generation LLC (TransAlta Centralia).

- 2 PSE requests an order: (1) approving the Coal Transition PPA, subject to and conditioned upon certain Commission determinations and findings specified in Section VI of the Petition; (2) approving PSE's recovery of the equity component of the Coal Transition PPA as provided in RCW 80.04.570(6); (3) approving deferral of certain costs associated with the Coal Transition PPA throughout the entire term of the Coal Transition PPA including later volume and pricing changes; and (4) finding that the Coal Transition PPA is prudent, regardless of whether the term of the Coal Transition PPA terminates upon its expiration or is terminated prior to its expiration.

- 3 **PARTY REPRESENTATIVES:** Sheree Strom Carson, Jason Kuzma and Donna Barnett, Perkins Coie, Bellevue, Washington, represent PSE. Simon ffitich and Lisa W. Gafken, Assistant Attorneys General, Seattle, Washington, represent the Public Counsel Section of the Washington Office of Attorney General (Public Counsel). Sally Brown and Greg Trautman, Assistant Attorney's General, Olympia, Washington, represent the Commission's regulatory staff (Commission Staff or Staff).¹

- 4 Melinda Davison and Joshua Weber, Davison Van Cleve, Portland, Oregon, represent the Industrial Customers of Northwest Utilities (ICNU). Danielle Dixon, Senior

¹ In formal proceedings, such as this, the Commission's regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. See RCW 34.05.455.

Policy Associate, and Nancy Hirsch, Policy Director, Northwest Energy Coalition (NWEC), represent NWEC.

5 **COMMISSION DETERMINATIONS:** The Commission determines that it should approve PSE’s Petition, subject to a condition requiring an annual report deemed necessary to protect ratepayers and the broader public interest, as required in the legal and policy environment that establish the concept of “coal transition power.” Based on our evaluation of the Coal Transition PPA in the context of Chapter 80.80 RCW, RCW 80.04.570 and the Memorandum of Agreement between TransAlta and the Governor’s office that is required under RCW 80.80.100, we find the Coal Transition PPA acceptable and within the bounds the prudence standards that we apply to such an agreement. The Coal Transition PPA, however, includes certain provisions that could give rise to further Commission inquiry if TransAlta substantially limits operation of the Centralia plant.

6 We are concerned specifically with the potential that the power TransAlta commits to deliver could lose its character as “coal transition power,” as we understand the term within its statutory definition and other provisions of law that establish its essential characteristics. We are most concerned with two circumstances that are unlikely, according to our record, but nevertheless conceivable, circumstances. One is that, contrary to PSE’s expectations,² TransAlta will not continue to operate the Centralia Coal Facility and therefore satisfy most, albeit not necessarily all, of its delivery obligations with power from the plant. This could mean, among other things, the loss of family-wage jobs, the preservation of which is one policy goal of the Coal Transition Energy Bill. The other concern is that TransAlta will not continue to provide the financial assistance provided for under RCW 80.80.100 and contractually memorialized in the Memorandum of Agreement (MOA) between TransAlta and the Governor’s Office. The legislature expressly contemplates in RCW 80.80.100 that in exchange for the benefits conferred by the Coal Transition Energy Bill will help fund the transition of the local economy in the region that depends on the Centralia Coal Facility as an economic mainstay. Yet, there are various opportunities for TransAlta to terminate the MOA, both as specified in RCW 80.80.100, and otherwise. This means these funds conceivably could be lost.

² See, e.g., TR. 235:15-239:3; 240:3-8; 241:8-244:16; 259:16-260:11 (*Kuzma*).

- 7 In light of these concerns, we condition our approval of the Coal Transition PPA by requiring an annual report from PSE that will enable the Commission to engage in some ongoing scrutiny of the implementation of the statute and PPA. Given the unique nature of the Coal Transition PPA, we recognize that the Commission may determine at some point in the future that its expectations under the legal and policy environment in which the concept of coal transition power resides are not being met. The Commission may then evaluate whether to revisit some aspects of the Coal Transition PPA.
- 8 In addition to determining that the Coal Transition PPA should be approved as presented, subject to the imposition of a reporting requirement, we also resolve several issues related to PSE's cost-recovery proposals. We find that the equity adder to which PSE is entitled under RCW 80.04.570(6) should be based on a hypothetical "equivalent plant" cost of \$110 million. We accept PSE's proposals to calculate the return amount using its currently authorized 7.24 percent pre-tax weighted average cost of equity over the term of the contract and to levelize the recovery of return using PSE's methodology, which recognizes the time-value of the stream of equity return payments to which the Company is entitled during the life of the contract.
- 9 As to PSE's request that it be authorized to defer incremental costs that arise between rate proceedings with changes in volume, price or both during the term of the Coal Transition PPA, we think it better to postpone consideration of the issue until PSE seeks recovery of the initial costs of the PPA that it will begin to incur on December 1, 2014. PSE acknowledges that this date, nearly two years from now, leaves ample opportunity for the Company to file either a general rate case or a Power Cost Only Rate Case (PCORC). Either of these proceedings would be a more appropriate one for consideration of cost accounting questions.

MEMORANDUM

I. Background and Procedural History

- 10 TransAlta Centralia owns and operates a baseload coal-fired electric generating plant of approximately 1340 megawatts of electric generating capacity located at Centralia,

Washington. The plant consists of two generation units and two boilers. The plant is subject to Chapter 80.80 RCW, which imposes an emissions performance standard on baseload electric generation in the State of Washington. Under the statute, as originally enacted, electric utilities such as PSE could not enter into a long-term financial commitment for baseload electric generation from the Centralia plant on or after July 1, 2008, because the generating plant's emissions exceed the emissions performance standard of 1100 pounds of greenhouse gases per megawatt-hour.³

- 11 On May 21, 2009, Governor Gregoire issued Executive Order 09-05, Washington's Leadership on Climate Change, which directed the Department of Ecology to work with TransAlta Centralia to establish an agreed order to apply the emissions performance standard to the Centralia Coal Facility by no later than December 31, 2025. On April 26, 2010, Governor Gregoire and TransAlta Centralia entered into a memorandum of understanding to enter discussions on an agreement to reduce gas emissions from the Centralia Coal Facility and provide replacement capacity by 2025.
- 12 On April 29, 2011, Governor Gregoire signed Engrossed Second Substitute Senate Bill 5769 (Coal Transition Energy Bill), which provides certain deferrals of the greenhouse gas emissions performance standard to encourage the early closure of coal plants in Washington. As a practical matter, this meant the Centralia facility, the only such plant operating in Washington. The Coal Transition Energy Bill amended RCW 80.80.040 to allow the Centralia facility to comply with greenhouse gas emissions performance standards by shutting down one of its two boilers by the end of 2020 and the other by the end of 2025.⁴
- 13 The Coal Transition Energy Bill amended RCW 80.80.040 to allow electric utilities such as PSE to enter into new financial commitments for the output from the facility for terms greater than five years. The Coal Transition Energy Bill also established a process that allows such electric utilities to petition the Commission for approval of a power purchase agreement for coal transition power.⁵ If such a contract is approved, the utility is allowed to earn and recover the equity

³ See RCW 80.80.040(1)(a) and RCW 80.80.040(1)(c)(i)(A).

⁴ RCW 80.80.040(1)(c)(i)(A).

⁵ See RCW 80.04.570(6) and WAC 480-100-415.

component of its authorized rate of return in the same manner as if it had purchased or built an equivalent plant and to recover the cost of the coal transition power under the power purchase agreement. This truly unique equity adder is expressly limited to “an agreement for acquisition of coal transition power” and does not apply to “any other power purchase agreement or other power contract.”⁶

14 On December 23, 2011, Governor Gregoire and TransAlta Centralia entered into the MOA, which memorialized in contractual form the arrangements set forth in the Coal Transition Energy Bill.⁷ The MOA between TransAlta Centralia and the State of Washington is effective as of April 1, 2012 and expires no earlier than December 31, 2025, unless terminated earlier pursuant to its terms.⁸

15 On July 24, 2012, PSE and TransAlta Centralia entered into the Coal Transition PPA that is the subject of this proceeding. It provides that PSE will purchase up to 380 MW of coal transition power from what the PPA refers to as the Centralia Transition Coal Facility (CTCF), with average deliveries over the life of the contract of 346 MW. The contract quantity varies over time and the price increases over time.⁹ Starting on December 1, 2014, the initial quantity is 180 MWh/hr. The quantity increases to 280 MWh/hr on December 1, 2015, and to 380 MWh/hr on December 1, 2016. The delivery rate thereafter remains steady through December 31, 2024. On January 1, 2025, the contract quantity decreases to 300 MWh/hr through the termination date, December 31, 2025.

⁶ RCW 80.04.570(8). The Commission is keenly aware that the Legislature strictly limited the applicability of an equity adder concept to coal transition contracts and did not authorize such a feature in connection with any other power purchase agreement or, indeed, any other form of contract for the sale and purchase of electricity. The action we take here, therefore, cannot be considered precedential in any sense or an indication of a change in the Commission’s traditional views regarding the regulatory treatment of purchased power.

⁷ See Exhibit No. RG-8HC at 434-447. See also RCW 80.80.100.

⁸ *Id.*

⁹ See Exhibit No. RG-1HCT at 9:1-11:2; see also Exhibit No. RG-3C at 16-17 (Coal Transition PPA Section 3.1) and 45 (Exhibit B to Coal Transition PPA). The exact pricing terms are designated “Confidential” under Order 01 Protective Order with “Highly Confidential” Provisions, entered in this proceeding on September 10, 2012.

- 16 On August 20, 2012, PSE filed its Petition seeking Commission approval of the Coal Transition PPA under RCW 80.04.570.¹⁰ PSE's filing included supportive testimony and exhibits by Ms. Barnard, Mr. Bevil, Mr. Garratt and Ms. Selig.¹¹
- 17 Staff, Public Counsel and NWECA each filed response testimony and exhibits on November 2, 2012. Each party sponsors one witness: Mr. Gomez for Staff, Mr. Woodruff for Public Counsel and Ms. Dixon for NWECA. While it is fair to observe that none of these witnesses flatly opposed Commission approval of the Coal Transition PPA, it is equally fair to observe that none offers unqualified support for PSE's Petition. Although ICNU did not file testimony, its representative participated in oral argument following the evidentiary hearing and supported various positions taken by these parties.
- 18 Mr. Garratt and Ms. Barnard filed rebuttal testimony for PSE on November 16, 2012. They contest the principal issues raised by the response testimonies and clarify PSE's initial filing with respect to certain secondary issues. Mr. Garrett filed supplemental rebuttal testimony on November 19, 2012 in response to corrections Mr. Gomez filed to his responsive testimony on November 15, 2012.
- 19 The Commission conducted evidentiary hearings on December 12, 2012. We heard oral argument from all parties on December 20, 2012.

II. Issues

- 20 The Legislature has set forth the standards, which, if met, mean that we "must approve" the PPA.

The commission must approve a power purchase agreement for acquisition of coal transition power pursuant to this section only if the

¹⁰ Petition for Approval of a Power Purchase Agreement for Acquisition of Coal Transition Power, as Defined in RCW 80.80.010, and the Recovery of Related Acquisition Costs.

¹¹ Ms. Barnard testifies concerning the proposed cost recovery methodology. Mr. Bevil testifies about 2011 RFP process and the quantitative and qualitative evaluation of the TransAlta CTPPA. Mr. Garratt testifies about the IRP and RFP and the Company's internal decision-making processes and about PSE's proposed calculation of the equity component allowed under the statute. Ms. Selig offers a more detailed look into PSE's quantitative analyses.

commission determines that, considering the circumstances existing at the time of such a review: The terms of such an agreement provide adequate protection to ratepayers and the electrical company during the term of such an agreement or in the event of early termination; the resource is needed by the electrical company to serve its ratepayers and the resource meets the need in a cost-effective manner as determined under the lowest reasonable cost resource standards under chapter 19.280 RCW, including the cost of the power purchase agreement plus the equity component as determined in this section. As part of these determinations, the commission shall consider, among other factors, the long-term economic risks and benefits to the electrical company and its ratepayers of such a long-term purchase.¹²

Further, the Legislature set forth the methodology for determining the “equity component” the utility entering into such a PPA may earn.

(6)(a) Upon commission approval of an electrical company’s power purchase agreement for the acquisition of coal transition power in accordance with this section, the electrical company is allowed to earn the equity component of its authorized rate of return in the same manner as if it had purchased or built an equivalent plant and to recover the cost of the coal transition power under the power purchase agreement. Any power purchase agreement for the acquisition of coal transition power that earns a return on equity may not be included in an imputed debt calculation for setting customer rates.

(b) For purposes of determining the equity value, the cost of an equivalent plant is the least cost purchased or self-built electric generation plant with equivalent capacity. In determining the least cost plant, the commission may rely on the electric company’s most recent filed integrated resource plan. The cost of an equivalent plant, in dollars per kilowatt, must be determined in the original process of commission approval for each power purchase agreement for coal transition power.

(c) The equivalent plant cost determined in the approval process must be amortized over the life of the power purchase agreement for acquisition of coal transition power to determine the recovery of the equity value.

¹² RCW 80.04.570(4).

(d) The recovery of the equity component must be determined and approved in the review process set forth in this section. The approved equity value must be in addition to the approved cost of the power purchase agreement.¹³

21 No party contests PSE on the question whether the Coal Transition PPA is needed by the Company to serve customers. Mr. Gomez testifies that “Staff stipulates that the [Coal Transition] PPA is needed by PSE to serve its ratepayers over the term of the contract, and that the [Coal Transition] PPA meets this need in a cost-effective manner.”¹⁴ Staff and the other parties do not oppose Commission approval of the Coal Transition PPA but recommend that various conditions be imposed to provide “adequate protection to ratepayers,” as required under RCW 80.04.570(4).

22 Staff and Public Counsel challenge PSE on the question of what is the cost of an equivalent plant for purposes of determining how much equity return PSE should be allowed to recover under the statute.¹⁵ As summarized below, Staff raises several additional issues related to the “equity adder” proposed by PSE:

- Staff and Public Counsel challenge PSE’s proposal to measure the cost of an equivalent plant based on a bid the Company received during its most recent Integrated Resource Plan (IRP) and associated Request for Proposals (RFP) process, but rejected.¹⁶ They contend that, considering the IRP/RFP analyses and results, PSE did not select the “least cost purchased or self-built electric generation plant with equivalent capacity.”¹⁷ Staff and Public Counsel propose that the Commission rely on the Company’s selection and purchase in November 2012 of the Ferndale Combined Cycle Turbine Cogeneration Facility, which was identified as a least cost option through the 2011 RFP process.

¹³ RCW 80.04.579(6).

¹⁴ Exhibit No. DCG-1HCT at 3:16-17. Staff clarified during oral argument that this stipulation depends on the equity adder cost of the contract being based as advocated by Staff, not the higher level based on PSE’s proposed “cost equivalent plant.”

¹⁵ RCW 80.04.570(6)(a).

¹⁶ By way of shorthand reference in this Order, we sometimes refer to the two-step process as the “IRP/RFP.”

¹⁷ RCW 80.04.570(6)(b).

- Staff challenges PSE’s proposal to fix the equity return throughout the term of the Coal Transition PPA at 7.24 percent, the Company’s currently authorized pre-tax weighted average cost of equity return. Staff argues the return should be adjusted as set in subsequent PSE general rate cases.¹⁸
- There is a methodological dispute between PSE and Staff concerning the calculation of levelized costs for purposes of setting the equity adder value.
- Staff recommends that the equity adder should be allowed only for power generated by coal fuel at the CTCF or a substitute source of energy if required by an abnormal circumstance of limited duration that prevents delivery from the CTCF.

23 Public Counsel and NWECA both initially recommended that we impose conditions requiring changes in the structure and specific terms included in the Coal Transition PPA. Public Counsel withdrew its proposal during oral argument but NWECA’s recommendation remains at issue. NWECA challenges Section 10.1 of the Coal Transition PPA, which implements RCW 80.04.570(2), arguing that it should be revised to establish TransAlta as the assumed risk taker in the event of future greenhouse gas emissions regulations or requirements, while still allowing for a contract reopener at the time of any such regulations or requirements to assess specific details, if needed.

24 Public Counsel initially argued that the Commission should condition approval of the Coal Transition PPA by requiring the contract to be restructured to include a unit contingency requirement (*i.e.*, PSE’s obligation to take power at any given time is contingent on the plant actually operating at a certain level) and by giving PSE dispatch rights. During oral argument Public Counsel said it would not urge the Commission to require contract reformation, but instead urged that we recognize the absence of such rights in the Coal Transition PPA make it too reliant on the use of resupply power.¹⁹ Public Counsel recommends that the Commission accept Staff’s position that resupply power be narrowly defined and that PSE’s right to equity return

¹⁸ PSE states on rebuttal that while accepting Staff’s recommendation will increase the complexity of the return calculation, “PSE can accept the proposal.” Exhibit No. RG-10HCT at 33:15-34:2.

¹⁹ See TR. 290:23-291:24 (ffitch).

should apply only to power produced by the CTCF and the limited amount of resupply power that would qualify under Staff's proposal.

- 25 Staff and NWEAC recommend that the Commission condition approval of the Coal Transition PPA to protect the relationship between the Coal Transition PPA and TransAlta's obligations to provide financial support to affected communities under the MOA and RCW 80.80.100. Public Counsel subscribed to this position during oral argument.
- 26 Finally, Staff challenges PSE's proposal to defer certain costs during the life of the Coal Transition PPA.

III. Discussion and Decisions

A. Equity Return

1. What is the Cost of an "Equivalent Plant"?

- 27 *Commission Determination: We find that the cost of an equivalent plant for purposes of calculating the amount of equity return to which PSE is entitled under RCW 80.04.570(6) is \$110 million.*
- 28 RCW 80.04.570(6)(a) provides that PSE is allowed to earn the equity component of its authorized rate of return on the Coal Transition PPA "in the same manner as if it had purchased or built an equivalent plant." RCW 80.04.570(6)(b) states how the Commission should determine the value of an equivalent plant for purposes of calculating the equity return to which a coal transition power purchaser is entitled under the statute:

For purposes of determining the equity value, the cost of an equivalent plant is the *least cost* purchased or self-built electric generation plant with *equivalent capacity*. In determining the least cost plant, the commission *may rely* on the electrical company's most recent filed integrated resource plan. The cost of an equivalent plant, in dollars per kilowatt, must be determined in the original

process of commission approval for each power purchase agreement for coal transition power.²⁰

These requirements are by no means prescriptive. They offer guidance but also give the Commission significant latitude to determine the cost of an equivalent plant for purposes of calculating the equity return available for a coal transition power purchase agreement based on the record and the application of informed judgment.²¹

29 Three parties address this issue: PSE, Staff and Public Counsel. These parties all suggest that we should rely on the Company's most recently completed IRP and the associated RFP process in which the Coal Transition PPA and acquisition of Ferndale were selected as providing together the least cost means by which PSE can satisfy its capacity needs in the near to intermediate term. The parties differ, however, in their perspectives on what information garnered during this process should be the focus of our determination and they propose significantly different outcomes.

30 PSE, focusing on a plant acquisition proposal received but rejected during the 2011 RFP process, argues the cost of an equivalent plant is \$215 million. Staff and Public Counsel focus on a plant acquisition bid into the 2011 RFP that PSE ultimately purchased in November 2012 for \$84.2 million: the Tenaska Ferndale Cogeneration Facility (Ferndale). Staff considers Ferndale's unadjusted purchase price as the cost of an equivalent plant. Public Counsel adjusts for the larger volumes under the Coal Transition PPA relative to Ferndale's capacity and allows for certain transaction costs and costs of improvements, and arrives at \$110 million as the cost of an equivalent plant.

²⁰ RCW 80.04.570(6)(b) (emphasis added).

²¹ This is necessary, among other reasons, because it is highly unlikely that an actual plant available for purchase at any given time will match perfectly in its operating characteristics the purchaser's requirements and seller's obligations under a purchase power agreement. Indeed, PSE's witness, Mr. Garratt, recognizes that "the Coal Transition PPA is a firm, 24x7 product, and the capacity factors of the projects bid into the 2011 RFP are less than 100%." Exhibit No. RG-1HCT at 24:16-17. Public Counsel's witness, Mr. Woodruff, testifies in this vein that "no plant can operate at a 100 percent capacity factor." Exhibit No. KDW-1HCT at 30:17-31:6. Accordingly, he says, "there is arguably no plant that is truly equivalent to the Coal Transition PPA and thus no 'true capital cost of an equivalent plant.'" *Id.*

31 Mr. Garratt explains the method PSE used to determine the equity amount it believes the Company should be entitled to recover under RCW 80.80.570(6).²² PSE first calculated an equivalent plant size of 346 MW, based on the average volume of power to be delivered during the term of the Coal Transition PPA. PSE then calculated a projected cost of an equivalent plant of approximately \$215 million, based on the per kilowatt cost of a plant ownership proposal PSE received in response to its 2011 RFP, but rejected.²³ According to Mr. Garratt, this ownership proposal for the Alternative Plant yielded the least cost purchased or self-built electric generation plant (expressed in dollars per kilowatt) among the proposals that PSE decided not to pursue as a result of the 2011 RFP.

32 Both Staff and Public Counsel contest PSE's exclusive focus on the Alternative Plant ownership proposal as the proper measure of an equivalent plant under the statute. Mr. Gomez testifies that Staff disagrees with the Company's decision to pass over what actually was the least cost purchase offer PSE received in response to its 2011 RFP, the Ferndale²⁴ project offered for sale by Tenaska Washington Partners. Mr. Gomez says that neither logic nor the law support PSE's view that Ferndale no longer qualifies as a touchstone for making the cost equivalent plant determination because it was chosen in the RFP for acquisition in conjunction with a revised offer PSE received from TransAlta.²⁵

33 Mr. Woodruff testifies similarly that the Alternative Plant is not an appropriate measure of an equivalent plant under the statute, for several reasons. First, he

²² Exhibit No. RG-1HCT at 24:10-29:3; Exhibit No. RG-9.

²³ The identity of the specific plant is designated "Highly Confidential" under Order 01 Protective Order with "Highly Confidential" Provisions, entered in this proceeding on September 10, 2012. We will refer to it for purposes of this Order as the "Alternative Plant."

²⁴ Exhibit No. RG-8HC at 372.

²⁵ Exhibit No. DCG-1HCT at 9:20-12:2. Mr. Gomez also states that "the [Ferndale] plant was not chosen until after the selection of the CTCF." Mr. Garratt says on rebuttal that "PSE made the decision to acquire the Ferndale Cogeneration Station before it determined to enter into the Coal Transition PPA." Exhibit No. RG-10HCT at 26:8-9. In point of fact, it appears that Ferndale actually was chosen in conjunction with the revised Coal Transition PPA that PSE ultimately selected to meet its identified capacity needs through about 2016. *See generally* Exhibit No. CB-3HC.

agrees with Staff that this is not the least cost plant demonstrated by the 2011 RFP to be available to PSE.²⁶ Mr. Woodruff points out that PSE acknowledged in discovery that the lowest cost option identified in the 2011 RFP was the proposal for Ferndale, which has an estimated cost about one-half of the Alternative Plant cost.²⁷ He says that PSE, in its response to Staff's discovery, justified choosing the Alternative Plant proposal on the basis that it represents the "*next* lowest capital cost" resource after Ferndale. PSE's discovery response contends Alternative Plant is the "lowest capital cost resource *available* to PSE" because the Company elected to acquire Ferndale.²⁸

34 Mr. Woodruff argues that the Alternative Plant is not the least cost alternative either under a plain English reading of the statute or if "least cost" is considered as a term of art in electric utility resource planning nomenclature. He says that "in the electric utility industry, the term 'least cost' refers to the "electric resource(s) expected to provide a utility's customers with reliable service at the lowest overall expected long-term cost."²⁹ He testifies that PSE itself found that Alternative Plant did not meet this criterion during the 2011 RFP.

35 Mr. Woodruff refers specifically to PSE's July re-evaluation of revised offers it received during the RFP evaluation process showing that the Alternative Plant is not PSE's least cost resource option.³⁰ The exhibit to which Mr. Woodruff refers shows that in PSE's original optimization results, the Alternative Plant was not selected as part of any least cost portfolio in any of the five analytic scenarios. Indeed, it is the only resource among ten options that was not selected in at least one of the five scenarios.³¹ The Alternative Plant also was not chosen in the additional optimization analyses performed on the revised proposals PSE received on June 22, 2012, and July

²⁶ Exhibit No. KDW-1HCT at 26:17-31:18.

²⁷ Exhibit No. KDW-14HC (PSE response to Staff Data Request No. 2).

²⁸ See, Exhibit No. KDW-14HC at 3; See also, Exhibit No. RG-1HCT at 25:16-20.

²⁹ Exhibit No. KDW-1HCT at 27:19-28:3.

³⁰ *Id.* at 24:4-8 (referring to Exhibit No. CB-4HC).

³¹ Exhibit No. CB-4HC at 4 (Figure 2). See also Exhibit CB-1HCT at 25:1-3 ("the Alternative Plant ownership . . . price sensitivity analysis [showed that] the Alternative Plant ownership purchase price needed to be reduced by approximately 50% just to be least cost in three of five scenarios.")

5, 2012.³² In addition, PSE found in its qualitative review that the Alternative Plant “[p]roject economics [are] less favorable than alternatives.”³³

36 Both Mr. Gomez and Mr. Woodruff testify that the Alternative Plant also is an inappropriate selection as an equivalent plant because it does not meet the capacity criterion for selection as a resource from which to calculate the equity return component of the Coal Transition PPA.³⁴ Mr. Gomez testifies that as part of PSE’s Phase II Qualitative Risks analysis the Company determined that the “capacity output of [the Alternative Plant] facility is large and would produce a substantial surplus of PSE’s capacity need until 2016 based on current load forecast.”³⁵ Mr. Gomez says the Ferndale facility’s 280 MW is a closer match for the 327 MW³⁶ of average energy he calculates will be delivered to PSE from the Coal Transition PPA, and the 221 MW of capacity that was originally envisioned in the 2011 IRP for a self-build single cycle combustion turbine plant.

37 Mr. Woodruff testifies similarly that the capacity of Alternative Plant is considerably greater than the capacity of the Coal Transition PPA, which averages 346 MW and varies between 180 MW and 380 MW.³⁷ Mr. Woodruff says that while neither Alternative Plant nor Ferndale is precisely the same capacity as the Coal Transition PPA, Ferndale is much closer to the Coal Transition PPA’s capacity and hence a better equivalent. Mr. Woodruff also points out that Alternative Plant is not among the four resources found during PSE’s reevaluation of proposals to meet the

³² *Id.* at 5-6 (Figures 3 and 4).

³³ *Id.* at 10.

³⁴ The Alternative Plant, in fact, is significantly larger than the capacity acquired via the Coal Transition PPA. *See* Exhibit No. DCG-1HCT at 10:16-17; *see also* Exhibit No. KDW-1HCT at 29:9-30:2.

³⁵ Exhibit No. DCG-1HCT at 10:17-20 (quoting Exhibit No. CB-4HC at 10).

³⁶ It is not clear how Mr. Gomez calculated this number. Mr. Garratt testifies that the average volume of power to be delivered over the life of the contract is 346 MW. Exhibit No. RG-1HCT at 24:12-13. Mr. Woodruff also finds an average delivery of 346 MW. Exhibit No. KDW-1HCT at 29:9-18.

³⁷ Exhibit No. KDW-1HCT at 29:7-18.

Company's identified capacity need while both the Coal Transition PPA and Ferndale were determined to meet this need.³⁸

38 Mr. Gomez and Mr. Woodruff offer several additional reasons why Ferndale should be considered an equivalent plant rather than the Alternative Plant. Mr. Gomez, for example, points to the RFP scoring results for Phase II showing the Alternative Plant offer as having a *negative* portfolio benefit of \$62.4 million, with significantly higher risks associated with the acquisition than the Ferndale plant offer with its portfolio benefit of \$96.1 million.³⁹ Mr. Woodruff testifies additionally that the Company's analyses show it found that there were qualitative risks associated with the condition of the plant, the availability and cost of transmission, the adequacy of the pipeline capacity, and the likely possibility that the plant could not be economically be upgraded to meet Emissions Performance Standards.⁴⁰ Thus, Mr. Woodruff concludes, there are a number of quantitative and qualitative reasons that disqualify Alternative Plant from consideration for setting the cost of an equivalent plant under RCW 80.04.570.

39 We find that the facts and analyses available to us from the 2010 IRP/2011 RFP process militate strongly in favor of using Ferndale as a key factor in our determination of a cost equivalent plant for purposes of RCW 80.04.570(6). While PSE originally identified a 500 MW power purchase agreement with TransAlta as a preferred means to meet its near-term resource needs, subsequent developments brought the 280 MW Ferndale plant to the forefront as a way to meet the Company's identified need through 2013 (*i.e.*, 242 MW).⁴¹ The Ferndale acquisition option was selected in conjunction with negotiation of a 380 MW option for coal transition power that would add 180 MW of additional capacity in 2014 and 280 MW in 2015. These incremental increases satisfy PSE's projected needs for capacity additions (*i.e.*, 460 MW in 2014 and 554 MW in 2015). Beginning in 2016, the Coal Transition PPA would add 380 MW of capacity and,

³⁸ Exhibit No. CB-4HC (Figure 11).

³⁹ See Exhibit No. DCG-1HCT at 11:3-11 (citing Exhibit No. CB-4HC at 18).

⁴⁰ Exhibit No. KDW-1HCT at 30:9-16 (citing Exhibit No. CB-4HC at 10).

⁴¹ See Exhibit No. CB-1HCT at 15:6 and related discussion at 14:1-15:14. See also Exhibit No. RG-10HCT at 2:1-14.

again in conjunction with Ferndale, would meet much of PSE's identified supply-side capacity requirement (*i.e.*, 728 MW) at that time.⁴²

40 In other words, PSE determined on the basis of its own careful analysis during the RFP process that the combination of Ferndale and the Coal Transition PPA represents the 'least cost' alternative to meet the Company's capacity needs as identified in the 2010 IRP load forecast as updated in connection with the 2011 RFP process.⁴³ That is, these are the electric resources expected to provide PSE's customers with reliable service at the lowest overall expected long-term cost.

41 On the other hand, PSE's analyses during the 2011 RFP process showed that the Alternative Plant was not a viable option for meeting these supply side capacity needs. It cannot be regarded as a "least cost" alternative in the context of the IRP/RFP process in which PSE evaluated it. It is not by most, if any, measures equivalent to the Coal Transition PPA. Indeed, by both quantitative evaluations and qualitative considerations it cannot be found to represent the least cost mix of electric resource(s) expected to provide PSE's customers with reliable service at the lowest overall expected long-term cost. The Alternative Plant purchase offer is simply not a good measure, or basis for measurement, of the cost of a plant equivalent to the Coal Transition PPA.⁴⁴

42 Our focus, given the evidence before us, is on what was available for purchase in response to the 2010-2011 IRP/RFP process. Ferndale was available and, indeed,

⁴² *Id.*; See also Exhibit No. RG-10HCT at 3:1 ("The Coal Transition PPA ramps to match PSE's capacity need over time") and 17:3-5 ("PSE concluded that the Ferndale Cogeneration Station ownership offer and the Coal Transition PPA offer are least cost and least risk resources after considering the quantitative and qualitative analyses performed in the 2011 RFP.").

⁴³ See *Id.* at 17:3-5.

⁴⁴ The fact that the Alternative Plant was arguably available as a substitute for the Coal Transition PPA, even if that argument had merit, is simply beside the point. It is entirely conceivable that no actual plant sale, or offer to sell, could be considered to be "the least cost purchased or self-built electric generation plant with equivalent capacity" under RCW 80.04.570(6)(b). In any event, PSE's argument that the Alternative Plant was available to meet the need identified in the IRP/RFP process does not hold up under the Company's own evaluation of alternatives, in which it was rejected as an option.

was selected for acquisition in conjunction with the selection of the Coal Transition PPA. This weighs strongly in favor of using the Ferndale plant cost as the measure of the per kWh price of an equivalent plant for the full capacity acquired to meet PSE's requirements through at least 2016. PSE, in contrast, would have us ignore the transaction it selected as least cost in favor of a transaction it rejected because it was not least cost and was otherwise an unsuitable option for meeting the Company's resource needs.⁴⁵ This defies logic.

43 We find that the best evidence for determining the cost of an equivalent plant for purposes of RCW 80.04.570 is the price that PSE paid for Ferndale.⁴⁶ PSE determined via the 2011 RFP process that Ferndale is the least cost electric generation plant with capacity that PSE might otherwise have obtained under the original coal transition PPA it evaluated. Although Ferndale's capacity is a bit less than the amount PSE contracted for under the Coal Transition PPA, it is easy enough to adjust for this and determine the full cost of an equivalent plant following PSE's approach. Thus, using 346 MW as the appropriate size plant, considering average deliveries of power over the life of the Coal Transition PPA, coupled with the per kilowatt price PSE paid for Ferndale (*i.e.*, \$318/kW), we determine the cost of an equivalent plant is \$110 million.⁴⁷

⁴⁵ We note in this connection that there is nothing in RCW 80.04.570 that requires the Commission to base its determination of the cost of an equivalent plant on the bid price of a plant actually available for sale at the time. It is entirely conceivable that no such plant would even exist at the time of the Commission's evaluation.

⁴⁶ In the language of property valuation, Ferndale can be regarded as a "comparable sale." The Alternative Plant bid, in contrast, represents nothing more than an offer that did not meet with acceptance in the market.

⁴⁷ The \$318/kW price was calculated by PSE. *See* Exhibit No. DCG-4HC (PSE Response to Staff Data Request 2). This price includes PSE's estimated costs to effect certain plant improvements "to meet PSE's compliance and design standards," and transaction costs. Staff objects to the recognition of these costs when determining the cost of equivalent plant. *See* Exhibit DCG-1HCT at 11:11-14. We find, however, that it is appropriate to consider these costs and recognize them in making our determination.

2. Should the Rate of Return on Equity be Constant over the Life of the Contract?

44 *Commission Determination: Considering the unique ratemaking requirements imposed by RCW 80.04.570, we find that it is appropriate to accept PSE's proposal to hold the equity return component constant at PSE's currently authorized pre-tax weighted average cost of equity of 7.24 percent for the term of the Coal Transition PPA.*

45 PSE proposes that the Commission set the equity return rate at the currently authorized pre-tax weighted average 7.24 percent for the entire term of the Coal Transition PPA, regardless of what the Commission may allow as an authorized equity ratio or return on equity in future rate proceedings.⁴⁸ Mr. Garratt testifies that: “[f]or ease of calculation, this pre-tax weighted average cost of equity remains fixed throughout the term of the Coal Transition PPA.”⁴⁹

46 Mr. Gomez testifies that Staff sees no reason why the equity return rate should remain the same throughout the term of the Coal Transition PPA. He contends it should change just as PSE's authorized return on equity applicable to other assets changes from one general rate case to another.⁵⁰

47 Mr. Garratt reiterates on rebuttal that PSE proposed to use its currently authorized pre-tax weighted average cost of equity return for the term of the Coal Transition PPA to simplify the up-front calculation of total equity return, which is required to be recovered on a levelized basis over the life of the contract. Mr. Garratt says that Staff's proposal will increase the complexity of the return calculation but “PSE can accept the proposal.”⁵¹

⁴⁸ This pre-tax weighted average cost of equity of 7.24% reflects the return on equity and equity ratio authorized by the Commission in PSE's most recent general rate proceeding.

⁴⁹ Exhibit No. RG-1HCT at 26:18-19.

⁵⁰ Exhibit No. DCG-1HCT at 12:4-18.

⁵¹ Exhibit No. RG-10HCT at 34:1-2.

- 48 Our determination of this issue is influenced by the unique ratemaking requirements imposed by RCW 80.04.570. We are directed to allow PSE to earn return on the Coal Transition PPA based on the cost of an equivalent plant, as if PSE were acquiring a hard asset and adding it to rate base. In the case of a hard asset, PSE's capital investment would be depreciated over a fixed term and PSE is allowed to earn a return on a declining rate base at whatever rate of return on equity the Commission authorized from time to time. This is not an appropriate approach in the case of the Coal Transition PPA because most of the total equity return would be recovered during the early years of the contract, putting customers at risk in the event of early termination of the agreement. This effect is exacerbated by the short duration of the Coal Transition PPA relative to the depreciable life of an actual plant in which PSE makes an actual capital investment. We should avoid risk and uncertainty for PSE's customers who pay the costs of the Coal Transition PPA to the extent this can be accomplished.
- 49 It is more reasonable, then, for the Commission to determine at the outset the full amount of return PSE will be allowed to recover over the life of the Coal Transition PPA and provide for recovery of the total amount on a levelized basis over the term of the contract. This levelized return, recovered on a per MWh basis, protects customers in the event the contract is terminated early. This is PSE's approach. We find it both simple and sensible. We accordingly determine that it is appropriate in this unique situation to fix the allowed return on the Coal Transition PPA at PSE's currently authorized pre-tax weighted average cost of equity: 7.24 percent return.
- 50 There is a second factor to consider in this connection, though it was not addressed explicitly by the parties. This is the question of income tax effect. The 7.24 percent pre-tax weighted average cost of equity is calculated using PSE's currently authorized rate of return on equity of 9.8 percent, its currently authorized equity share in the Company's capital structure of 48 percent and the currently effective federal corporate income tax rate of 35 percent. The formula is: $(9.8\% \times 48\%) / 65\% = 7.24\%$. While we determine PSE's authorized rate of return on equity in general rate cases we have no control over the federal income tax rate. PSE is at risk if the corporate income tax rate increases. Ratepayers are at risk if it decreases. Should the corporate income tax rate change during the term of the Coal Transition PPA, the Commission may consider in an appropriate case whether the equity adder should be adjusted to reflect the new rate.

3. How Should Levelized Cost be Determined?

51 *Commission Determination: We find that PSE’s method for levelizing the total equity return over the term of the contract, recognizing the net present value of the stream of payments PSE will receive if the contract runs its full term, is reasonable. We apply this method in conjunction with our \$110 million equivalent plant value and determine that the cost to customers of the adder for the equity component will be \$1.49/MWh.*

52 Mr. Garratt testifies that a levelized cost approach results in equal (or “levelized”) payments over the applicable time period (*e.g.*, the term of a power purchase agreement or the depreciable life of a rate-based asset) and which has an equivalent present value to the present value of the stream of payments based on the traditional, front-end loaded regulatory methodology resulting from earning a fixed return upon a declining asset value.⁵² Mr. Garratt says this approach was discussed with stakeholders during the legislative process that led to the coal transition provisions in Chapter 80.80 RCW and RCW 80.04.570 as a way to protect customers in the event of early termination of the Coal Transition PPA.⁵³

53 According to Mr. Garratt, PSE calculated the levelized cost of the equity component of the Coal Transition PPA using its currently authorized weighted average cost of capital (*i.e.*, 7.8 percent) as its interest cost. Mr. Garratt testifies that this accounts for the time value of money using a methodology that PSE has used to levelize costs in all of PSE’s requests for proposals for the past ten years.⁵⁴

54 Staff, however, uses an interest rate of zero, effectively calculating a simple average by dividing the nominal equity amount by the time period for payments (*i.e.*, 133 months). Thus, Staff ignores the cost of deferring payments by calculating simple average cost rather than the levelized cost of the net present value.⁵⁵

⁵² Exhibit No. RG-15T at 2:23-3:5.

⁵³ *Id.* at 3:8-10.

⁵⁴ *Id.* at 3:13-18

⁵⁵ *Id.* at 4:17-18.

55 Mr. Garratt, using PSE's cost equivalent plant value and fixed rate of return, demonstrates that Staff's use of a simple average cost rather than PSE's levelized cost results in a return of \$2.57/MWh as compared to the \$2.92/MWh result using PSE's methodology.⁵⁶ Staff's approach, applied to PSE's return calculation, would mean that the net present value of the stream of equity payments to PSE over the life of the Coal Transition PPA would be \$57.39 million. This is significantly less than the \$66.76 million net present value of the equity return PSE would realize from a \$215 million plant depreciated over the term of the Coal Transition PPA or the \$65.26 million net present value calculated using PSE's methodology.⁵⁷

56 We determine that PSE's methodology for levelizing costs is appropriate to use. It would not be fair to PSE to ignore the time value of money in making this determination. Even though it results in PSE recovering more return on a nominal basis over the term of the Coal Transition PPA than the nominal return that would result under traditional ratemaking,⁵⁸ PSE's approach protects ratepayers by spreading the authorized return over the entire volume of power deliveries. This means that, consistent with the statutory directive,⁵⁹ customers do not bear the risks of early termination.

57 Using the method we approve, coupled with our decisions on the cost equivalent plant and equity return, results in an equity adder of \$1.49 per MWh, assuming no change is required in the future due to a change in the federal corporate income tax rate. Equity payments to PSE at this level over the term of the contract have a net present

⁵⁶ Exhibit No. RG-16 (compare Table 1 (Staff method) to Table 2 (PSE method)).

⁵⁷ *Id.* Columns B and Rows 26 of each of Tables 1 and 2 in Exhibit No. RG-16 calculate the net present value cost of the monthly equity returns calculated based on the respective levelized cost calculation methodologies. PSE's method results in a present value cost of \$65.26 million, which is approximately equal to the original present value cost in Column B, line 16 of each of Tables 1 and 2 (*i.e.*, \$66.76 million NPV at 7.8%). Commission Staff's methodology, however, results in a present value (Column B, line 26) of \$57.39 million, which is 14% lower than the original present value cost in Column B, line 16 of each of Tables 1 and 2. *See also* Exhibit No. DCG-16CX.

⁵⁸ This is illustrated in Exhibit No. DCG-16CCX at 8.

⁵⁹ *See* RCW 82.04.570(4) (The Commission must determine that "[t]he terms of such an agreement provide adequate protection to ratepayers and the electrical company during the term of such an agreement or in the event of early termination . . .").

value of approximately \$34.13 million.⁶⁰ The nominal value of this return over the full term of the Coal Transition PPA is about \$44.12 million.

4. Should “Resupply Power” be Eligible for Equity Return?

58 *Commission Determination: We find that PSE should be allowed to recover an equity return on the full volume of power TransAlta delivers under the terms of the Coal Transition PPA, including resupply power. However, we will require PSE to monitor, and report to the Commission annually, TransAlta’s production levels at the Centralia Coal Transition Facility. PSE will also be required to report whether and, if so, to what extent TransAlta has satisfied any part of its delivery obligations through the use of resupply power. The report must identify the amounts of resupply power by source. Although PSE expects TransAlta to continue to operate the plant in a manner that will result in most power delivered under the Coal Transition PPA being from the Centralia Coal Transition Facility, this is not required under the agreement. It is conceivable that deliveries from the facility will reach a point where the contract may be determined to no longer qualify under the terms of RCW 80.04.570 and related authority as a “coal transition PPA.” In such unlikely circumstances, the Commission may initiate a proceeding to consider whether it remains prudent for PSE to continue taking deliveries under the contract and, if so, whether PSE can continue to recover any equity return in association with any volumes delivered under the contract.*

59 PSE’s right to recover return is not tied to production from the CTCF under the terms of the Coal Transition PPA. Section 3.2 of the Coal Transition PPA allows TransAlta to provide power from any source or sources if, *for any reason*, the output from the CTCF is reduced or curtailed.⁶¹ This is sometimes referred to as a “resupply provision,” though that term is not defined in the Coal Transition PPA. Staff objects that there is nothing in the agreement that prevents TransAlta from cutting back on

⁶⁰ See Exhibit No. KDW-1HCT at 32:1-14.

⁶¹ Exhibit No. RG-3C (Coal Transition PPA Section 3.2 (b) (Page 17 of 51) (*emphasis added*))

CTCF power production, delivering to PSE lower cost power from other sources,⁶² and then benefiting from the price arbitrage. Mr. Woodruff testifies similarly that:

During periods when the market prices in the PNW are below Centralia's variable operating costs, TransAlta would be expected to make the economically rational decision to reduce Centralia's output – possibly to zero – and purchase power from other sources to meet its delivery obligations under the Coal Transition PPA. During such periods, this strategy should be quite advantageous to TransAlta.⁶³

In addition, Mr. Woodruff makes the point that:

There are only weak contractual links between the operation of Centralia and the delivery and pricing terms of the Coal Transition PPA. From the perspective of PSE's customers, Centralia is barely relevant to the basic structure of the Coal Transition PPA. PSE customers will be required to purchase fixed amounts of power delivered by TransAlta for every hour from December 1, 2014, to December 31, 2025 at fixed prices regardless of whether the Centralia plant is operating.⁶⁴

60 Staff and Public Counsel both recommend that we condition any approval of the Coal Transition PPA to address these concerns. Staff makes a specific recommendation in which Public Counsel joined during oral argument.⁶⁵ Staff argues that the equity adder should be allowed only for power generated by coal fuel at the CTCF or under Staff's proposed definition of resupply. According to Mr. Gomez:

The proper interpretation of "resupply," as it relates to a power purchase agreement for the acquisition of coal transition power, is a

⁶² Although Staff does not say so, this might include surplus power from BPA that recent events inform us may sometimes be available on the market at no cost or even at a "negative price." Even under more ordinary conditions, it is likely that power will be available on the market from time to time at lower costs than provided under the Coal Transition CTPPA.

⁶³ Exhibit No. KDW-1HCT at 11:3-8.

⁶⁴ *Id.* at 7:18-8:5.

⁶⁵ Public Counsel initially recommended contract reformation to resolve this issue, but dropped that position during oral argument in favor of Staff's approach.

seller's right to substitute the source of energy *in the event of an abnormal circumstance of limited duration that prevents delivery from the CTCF*.⁶⁶

Mr. Gomez contends that this definition should be applied to the Coal Transition PPA to provide adequate protection to ratepayers.⁶⁷ He says, in addition, that Staff's proposal in this connection "is in keeping with the law's goal of maintaining employment in affected communities."⁶⁸

61 Mr. Garratt does not dispute that the Coal Transition PPA allows TransAlta to obtain power from sources other than the CTCF. Focusing on the several policy goals underlying greenhouse gas emissions and coal transition legislation, however, Mr. Garratt testifies that:

Allowing resupply upon curtailment "for any reason" promotes the public interests that the Legislature sought to promote. The Legislature found that "an electrical company's acquisition of coal transition power helps to achieve the state's greenhouse gas emission reduction goals by effecting an orderly transition to cleaner fuels and supports the state's public policy." Resupply can help reduce greenhouse gas emissions by replacing coal-fired generation with power from other sources, such as hydropower during high water periods. Resupply can also promote grid stability and reliability, and the integration of wind, solar and other variable renewable energy resources, by allowing TransAlta to reduce facility generation at times when there is excess generation present on the grid.⁶⁹

⁶⁶ Exhibit No. DCG-1HCT at 8:5-14 (emphasis added).

⁶⁷ *Id.* at 8:5-14. It is unclear whether relieving PSE's customers from the burden of paying the equity adder would provide adequate protection to ratepayers in circumstances where market power is available at a price lower than TransAlta's variable costs, particularly if this situation persists for significant periods of time during the contract term. During such periods, PSE's ratepayers will capture none of the benefits of the lower cost power. The Coal Transition PPA, viewed as a hedge against higher power prices, may work out to customers' benefit over its full term if such higher prices eventuate. It is also possible, however, that the power prices under the Coal Transition PPA will result in PSE's customers paying more for power than would be the case if PSE had more flexibility under the terms of the contract, or made alternative arrangements to obtain power at prices indexed in one way or another to the market.

⁶⁸ *Id.* at 13:14-19.

⁶⁹ *Id.* at 30 (quoting RCW 80.04.560). *See also* RCW 80.80.005.

- 62 NWEC’s position supports PSE in this connection. Ms. Dixon testifies that NWEC favors having TransAlta substitute lower carbon emitting sources to meet its power delivery obligations, when feasible. Indeed, Ms. Dixon, focusing on the state’s policy goal of reducing emissions, testifies the public interest would benefit if the Coal Transition PPA was amended in such a way as to “incent TransAlta to take advantage of lower GHG emitting resources while still meeting the terms of the contract.”⁷⁰
- 63 Making an additional point, Mr. Garratt refers to an informal opinion letter drafted by the Attorney General’s Office and argues that Staff’s recommendation is inconsistent with the advice it gives the Governor’s Office on this question. Mr. Garratt relates that the Attorney General opined that the inclusion and exercise of resupply rights in a power purchase agreement for coal transition power does not affect the statutory right of the electrical company to recover its costs, including the equity component allowed under RCW 80.04.570(6)(a).⁷¹
- 64 We recognize that there may be times when TransAlta will not be able to provide the full volume of power required under the contract from the CTCF. During the last five years of the contract term, for example, when the single generator then operating must be shut down for maintenance, it will be necessary for TransAlta to find replacement power to meet its delivery obligations. At any time during the contract term, there may be unanticipated events that require both generators to be ramped down, or shut down, for brief periods. There may be times when it simply makes sense to shut down the two generators at the same time to conduct routine maintenance. Under these circumstances, there is a reasonable sharing of risks because TransAlta will have to obtain power for delivery to PSE regardless of whether it can do so at prices lower than the variable costs of operating the plant.
- 65 It would be a different matter entirely, however, if TransAlta elects to shut down production from the CTCF generators and obtain power from other sources for a significant period of time, or permanently, simply because it is financially advantageous to TransAlta to do so. PSE argues, and the weight of the evidence

⁷⁰ Exhibit No. DOD-1-HCT at 11:14-20.

⁷¹ Exhibit No. RG-10HCT at 27:15-28:6 (citing Exhibit No. RG-8HC at 452).

supports, that this is not a likely eventuality.⁷² No one denies, however, that TransAlta could continue to meet its delivery obligations using resupply power without violating the terms of the Coal Transition PPA. Were this to occur, the contract between TransAlta and PSE could be found to have lost its status as a coal transition PPA within the meaning of RCW 80.04.570 and Chapter 80.80 RCW. This is because RCW 80.80.010(5) defines “coal transition power” to mean “the output of a coal-fired electric generation facility that is subject to an obligation to meet the standards contained in RCS 80.80.040(3)(c).”

66 The informal opinion letter from the Attorney General’s office to which Mr. Garratt refers addresses this concern, recognizing that a strict reading of the statute would allow only the recovery of the output of the plant, and not resupply power. However, the informal opinion rejected that conclusion as “contrary to RCW 80.04.570 as a whole, to general principles of rate-setting, and to the purposes the Legislature identified in enacting E2SSB 5759.”⁷³ As part of its analysis, the opinion letter notes the limited nature of resupply rights, as the opinion “assumes that, given the nature of resupply rights, such rights would be exercised *intermittently* over the multi-year term of a power purchase agreement, on an as-needed basis”⁷⁴ It observes that “the actual amounts of resupply power . . . cannot be known at the time the agreement is reviewed by the Commission.”⁷⁵ Also, the opinion letter explains that while “RCW 80.04.570 does not itself address resupply rights, a related statute contemplates that power purchase agreements may involve some purchased power coming from other sources, as would occur through resupply.”⁷⁶ The opinion cites RCW 80.80.040(7) which provides:

⁷² See *supra* footnote 2; Mr. Woodruff testifies, for example that TransAlta probably will not opt to meet its delivery obligations entirely without generation from the CTCF. He expects that the cost of generation from the CTCF will be less at times than wholesale electricity market prices in the Pacific Northwest. Under these circumstances, he anticipates that “TransAlta would operate Centralia at high capacity factors to provide the power needed to meet its delivery obligations under the Coal Transition PPA.” Exhibit No. KDW-1HCT at 9-15. Mr. Woodruff testifies in addition that “key provisions of the PPA suggest that TransAlta views Centralia as important to its continued performance under the PPA.” *Id.* at 9:16-10:3.

⁷³ Exhibit No. RG-8HC at 453.

⁷⁴ *Id.* at 452 (emphasis added).

⁷⁵ *Id.* at 454.

⁷⁶ *Id.*

In no case shall a long-term financial commitment be determined to be in compliance with the greenhouse gas emissions performance standard if the commitment includes more than twelve percent of electricity from unspecified sources.

67 The opinion reasons from this provision that :

A limit on how much power may be supplied from unspecified sources plainly contemplates that agreements may involve power being provided from sources other than the power facility entering the agreement. This would include resupply power once that right is exercised.⁷⁷

Thus, without disputing that the Coal Transition PPA may properly include a resupply provision such as found in Section 3.2 of the agreement, or that PSE may earn equity return on resupply power, we conclude that there may be a limit under the statute on the use of such power. This interpretation is consistent with, and furthers, one of the purposes of the statute. The Legislature was clear that preservation of jobs at the plant was among those purposes. A cessation of plant operations, to the extent such a cessation would result in loss of jobs would be contrary to this purpose. By our interpretation, we seek to minimize that possibility.⁷⁸

68 We need not at this juncture determine definitively the full legal consequences that might flow from these circumstances, if they eventuate. It is better to take a conservative and practical approach than to establish a bright line beyond which the volume of resupply power means the contract between PSE and TransAlta will lose its character as a coal transition power purchase agreement.⁷⁹ It is for this reason that we issued Bench Request No. 2, to which PSE responded on December 28, 2012.

⁷⁷ *Id.*

⁷⁸ The Legislature found that “coal-fired baseload electric generation facilities are a significant contributor to family-wage jobs and economic health in parts of the state and that transition of these facilities must address the economic future and the preservation of jobs in affected communities.” Laws of 2011, ch. 180, § 101(4).

⁷⁹ We also need not determine today the full legal consequences of such a finding. We note, however, that it could support a conclusion that PSE is no longer entitled to recover equity return on deliveries under the agreement.

The confidential information PSE provided in its response shows the Historical Generation of the CTCF in GWhs on a quarterly basis from the 1st Quarter of 2008 through the 4th Quarter of 2012, as of the time of the response. These data show that TransAlta's operations of the CTCF are consistently at a level, in all quarters of the year, that would result in all power delivered under the Coal Transition PPA being from the facility.⁸⁰ Over the five years reported, had the Coal Transition PPA been in effect, only 10 percent of the deliveries to PSE would have been considered resupply power.

69 We determine that it is necessary to condition our approval of the Coal Transition PPA in connection with this issue only to the extent of imposing a reporting requirement. This will enable the Commission to know if TransAlta exercises its resupply right to a degree that might be found to put the Coal Transition PPA in jeopardy. If Commission Staff's continuing review suggests that the contract has lost its identity as a coal transition agreement, the Commission may initiate proceedings to determine whether this is the case and, if so, what consequences flow from the determination.

B. Contract Structure and Terms

1. Should Section 10.1 of the Coal Transition PPA be Modified to Establish TransAlta as the Assumed Risk Taker in the Event of Future Greenhouse Gas Emissions Regulations or Requirements?

70 *Commission Determination: Section 10.1 of the Coal Transition PPA implements RCW 80.04.570(2) using largely the terms of the statute itself. We reject NWECC's recommendation that we require the PSE and TransAlta to reopen their negotiations and modify the contract to reflect NWECC's policy position, which in this instance is contrary to what the statute provides.*

⁸⁰ Section 3.2 of the Coal Transition PPA effectively provides that TransAlta will "supply the Hourly Contract Quantity from the CTCF" unless "the output of the CTCF is reduced or curtailed."

71 NWEC is concerned Section 10.1 of the Coal Transition PPA, which implements RCW 80.04.570(2).⁸¹ Employing the language of the statute, Section 10.1 provides that if new or revised emission performance standards or operational or financial requirements related to greenhouse gas emissions are imposed by law, PSE and TransAlta will initiate a process to modify the agreement to their mutual satisfaction. Any such agreement is subject to Commission review and approval, as expressly required by the statute. Finally, as provided in RCW 80.04.570(2), if PSE and TransAlta cannot agree, either party has the right to terminate the Coal Transition PPA without liability, if the party is adversely affected by the new standard or requirement.

72 Ms. Dixon testifies that NWEC does not support the Coal Transition PPA provisions as written. NWEC's position is that TransAlta should absorb the risk of future GHG emissions regulations. Ms. Dixon says the Coal Transition PPA could establish TransAlta as the assumed risk taker in the event of future greenhouse gas emissions regulations or requirements, while still allowing for a contract reopener at the time of any such regulations or requirements to assess specific details, if needed.

73 It is not entirely clear what NWEC is proposing, but it appears to be that we condition approval of the Coal Transition PPA by requiring the parties to reopen their negotiations now and somehow agree to place the risk of future greenhouse gas emissions requirements on TransAlta. This would, in Ms. Dixon's concept,

⁸¹ RCW 80.04.570(2) reads:

Any power purchase agreement for the acquisition of coal transition power pursuant to this section must provide for modification of the power purchase agreement to the satisfaction of the parties thereto in the event that a new or revised emission or performance standard or other new or revised operational or financial requirement or limitation directly or indirectly addressing greenhouse gas emissions is imposed by state or federal law, rules, or regulatory requirements. Such a modification to a power purchase agreement agreed to by the parties must be reviewed and considered for approval by the commission, considering the circumstances existing at the time of such a review, under procedures and standards set forth in this section. In the event the parties cannot agree to modification of the power purchase agreement, either party to the agreement has the right to terminate the agreement if it is adversely affected by this new standard, requirement, or limitation.

“internalize the cost of environmental harm into the cost of [the] product.”⁸² She acknowledges that if TransAlta assumes the risk of future GHG regulations, the agreed upon power price terms could change.

74 PSE does not address this issue in its rebuttal testimony.

75 As we stated at the beginning of this discussion, Section 10.1 of the Coal Transition PPA tracks very closely the language of the statutory provision that requires it. It is difficult to conceive how PSE and TransAlta could modify Section 10.1 along the lines NWEC suggests without running afoul of what the legislature intended by drafting RCW 80.04.570(2) using the language it chose. In particular, requiring TransAlta to expressly assume the risk of a change in greenhouse gas emission standards would seem to eliminate any claim by TransAlta that it is adversely affected by the change. Thus, TransAlta would not be able to exercise its right, expressly conferred by the statute, to terminate the Coal Transition PPA without liability “if adversely affected by the new standard or requirement, or limitation.”⁸³

76 The conflict between NWEC’s proposal and the requirements of RCW 80.04.570(2), which Section 10.1 of the Coal Transition PPA implements, is reason enough to reject it. In addition, however, we cannot square NWEC’s tacit acknowledgement that power prices under the Coal Transition PPA would likely increase if we effectively require TransAlta to internalize now the costs of possibly more stringent environmental regulations in the future, with NWEC’s claim that this somehow protects “the interest of PSE customers in avoiding future risk of GHG emissions.”⁸⁴ Quite the contrary is true. Higher prices under the Coal Transition PPA would simply pass on to ratepayers for the full term of the contract the increased risks TransAlta would assume relative to a change in the law that may or may not occur during its term. We reject NWEC’s recommendation.

⁸² Exhibit No. DOD-1HCT at 11:2. Ms. Dixon testifies in addition that modifying Section 10.1 of the Coal Transition PPA as NWEC recommends “could incent TransAlta to take advantage of lower GHG emitting resources while still meeting the terms of the contract.” *Id.* at 11:14-20. The specific contract term to which Ms. Dixon refers is Section 3.2, the provision Staff is concerned about in connection with its proposed treatment of “resupply power.”

⁸³ RCW 80.04.570(2).

⁸⁴ Exhibit No. DOD-1HCT at 10:19-11:13.

C. Relationship Between the Coal Transition PPA and TransAlta's Performance under the MOA

77 *Commission Determination: We conclude as a matter of law that if TransAlta terminates the MOA prior to the time PSE begins taking power in December 2014, or subsequently, PSE is not relieved of its obligations under the contract.⁸⁵ Thus, we reject Staff's proposal that we deem the PPA be terminated if the MOA is terminated. We also conclude that the Commission lacks authority to effectively modify the terms of the MOA, as NWECA urges us to do.*

78 *We also determine in this connection, however, that if TransAlta terminates the MOA under Section 8(c), or the MOA is terminated or cancelled by the State of Washington as a result of a failure by TransAlta to satisfy its payment obligations under Section 3 of the MOA the Commission should initiate proceedings to consider whether to require PSE to terminate the Coal Transition PPA to the extent it may do so without incurring liability. Finally, if the MOA is terminated at any time during the term of the Coal Transition PPA, for any other reason, the Commission may initiate proceedings to determine whether the contract retains its identity as a coal transition PPA under RCW 80.04.570 and related authority, and whether PSE should be authorized to continue to recover equity return as authorized under RCW 80.04.570(6).*

79 Staff recommends that the Commission condition its approval of the Coal Transition PPA by requiring that it will terminate if the MOA is terminated. Given its brevity, we quote below Mr. Gomez's entire discussion of this recommendation:

The MOA specifies the obligations required from each party as a result of the Coal Transition Energy Bill, E2SSB 5769. These obligations include annual payments by TransAlta totaling \$55.0 million to fund economic and community development in Lewis and South Thurston

⁸⁵ Section 9(d) of the MOA provides: "Termination of this MOA pursuant to Section 8 shall not in any manner impact the validity or enforceability of contracts or agreements entered into by the Parties, other than this MOA, prior to the date of such termination, including Qualified Power Purchase Agreements or other agreements for the sale of electrical output of the Facility."

County. Staff views PSE ratepayers, via the Coal Transition PPA, as a main source of these funds.⁸⁶

80 Ms. Dixon testifies for NWECC that TransAlta's commitment to invest in local economic development and clean energy was a critical element of the negotiations that led to amending the emissions performance standard for coal transition power.⁸⁷ This is substantiated, she says, by a legislative finding in ESSB 5769, Sec. 101(4):

The legislature finds that coal-fired baseload electric generation facilities are a significant contributor to family-wage jobs and economic health in parts of the state and that transition of these facilities must address the economic future and the preservation of jobs in affected communities.

81 Ms. Dixon testifies that the law and the MOA provide both time and funding to help the community succeed in its transition away from operating a coal-fired power plant, which will mean the loss of certain family-wage jobs. Providing educational and retraining opportunities for local workers is a critical piece of ensuring an orderly transition, in NWECC's view. At the same time, dedication of funds to energy efficiency and clean energy technologies will help create new good-paying "green jobs" while providing a path to cleaner power.

82 Ms. Dixon says NWECC's concerns in this area stem from the fact that TransAlta's financial commitments are not assured under the statute or the MOA. RCW 80.80.100(3)(c), for example, provides that the TransAlta is relieved of its obligations if certain tax exemptions currently available to the Centralia coal plant are repealed. In addition, the MOA includes a termination clause that TransAlta can invoke if it fails by December 15, 2013,⁸⁸ to execute sufficient long-term coal transition PPAs to

⁸⁶ Exhibit No. DCG-1HCT at 16:9-14.

⁸⁷ The MOA provides for \$20 million to the affected community for education, retraining, economic development, and community enhancement; \$10 million to the affected community for energy efficiency and weatherization; and \$25 million for energy technologies with the potential to create considerable energy, economic development, and air quality, haze, or other environmental benefits. *See* Exhibit No. RG-8HC at 2-3 (MOA Section 3).

⁸⁸ TransAlta's initial opportunity to terminate the MOA under this provision matured on December 15, 2012, but TransAlta elected to extend the deadline by one year, as allowed under the terms of the agreement.

sell at least 500 MWs of output from the Centralia facility. Because the average volume of power to be delivered to PSE during the term of the Coal Transition PPA is only 346 MW, Commission approval would not preclude TransAlta from invoking its termination rights under the MOA.

83 Even though PSE may terminate the PPA in this circumstance, NWEC is concerned that PSE could decide to continue the Coal Transition PPA without modification even if the MOA ceases.⁸⁹ The end result would be that the local community may see no financial support to facilitate the transition to a new economic base.

84 In light of these concerns, NWEC recommends that the Commission condition approval of the Coal Transition PPA by making it contingent on TransAlta committing to invest in at least the proportional level of funding outlined in the MOA that is represented by PSE's acquisition of 346 MW of output. This would provide certainty that at least \$13.8 million is invested in local economic development, \$6.9 million is invested in energy efficiency and weatherization, and \$17.3 million is invested in clean energy technologies. Ms. Dixon testifies that the requirement for financial assistance is part and parcel of the modifications to the emissions performance standard that are allowing PSE to enter into the Coal Transition PPA and it should be a factor in the Commission's determination of public interest.

85 Mr. Garratt points out in rebuttal that neither PSE nor the Commission is a party to the Memorandum of Agreement. He states that "PSE does not know what role, if any, the Commission should play with respect to a contract in which neither PSE nor the Commission is a party."⁹⁰ Responding more directly to Staff's recommendation, Mr. Garratt offers two reasons that militate against the Staff's proposal to condition approval of the Coal Transition PPA by requiring that it terminates if the MOA is terminated. First, he relates that TransAlta Centralia can terminate the MOA for reasons unrelated to power sales under the Coal Transition PPA. He cites two examples; TransAlta may terminate the Coal Transition PPA if:

⁸⁹ See Exhibit No. RG-10HCT at 40:12-41:6; See also Exhibit No. RG-3C at 34 (Coal Transition PPA Section 17.3).

⁹⁰ Exhibit No. RG-10HCT at 39:5-8.

- It loses its state sales and use tax exemptions currently available under RCW 82.08.811 and RCW 82.12.811.
- It is not allowed to use the type of air pollution control equipment to which the State of Washington agreed in the MOA.

The MOA, in Mr. Garratt's view, appears to recognize that TransAlta would lose the benefit of its bargain with the State or Washington if either of these things occur and should not have to continue paying the \$55 million for promotion of the state's policies.⁹¹

86 Mr. Garratt testifies also that TransAlta has the right to terminate the MOA if it has not been able to enter into long-term power purchase agreements for at least 500 megawatts of power by December 15, 2012. TransAlta Centralia has informed Governor Gregoire, however, that it will not exercise this option in 2012.⁹² However, the effect of this is to extend the MOA for one year, at which time TransAlta again has the option to terminate it. Should this occur during 2013, Mr. Garratt testifies that:

It is in the best interest of PSE's ratepayers that PSE have the right to decide whether to terminate under these circumstances. If purchases under the Coal Transition PPA remain the most cost-effective resource available, PSE may well decide that, notwithstanding termination of the Memorandum of Agreement, it is in the best interest of ratepayers to continue to make purchases under the Coal Transition PPA.⁹³

Thus, PSE would have the Commission reject Staff's recommendation that the Coal Transition PPA be terminated if the MOA is terminated.

⁹¹ Id. at 39-40.

⁹² See Exhibit No. RG-14 (letter dated October 24, 2012, from Paul Taylor to Governor Gregoire). The letter states that TransAlta has not yet achieved the 500 MW contracting threshold contemplated in the MOA.

⁹³ Exhibit No. RG-10HCT at 41:1-6.

87 Although we agree with the policy principles that underlie Staff's and NWECA's advocacy on this issue,⁹⁴ we are constrained by the law from accepting their specific recommendations. Insofar as Staff's recommendation is concerned, what we have before us today is a "power purchase agreement for acquisition of coal transition power" within the meaning of RCW 80.04.570. The Coal Transition PPA also is a "Qualified Power Purchase Agreement" as defined in the MOA. As previously noted, Section 9(d) of the MOA provides:

Termination of this MOA pursuant to Section 8 shall not in any manner impact the validity or enforceability of contracts or agreements entered into by the Parties, other than this MOA, prior to the date of such termination, including Qualified Power Purchase Agreements or other agreements for the sale of electrical output of the Facility.

Because the Coal Transition PPA is a Qualified Power Purchase or other agreement for the sale of electrical output of the CTEF, termination of the MOA cannot be the basis for terminating the PPA except to the extent PSE reserved its rights to do so and elects to exercise them.⁹⁵

88 Insofar as NWECA's recommendations are concerned, they would require us to effectively add provisions to the MOA that are inconsistent with RCW 80.80.100. We are not empowered to do this. Not only is the Commission not a party to the MOA, there is nothing in the MOA, or the applicable statutes, that gives the Commission any express or implied authority to alter this bilateral agreement.

89 Having reached these conclusions, however, we nevertheless conclude that the MOA is an important, if not essential, feature in the legal and policy landscape that gives rise to the very concept of "coal transition power." Absent the amendment of RCW Chapter 80.80 by the Coal Transition Energy Bill during 2011, the contract before us could not have been executed by TransAlta and PSE; there would be no Coal

⁹⁴ We understand this principle to be that the MOA and any agreement for the sale and purchase of coal transition power are so inextricably intertwined that the one should not exist in the absence of the other. The very concept of "coal transition power" depends in significant part on TransAlta's performance under the MOA that provides the funds for the transition.

⁹⁵ We note in this connection that the Commission, in a subsequent proceeding, could open the question whether it would be imprudent for PSE to not exercise these rights should the opportunity present itself.

Transition PPA, and we would not be reviewing the contract at all, much less under the special requirements of RCW 80.04.570.

90 RCW 80.80.100 requires the MOA. The statute provides that the MOA may only include the provisions specified in RCW 80.80.100. It sets forth these provisions in detail, including definitive requirements that the facility owner provide two forms of financial support as the coal plant is transitioned into closure:

- \$30 million in financial assistance for economic development and energy efficiency and weatherization to the affected community.⁹⁶
- \$25 million for energy technologies with the potential to create considerable energy, economic development, and air quality, haze, or other environmental benefits.⁹⁷

These financial benefits specified in the legislation provide an important part of the *quid pro quo* to which TransAlta agreed during negotiation of the MOA in exchange for the right to enter into long-term contracts for the sale of power from the Centralia coal facility even though the plant does not physically meet the state's emission performance standards, and will not do so during the remainder of its operation.

91 The legislature provided an additional benefit to TransAlta by providing an unprecedented inducement to investor-owned utilities such as PSE to enter into such contracts. We refer specifically to the provision included in RCW 80.04.570(6) that requires the Commission to allow such utilities to recover from their customers not only the cost of power provided under a coal transition PPA, but also to recover equity return as if the utility made a capital investment in a hard asset instead of simply entering into a power purchase agreement that requires no such investment.

92 Thus, we see the MOA, RCW Chapter 80.80 and RCW 80.04.570 as three intertwined elements that together establish the concept of coal transition power and define the rights and obligations of TransAlta, PSE and, most important, the people of

⁹⁶ RCW 80.80.100(3).

⁹⁷ *Id.*

Washington. The fulfillment of these rights and obligations provides a transition for TransAlta, allowing for an orderly and financially satisfactory retirement of the Centralia coal facility. The fulfillment of these rights and obligations provides a transition for citizens living in the communities most directly affected by the closure, maintaining family-wage jobs and promoting economic development that will substitute for the loss of the plant, which remains an economic mainstay in Centralia and surrounding suburban and rural communities. Finally, it is by the fulfillment of these rights and obligations that the state has provided for the broader public interest to benefit from the assured closure of a significant source of air pollution on a definite schedule.

93 It is true that the MOA and RCW Chapter 80.80 allow for the termination of certain of these mutual rights and obligations upon the occurrence of specified events. We cannot foresee whether any of these events will occur, or evaluate in the abstract the impact any such occurrence relative to the Commission's obligation to "[r]egulate in the public interest, as provided by the public service laws, the rates, services, facilities, and practices of all persons engaging within this state in the business of supplying any utility service or commodity to the public for compensation."⁹⁸ We determine, however, that significant changes in circumstances such as a decision by TransAlta to terminate the MOA, or its failure to meet its financial obligations under the MOA as contemplated under RCW 80.80.100, may require a reexamination of the contract between TransAlta and PSE. Should the contract be found under some set of circumstances to have lost its character, and its legal status, as a coal transition PPA, it may be incumbent upon the Commission to initiate proceedings to review the contract and, among other things, consider whether PSE can continue to earn the equity return allowed here, as provided only for a coal transition agreement under RCW 80.04.570.

D. Cost Deferral

94 *Commission Determination: The Commission determines that the question whether PSE should be authorized to defer the incremental costs it incurs as volume and price terms vary from time to time during the life of the Coal Transition PPA should be*

⁹⁸ RCW 80.01.040.

reserved for decision during a rate proceeding in which PSE seeks to recover its initial costs under the Coal Transition PPA, beginning in December 2014.

95 PSE seeks to defer both the contracted purchase price and the costs of the equity return associated with the Coal Transition PPA prior to those costs being included in rates. Additionally, PSE seeks to accrue interest on the deferred amounts, at PSE's net of tax rate of return for the period, currently 6.71 percent. A similar deferral would be used to adjust the yearly increases in contracted power and price increases in the Coal Transition PPA. Ms. Barnard testifies for PSE that:

PSE would not start booking these deferrals until December 2014 when the contracted volumes begin to flow. A deferral will continue until the date when new rates that address the costs being deferred take effect, and this deferral process will continue throughout the term of the Coal Transition PPA as volumes and prices change in accordance with the terms of the Coal Transition PPA.⁹⁹

96 Staff objects to PSE's proposal to defer costs. Mr. Gomez testifies that this situation is not one such as Goldendale, where PSE had limited control over the timing of the acquisition and was required to immediately borrow the large amount of funds necessary to secure the Goldendale Generating Station opportunity for its customers well in advance of enabling recovery methods. Here, PSE will not take its first delivery of power for nearly two years. This, according to Staff, provides the Company with sufficient time to include the Coal Transition PPA into rates via a Power Cost Only Rate Case (PCORC). Staff does not address specifically the question of deferrals PSE proposes during the term of the Coal Transition PPA as prices and volumes change from year to year.

97 Ms. Barnard focuses on this point in her rebuttal. She testifies that PSE cannot time a general rate case or PCORC filing perfectly to address changes in costs with the Coal Transition PPA that occur throughout its term. Ms. Barnard reiterates the point made in her direct testimony that what PSE proposes to defer are its incremental costs associated with the Coal Transition PPA that are not included in rates.¹⁰⁰ While these

⁹⁹ Exhibit No. KJB-1T at 5:8-12.

¹⁰⁰ Exhibit No. KJB-3T at 3:2-4.

costs change from year to year, the time required to process a general rate case, or even a PCORC, means it is necessary for PSE to maintain a deferral account for these costs or it may lose the opportunity to recover them.

98 PSE acknowledges that it can time the filing of a general rate case or a PCORC so that the costs of the Coal Transition PPA beginning on December 1, 2014, could be recovered in rates.¹⁰¹ PSE argues, however, that during the subsequent course of the contract, as TransAlta's delivery obligations change from time to time and the power price changes from year to year, it would become difficult to time PCORC and general rate proceedings to include the incremental costs associated with these changes, as they occur. PSE argues that without the authority to defer these costs, the Company would be at risk for losing its ability to recover them. PSE believes this problem would be most significant in the years when the volumes change.¹⁰²

99 As a general matter, it is more appropriate to consider the question of deferral accounting in the context of a rate proceeding. There is ample time for PSE to initiate such a proceeding before the time it begins taking power under this contract in December 2014. We accordingly determine that the Commission will await PSE's initial filing to recover its costs under the Coal Transition PPA to determine this issue.

FINDINGS OF FACT

100 Having discussed above the evidence received in this proceeding concerning all material matters, the Commission now makes and enters the following summary of facts, incorporating by reference pertinent portions of the preceding detailed findings.¹⁰³

¹⁰¹ PSE's counsel agreed during oral argument that this is the case: "I believe that PSE probably does not see a need necessarily to defer the first tranche of the agreement, because they will have two years to prepare for that." TR. 255:7-10 (Kuzma).

¹⁰² *Id.* at 225:18-21.

¹⁰³ We recognize that certain findings of fact and conclusions of law are mixed findings and conclusions, including findings 2, 4, 5 and 6. In light of their significance relative to the specific statutes governing our review of the Coal Transition PPA, we underscore this point by repeating findings 4, 5 and 6 in the conclusions of law section of this Order.

- 101 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including electrical companies.
- 102 (2) Puget Sound Energy, Inc., (PSE) is a “public service company” and an “electrical company,” as those terms are defined in RCW 80.04.010 and as those terms otherwise are used in Title 80 RCW. PSE is engaged in Washington State in the business of supplying utility services and commodities to the public for compensation.
- 103 (3) On July 24, 2012, PSE and TransAlta Centralia entered into the Coal Transition PPA that is the subject of this proceeding. It provides that PSE will purchase up to 380 MW of coal transition power, with average deliveries over the life of the contract, through 2025, of 346 MW.
- 104 (4) Considering the circumstances existing at the time of the Commission’s review, the terms of the Coal Transition PPA provide adequate protection to ratepayers and PSE during the term of the Coal Transition Power PPA or in the event of early termination.
- 105 (5) PSE needs the Coal Transition PPA to serve its ratepayers and the resource meets this need in a cost-effective manner as determined under the lowest reasonable cost resource standards under chapter 19.280 RCW, including the cost of the Coal Transition Power PPA plus the equity component as determined in RCW 80.04.570.
- 106 (6) The Coal Transition PPA includes termination dates consistent with the applicable dates in RCW 80.80.040(3)(c).
- 107 (7) The cost of an equivalent plant for purposes of determining the equity return component for the Coal Transition PPA is \$110 million, which is a total equivalent plant cost for the Coal Transition PPA of a plant of approximately 346 MW.

CONCLUSIONS OF LAW

108 Having discussed above all matters material to this decision, and having stated
detailed findings, conclusions, and the reasons therefore, the Commission now makes
the following summary conclusions of law, incorporating by reference pertinent
portions of the preceding detailed conclusions:

109 (1) The Washington Utilities and Transportation Commission has jurisdiction over
the subject matter of, and parties to, this proceeding.

110 (2) The Coal Transition PPA is a long-term financial commitment for the
purchase of coal transition power, as such terms are defined in RCW
80.80.010(16) and RCW 80.80.010(5), respectively, and as such terms are
otherwise used in Title 80 RCW.

111 (3) The Coal Transition PPA is a power purchase agreement for acquisition of
coal transition power, subject to the Commission's review and authority under
RCW 80.04.570 and as otherwise provided in RCW Chapter 80.80.

112 (4) Considering the circumstances existing at the time of the Commission's
review, the terms of the Coal Transition PPA provide adequate protection to
ratepayers and PSE during the term of the Coal Transition Power PPA or in
the event of early termination

113 (5) PSE needs the Coal Transition PPA to serve its ratepayers and the resource
meets this need in a cost-effective manner as determined under the lowest
reasonable cost resource standards under chapter 19.280 RCW, including the
cost of the Coal Transition Power PPA plus the equity component as
determined in RCW 80.04.570.

114 (6) The Coal Transition PPA includes termination dates consistent with the
applicable dates in RCW 80.80.040(3)(c).

115 (7) As required under RCW 80.04.570(2), the Coal Transition PPA provides for
modification of its terms to the mutual satisfaction of the parties, if a new or
revised emission or performance standard or other new or revised operational

or financial requirement or limitation directly or indirectly addressing greenhouse gas emissions is imposed by state or federal law, rules, or regulatory requirements. Under the Coal Transition PPA, such a modification must be consistent with RCW 80.04.570 and is subject to review and approval by the Commission. If the parties cannot agree to modification of the Coal Transition PPA, either party has the right to terminate the Coal Transition Power PPA if such party is adversely affected by the new standard, requirement, or limitation as described in RCW 80.04.570(2).

- 116 (8) PSE must be authorized to earn the equity component of its authorized rate of return as provided in RCW 80.04.570(6). The rate of return should be fixed throughout the term of the Coal Transition PPA at the Company's currently authorized pre-tax weighted average cost of equity of 7.24 percent, subject to possible adjustment if there is a change in the federal corporate income tax rate.
- 117 (9) The equivalent plant cost of \$110 million, as determined by the Commission to be the least cost purchased or self-built electric generation plant with equivalent capacity, must be amortized over the life of the power purchase agreement for acquisition of coal transition power, which is the term of the Coal Transition PPA (commencing on December 1, 2014, and expiring on December 31, 2025) to determine the recovery of the equity value. Assuming no change in the federal corporate income tax rate, the equity component of PSE's authorized rate of return for the Coal Transition PPA will be earned by PSE and recovered, in an amount equal to \$1.49/MWh for each MWh of energy paid for by PSE under the Coal Transition PPA, throughout its term regardless of whether the term of the Coal Transition PPA terminates upon its expiration or is terminated prior to its expiration.
- 118 (10) The approved recovery of PSE's costs incurred under the Coal Transition PPA should consist of two separate expenses, as proposed by PSE:
- TransAlta Centralia will bill the cost per MWh of energy, and PSE will record this expense in FERC Account 555, Purchase Power. PSE will *pro form* this cost into power costs in the same manner as PSE *pro forms* costs associated with other power purchase agreements and treat this cost in the

Company's Power Cost Adjustment (PCA) mechanism in the same manner PSE treats costs associated with other power purchase agreements.

- PSE will *pro form* the equity return cost per MWh into power costs in general rate case filings. PSE will account for the costs associated with the equity return component on Schedule B-1 of the PCA mechanism.

- 119 (11) PSE's entry into the Coal Transition PPA is prudent and the associated costs are reasonable for recovery in rates, subject to a future prudence review of PSE's actual power costs as provided in Paragraph 4 of the PCA Settlement Agreement approved in Dockets UE-011570 and UG-011571.
- 120 (12) The Commission's continuing obligation to regulate in the public interest, as provided by the public service laws, requires the Commission to impose on PSE a reporting requirement so that the Commission can be kept apprised of the operation of the Coal Transition PPA within the legal and policy framework discussed in the body of this Order. PSE should be required to work with Commission Staff to determine the specific form and requirements for an annual report that will include, at a minimum, detailed information on a quarterly basis concerning the operations of Centralia coal transition facility and the sources of power used by TransAlta to fulfill its delivery obligations to PSE. The report also should include data concerning the payments TransAlta makes under the terms of the MOA and a description of the uses to which these funds are dedicated.
- 121 (13) Commission approval of the Coal Transition PPA, subject to the conditions and requirements of this Order, is in the public interest.

ORDER

THE COMMISSION ORDERS THAT:

- 122 (1) The Coal Transition Power Purchase Agreement between TransAlta Centralia Generation LLC and Puget Sound Energy, Inc., is approved consistent with and subject to the determination of issues as discussed in the body of this Order.

- 123 (2) The equity component of PSE's authorized rate of return for the Coal Transition PPA will be earned by PSE and recovered, in an amount equal to \$1.49/MWh for each MWh of energy paid for by PSE under the Coal Transition PPA, throughout its term regardless of whether the term of the Coal Transition PPA terminates upon its expiration or is terminated prior to its expiration, subject to possible revision if the federal corporate income tax rate is changed during the term of the contract.
- 124 (3) PSE's costs under the Coal Transition PPA, as determined in this Order, are reasonable for recovery in rates, subject to a future prudence review of PSE's actual power costs as provided in Paragraph 4 of the PCA Settlement Agreement approved in Dockets UE-011570 and UG-011571.
- 125 (4) The approved recovery of PSE's costs incurred under the Coal Transition PPA will consist of two separate expenses, as proposed by PSE:
- TransAlta Centralia will bill the cost per MWh of energy, and PSE will record this expense in FERC Account 555, Purchase Power. PSE will *pro form* this cost into power costs in the same manner as PSE *pro forms* costs associated with other power purchase agreements and treat this cost in the Company's Power Cost Adjustment (PCA) mechanism in the same manner PSE treats costs associated with other power purchase agreements.
 - PSE will *pro form* the equity return cost per MWh into power costs in general rate case filings. PSE will account for the costs associated with the equity return component on Schedule B-1 of the PCA mechanism.
- 126 (5) The Commission's approval is subject to the condition that Puget Sound Energy, Inc., within 30 days after the date of this Order, will enter into good faith discussions and determine in coordination with Commission Staff the content and form of an annual report that will be filed with the Commission under Docket UE-121373, as provided under WAC 480-07-880(3). The report should include monthly data for the preceding 13 months beginning with the period December 1, 2014, through December 31, 2014, and must be provided no later than March 31 of each year, beginning in 2015. The report must include data that show plant operations and the sources of power from which TransAlta satisfies its delivery obligations to PSE under the Coal Transition

PPA, and information concerning the payments and disposition of payments as required under the Memorandum of Agreement between the Governor's Office and TransAlta Centralia entered into on December 23, 2011, memorializing in contractual form the requirements set forth in the Coal Transition Energy Bill, as codified in RCW 80.80.100. The report should include such other data as agreed between Commission Staff and Puget Sound Energy, Inc. These parties should file a detailed description of the report they propose within 120 days after the date of this Order. The proposed content and form of the report is subject to approval by the Commission's Executive Director and Secretary to whom the Commission delegates this responsibility.

- 127 (6) The Commission retains jurisdiction to effectuate the terms of this Final Order.

Dated at Olympia, Washington, and effective January 9, 2013.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION¹⁰⁴

JEFFREY D. GOLTZ, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner

¹⁰⁴ On January 7, 2013, pursuant to her authority under RCW 80.01.035, Governor Christine Gregoire appointed former Commissioner Patrick J. Oshie, who resigned from office effective January 6, 2013, as Commissioner Pro Tempore for purposes of completing and signing this Final Order.

NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.